FINANCIAL SERVICES INSTITUTE

VOICE OF INDEPENDENT FINANCIAL SERVICES FIRMS AND INDEPENDENT FINANCIAL ADVISORS

VIA ELECTRONIC MAIL

April 17, 2017

Edward Hugler
Acting Secretary
Department of Labor
200 Constitution Avenue, NW
Washington, DC 20210

Re: RIN 1210-AB79 the Delay of File Number 29 CFR Parts 2509 and 2510 Definition of the Term "Fiduciary;" Conflict of Interest Rule--Retirement Investment Advice; DOL Fiduciary Rule

Dear Acting Secretary Hugler:

On February 3, 2017, President Trump issued a memorandum (Presidential Memorandum) regarding the Department of Labor's (DOL) Fiduciary Rule (Fiduciary Rule or Rule), instructing the DOL to determine whether it may adversely affect the ability of Americans to gain access to retirement information and financial advice.[1] The Presidential Memorandum stressed that one of the guiding principles for financial services regulation was to empower Americans to make their own financial decisions and to facilitate their ability to save for retirement. The Presidential Memorandum directs the DOL to examine the Fiduciary Rule to determine if it will harm investors by both reducing their access to certain retirement savings products and services and increasing the price they must pay to gain access to those services, cause dislocations or disruptions within the retirement services industry, and cause an unnecessary increase in litigation. On April 4, 2017, in response to the Presidential Memorandum, the DOL finalized a 60-day delay of the applicability of the Fiduciary Rule, so that the DOL can examine its impact pursuant to the Presidential Memorandum.[2]

The Financial Services Institute[3] (FSI) appreciates the opportunity to comment on this important issue. While FSI strongly supports the implementation of a Securities and Exchange Commission (SEC) developed uniform fiduciary standard[4], FSI strongly opposes the implementation of the Fiduciary Rule and supports its immediate repeal. New research makes it clear that the Rule will harm investors by reducing investor access to retirement advice, disrupting

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[1] See "Presidential Memorandum" at https://www.whitehouse.gov/the-press-office/2017/02/03/presidential-memorandum-fiduciary-duty-rule.

[2] See "Proposed Rule" available at, https://s3.amazonaws.com/public-inspection.federalregister.gov/2017-04096.pdf

[3] 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.

[4] FSI believes the SEC is the appropriate regulator to promulgate a uniform fiduciary standard because they are the expert regulator on the financial services industry and could create a workable standard that applies to all financial services firms, advisors, clients and accounts.

the retirement services industry, and causing a surge in unnecessary litigation. The result will be an increase in the prices that investors must pay to gain access to retirement advice and services. Therefore, FSI strongly supports the repeal of the Fiduciary Rule to create a new SEC standard that benefits all investors and the retirement savings industry.

Executive Summary of FSI's Comments

On April 4, 2017, the DOL finalized the delay of the applicability date of its Fiduciary Rule to June 9, 2017 to conduct a study of the Rule's impact per the Presidential Memorandum. While FSI appreciates the DOL's delay of the implementation of the Fiduciary Rule, the 60-day delay is an insufficient amount of time to conduct the required analysis. In addition, the DOL has conveyed to the public that they will not be examining the Fiduciary Rule holistically in this period, but rather addressing only the exemptions in the Rule. In doing so, we believe the DOL has chosen to ignore the clear mandate of the Presidential Memorandum to conduct a thorough legal and economic analysis of the Fiduciary Rule before it becomes applicable. Instead, the DOL will allow the Fiduciary Rule to become applicable on June 9, 2017 and continue its analysis while the Rule is already in effect. The harm that course of action will cause to both investors and the industry will be substantial and could perhaps permanently impact Americans' ability to save for their retirement.

- New research indicates that the Fiduciary Rule will increase consumer costs by **$46.6 billion**, or **$813 annually per account.**
- Additionally, the Fiduciary Rule will result in **$1,500** in duplicative fees for retirement savers that have already paid a fee on their commission-based accounts.
- The Rule could force **28 million** Americans out of managed retirement accounts completely.[5]
- FSI members have already incurred costs of **$189 million** preparing for the Fiduciary Rule's implementation. It is estimated that should the Rule's implementation resume on June 9, these firms will spend an **additional $205 million** in preparation and compliance costs.
- The total implementation costs for FSI members are estimated to be **$394 million**.
- If the FSI experience were extrapolated to the universe of broker-dealers, the total implementation costs to the industry will likely approach **$3.2 billion**.
- For FSI members, on-going operating expenses are an estimated **$230 million**. When extrapolated to the universe of brokers-dealers, this estimate suggests that the annual recurring cost to the industry will be **$1.5 billion**.
- In total, the 10-year costs of the Fiduciary Rule to the broker-dealer industry is estimated to be approximately **$14.2 billion** using a 3% discount rate, **nearly three times higher than the DOL estimate.**

This research and our own members' experience make it clear that the Fiduciary Rule as adopted fails each test included in the Presidential Memorandum and must be promptly rescinded to ensure Americans are empowered to make their own financial decisions and to save for retirement. We summarize our comments below:

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[5] Meghan Milloy, "The Consequences of the Fiduciary Rule for Consumers" (April 2017) available at https://www.americanactionforum.org/research/consequences-fiduciary-rule-consumers/.

I. The Regulatory Impact Analysis of April 2016 (RIA) relied upon by the DOL is flawed in ways that undermine its reliability

- The RIA provided no empirical evidence that investors receive conflicted advice due to compensation conflicts and thus realize reduced investment returns. Instead, the RIA cited anecdotal evidence that did not establish a connection between compensation conflicts and poor advice.
- The RIA ignores empirical evidence quantifying the benefits to consumers of financial advice by focusing only on the cost of the advice and ignoring the benefits of advice.
- The costs to the industry of complying with the Rule are grossly underestimated in the RIA and it is now possible to quantify the costs firms have incurred and will bear in the future.
- The RIA failed to consider the role of financial advisors in bringing and keeping investors in the retirement system. As a result, it failed to adequately weigh the risk that the Fiduciary Rule will reduce the number of investors participating in the retirement system.
- The RIA failed to consider the potential negative impact of encouraging passive over active investments.
- The RIA fails to recognize that millions of working Americans have retirement savings today because of their financial advisors.
- Policy makers need to develop more retirement savers in this country, not fewer. To accomplish that, we need to encourage more interaction between financial advisors and employers and employees, not less.
- The most significant problem faced by the US private retirement system is the need to extend coverage to a larger percentage of our workforce. Financial advisors are the answers to that problem, not the cause.
- Resources providing new or updated information relevant to the RIA and the Presidential Memorandum can be found in the Appendix attached to this letter.

II. The anticipated applicability of the Fiduciary Rule will harm investors by reducing their access to certain retirement savings offerings, product structures, information, and related financial advice

- Because of compliance concerns with the Fiduciary Rule, firms are no longer offering certain mutual funds in brokerage IRA accounts and are no longer offering non-traded REITS thereby limiting advice on the purchase of annuities.
- Without access to a financial advisor, investors lose an important source of financial education. Financial advisors provide an important service for investors who are often overwhelmed by the investment choices available to them. This is particularly true for the lower and middle class investors, and it is imperative that they have access to financial education and guidance.
- The Fiduciary Rule will result in consolidation of the retirement savings industry to the detriment of investors because it favors passive investment advice and robo-advisors. This in turn damages investors' ability to properly plan for retirement and institutionalizes income disparity.

III. The anticipated applicability of the Fiduciary Rule has resulted in dislocations or disruptions within the retirement services industry that adversely affect investors and retirees

- The DOL has adversely impacted retirees by forcing firms to shift clients from commission to fee-based accounts.
- The Fiduciary Rule reduces investors' access to retirement planning by reducing the availability of financial advisors to low and middle class investors. Restricting investor access to these services is particularly problematic because research from a variety of sources has shown that investors who work with financial advisors save more, are better prepared for their retirement, and have greater confidence in their retirement planning.
- The Fiduciary Rule will cause disruption in the retirement savings industry by reducing investor choice in products, services and providers to facilitate their planning for retirement. Firms have announced that the DOL Fiduciary Rule will force them to alter their business strategies in ways that would limit the investment vehicles they offer investors. For instance, the Fiduciary Rule has caused firms to consider whether they must eliminate A-share mutual fund offerings, the low cost direct-to fund business, and other offerings that benefit investors.
- The majority of investors prefer to remain in commission based accounts. As those options decrease, financial advisors will no longer be able to serve these clients.

IV. The Fiduciary Rule will cause an increase in litigation costs that will increase the prices that investors and retirees must pay to gain access to retirement services

- The DOL has stated that the Best Interest Contract Exemption (BICE) is constructed to use private litigation as the primary, if not sole, means of enforcement. Therefore, it is unmistakable that there will be a significant increase in both class action and other private litigation.
- The Fiduciary Rule, and resulting litigation, will raise the cost of operation for industry participants and will result in higher fees for investors, raising the cost of saving for retirement and reducing investor access to investment advice.

V. The Fiduciary Rule as written is inconsistent with the Administration's priorities to empower Americans to make their own financial decisions, to facilitate their ability to save for retirement and build the individual wealth necessary to afford typical lifetime expenses, such as buying a home or saving for college, and to withstand unexpected financial emergencies

- The Fiduciary Rule is inconsistent with this guiding principle because it limits investors' access to professional financial advice and education, limits the investment options available to investors, increases costs to investors through the threat of litigation, and discourages investors from seeking professional financial advice to increase their individual wealth.

VI. Conclusion

- FSI concludes that the Fiduciary Rule fails each of the tests in the Presidential Memorandum and will have a devastating impact on retirement investors' ability to save for retirement. As such, the Fiduciary Rule should be rescinded as soon as is practicable.

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 U.S., there are approximately 167,000 independent financial advisors, which account for approximately 64.5% percent of all producing registered representatives.[6] 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 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 advice, 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.[7]

Discussion

FSI appreciates the opportunity to comment on the directives issued through the Presidential Memorandum. While FSI appreciates the DOL delaying the implementation of the Rule, more than 60-days is needed to conduct a thorough review of the Fiduciary Rule because it carries such significant consequences to the industry and to investors. The delay has offered too brief a period to adequately examine the substantial impact of the Fiduciary Rule and has only fostered more uncertainty and confusion for investors and the industry. The DOL has suggested that they will address the exemptions after making the Rule applicable, which would only increase marketplace confusion, harming the industry and investors as they try to determine how the DOL will act. In doing so, the DOL has willfully chosen to ignore the Presidential Memorandum to conduct a thorough legal and economic analysis before the Rule becomes applicable. The harm that course of action will cause to both investors and the industry will be substantial and could perhaps permanently impact Americans' ability to save for their retirement. The entirety of the Fiduciary Rule must be repealed, and allowing it to become applicable in a piece-meal fashion will only further increase confusion on the part of the industry and investors.

While the impact of the Fiduciary Rule on the industry is enormous, of even greater concern is the impact on investors. The Fiduciary Rule will make it significantly harder for consumers to gain access to high quality retirement advice, products, and services. Dislocations

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[6] The use of the term "financial advisor" or "advisor" as referred to by FSI 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.
[7] Oxford Economics for the Financial Services Institute, The Economic Impact of FSI's Members (2016) available at https://www.oxfordeconomics.com/recent-releases/the-economic-impact-of-fsi-s-members

and disruptions in the retirement services industry combined with the threat of class action lawsuits and other private litigation and increased compliance expenses will significantly raise broker-dealer firm costs. These firms will have no choice but to either pass these costs on to their clients or choose to no longer offer services to some retirement accounts. We are concerned that retirement advice for clients with small account balances will become cost-prohibitive and result in a dramatic decrease of investor access to retirement advice from a qualified financial advisor.

For these reasons and more, FSI supports the immediate rescission of the Fiduciary Rule to protect against these harmful consequences. We discuss our concerns in the context of the Presidential Memorandum directives, in greater detail below.

I. The Regulatory Impact Analysis is flawed in ways that undermine its reliability

We preface our comments about the ultimate questions raised in the Presidential Memorandum with our concerns about the RIA, which we have expressed throughout this regulatory process. In so doing, it is important to be clear about the stakes involved in this rulemaking. Our members and their independent financial advisors are in the business of providing financial services to, primarily, middle America. They provide those services with a business commitment, and in many cases a legal obligation, to act in the best interest of their clients.[8] They succeed far beyond any reasonable business expectation in honoring that commitment; less the 0.01% [9] of the industry's interactions with investors result in FINRA arbitration, and even the DOL made a finding that retirement investors are well served by their financial advisors most of the time.[10] That is due, in part, to the tens of millions of dollars our members spend annually rooting out, disciplining, and terminating the very small number of their financial advisors who do not put their clients' interests first.

Notwithstanding that record, DOL determined to broadly impose on our members, on a legally enforceable basis, the fiduciary standards of ERISA – the "highest known to the law,"[11] and more stringent than the fiduciary standards to which doctors, lawyers, and common-law trustees are held – for their dealings with retail retirement investors. This amounts to nothing less than a fundamental reorganization of the banking, insurance and securities industries. That fundamental change will have the adverse consequences for retirement investors about which the Presidential Memorandum is concerned, as we discuss below.

Moreover, it is apparently the ambition of DOL that this reorganization extends beyond retirement investors to retail investors generally. As DOL stated in its *Consumer Protections for Retirement Investors – FAQs on Your Rights and Financial Advisers*[12] (January 2017):

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[8] See SEC v. Capital Gains Research Bureau, Inc., 191 F. Supp. 897, 898 (S.D.N.Y. 1961).
[9] From 2010-2014 there have been 22,244 FINRA Arbitration Cases Filed, see https://www.finra.org/arbitration-and-mediation/dispute-resolution-statistics. Of these, during the period of 2010 to 2014, there were at least 51 FINRA arbitrations relating to IRAs (and another 18 dealing with qualified plans)—attesting to both the high level of success of the existing regulatory structure and the availability of remedies in the limited cases when "bad actors" fail to properly serve retirement investors, see FINANCIAL SERVICES INSTITUTE & BRIGGS AND MORGAN, PA, THE EFFICACY OF SECURITIES ARBITRATION AND PROPOSALS FOR CHANGE, available at https://www.financialservices.org/uploadedFiles/FSI_Content/Advocacy_Action_Center/Resources_and_Reference/White_Papers/fsi_white_paper_april2010_final.pdf
[10] See, e.g., See Definition of the Term "Fiduciary," 80 Fed. Reg. 21,928, 21,935 (Apr. 20, 2015); DEPARTMENT OF LABOR, FIDUCIARY INVESTMENT ADVICE: REGULATORY IMPACT ANALYSIS at 4 (Apr. 14, 2015), available at http://www.dol.gov/ebsa/pdf/conflictsofinterestria.pdf.
[11] *Donovan v. Bierwith*, 680 F.2d 263, 272 n. 8 (2d Cir. 1985).
[12] The DOL uses the term "advisers" to describe individual financial advisors, FSI uses the term "advisors" throughout the letter consistent with the way we have historically referred to individual financial advisor members.

> Advice you get regarding investments in your after-tax account is subject to rules issued under other federal and state laws, but the best interest standard and other significant consumer protections offered by the Department of Labor's Rule and exemptions only apply to retirement accounts … and other tax-preferred savings accounts … An investor can always ask an adviser whether the adviser will live by the fiduciary "best interest" standard in the Department of Labor Rule and exemptions for all investments – and if they will not, can consider finding one who does.[13]

All the resulting systemic change is premised on the RIA. As described by the DOL, the RIA is comprised of:

- Statistical comparisons finding poorer risk-adjusted investment performance in more conflicted settings;
- Experimental and audit studies revealing problematic adviser conduct;
- Studies detailing gaps in consumers' financial literacy, errors in their financial decision-making, and the inadequacy of disclosure as a consumer protection;
- Federal agency reports documenting abuse and investors' vulnerability;
- A 2015 study by the President's Council of Economic Advisers that attributed annual IRA investor losses of $17 billion to advisory conflicts;
- Economic theory that predicts harmful market failures due to the information asymmetries that are present when ordinary investors rely on advisers who are far more expert than them, but highly conflicted; and
- Overseas experience with harmful advisory conflicts and responsive reforms.[14]

The analysis estimated that financial advisors' conflicts arising from load sharing cost their IRA customers who invest in front-end-load mutual funds on average between 0.5 percent and 1.0 percent annually in estimated foregone risk adjusted returns, which the analysis concluded to be due to poor fund selection.[15]

Yet for all its 382 pages, the RIA failed adequately to consider five simple yet fundamental points that gravely undermine its conclusions.

A. The RIA did not establish the incidence with which retirement investors receive bad advice due to compensation conflicts

There is, quite simply, no empirical evidence in the RIA of the incidence with which investors receive bad advice and realize poorer returns due to compensation conflicts. That, in turn, means that there is no reliable way to determine the benefit to investors of this rulemaking. The RIA cites anecdotal reports and economic theory, and measures the incidence with which IRA investors purchase load mutual funds. Furthermore, none of that establishes how frequently compensation conflicts lead to bad advice and bad outcomes. For example, for those quantified purchases of load mutual funds by IRAs, there is no data on how frequently those purchases disserved the investor's interest – which would objectively seem to be the indispensable underpinning for a rulemaking of this magnitude.

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[13] Consumer Protections for Retirement Investors – FAQs on Your Rights and Financial Advisers (January 2017), at Q/A-19.

[14] Regulatory Impact Analysis for Final Rule and Exemptions, (April 2016), available at https://www.dol.gov/sites/default/files/ebsa/laws-and-regulations/rules-and-regulations/completed-rulemaking/1210-AB32-2/conflict-of-interest-ria.pdf.

[15] March 2, 2017 preamble at 12323.

B. The RIA failed adequately to consider the role of financial advisors in bringing and keeping investors in the retirement system

There are millions of working Americans who have retirement savings today because of their financial advisors. For example,

- It was a financial advisor who encouraged a Main Street business person to consider adopting a plan, notwithstanding that person's lack of expertise in retirement arrangements and the all-consuming demands of running the business.
- It was a financial advisor who coached that business person through the process of selecting a plan, choosing a recordkeeper and other service providers, and installing the plan.
- It was a financial advisor who sat in enrollment meetings with the low- and middle-income Americans working for the business, explaining to them the absolute necessity of committing a portion of their stretched-too-thin paychecks to save for retirement, educating them about the plan investment options, and giving them the information, tools and confidence to take charge of their own retirement savings.
- And it was a financial advisor who persuaded an employee, when leaving the business, to rollover his or her plan balance to an IRA to preserve it for retirement, rather than expending it on near-term desires or even pressing financial needs.

Quite simply, the most significant problem faced by the U.S. private retirement system is the need to extend coverage to a larger percentage of our workforce. Financial advisors are the answers to that problem, not the cause. Therefore, we urgently need to develop more retirement savers in this country, not fewer. To accomplish that, we need to encourage more interaction between financial advisors and employers and employees, not less.

The RIA failed adequately to weigh the risk that the Fiduciary Rule will perversely reduce the portion of the U.S. workforce that is participating in the retirement system. This deficiency takes on even more import considering the guiding principle of financial regulation articulated in the Presidential Memorandum: "to empower Americans to make their own financial decisions, to facilitate their ability to save for retirement and build the individual wealth necessary to afford typical lifetime expenses…"

C. The Rule will have repercussions for the U.S. financial markets, which the RIA inadequately considered

There is in financial circles, academia, and the marketplace an ongoing debate about the virtues of active versus passive investment methods. Until 2016, the federal government was neutral in those debates. That is no longer the case. There is no avoiding that the Fiduciary Rule will precipitate greater investment in passive options. There is, quite simply, less basis under the Fiduciary Rule to question an investment in an index fund than in an actively managed investment option.

The DOL's thumb on the scale in favor of passive investments will shift the operation of U.S. capital markets. It will affect the interests of not only retirement investors but all investors. It will change market demand. Our members tell us it could, for example, affect the market for Treasury bonds. It will distort market efficiency.

Passive investing is investing without critical analysis as investors choose their securities off a predetermined list rather than from opinions developed through research and observation of the market that indicates the growth potential or inherent value of a security. It is a well-known axiom that the undoing of every investment strategy is its own success. This is true because the popularity of the strategy changes the nature of our markets - eliminating previously existing advantageous and creating new opportunities. The DOL has no idea of the unintended consequences that will result from this push of $19 trillion of retirement investments into index funds, but we will all bear the consequences. None of this is adequately considered in the RIA. Furthermore, the relative expertise of the agencies to evaluate these considerations is one of the reasons we prefer that the SEC rather than the DOL lead a rulemaking on fiduciary duties in the investment markets.

D. By focusing on the return on investments, the RIA inadequately considered the positive effect of financial advisors on the savings of retirement investors

The manner in which the RIA evaluated the outcomes for retirement investors of commissioned investment products was too narrow. It is axiomatic that the return on $100 invested in a product carrying a load to pay a commission will be less than the return on a comparable no load product, by roughly the time value of the load. It is no surprise the RIA discovered results consistent with that axiom. However, even on this basis, the conclusions in the RIA are overstated. Originally the DOL projected that IRA holders receiving conflicted investment advice can expect their investments to underperform by 100 basis points per year over the next 20 years.[16] That figure has been since updated to demonstrate that in fact, they only underperform index funds by 64 basis points per year.[17]

Yet study after study shows that investors who work with, and, one way or another, pay financial advisors greatly benefit from that professional investment advice. Case in point,

- A study released by Oliver Wyman in July 2015 found that investors working with a financial advisor had a minimum of 25% more assets than non-advised individuals, irrespective of age and income levels. Individuals aged 35-54 with $100,000 or less in annual income who worked with a financial advisor had 38% more assets than those who did not work with a financial advisor.[18]
- A 2012 survey conducted by LIMRA found that investors working with a financial advisor are more likely to be saving for retirement at higher rates (defined as contributing more than 7% of their salary to a retirement plan) with 61% of investors who worked with an advisor saving at the higher rates compared to 36% of investors that were not working with a financial advisor.[19]
- A 2014 study by Prudential found that African-Americans with a financial advisor were significantly more likely to participate in employer sponsored retirement plans, have a

[16] DOL Fiduciary Rule Proposal 2015, available at, http://webapps.dol.gov/FederalRegister/HtmlDisplay.aspx?DocId=28201&AgencyId=8&DocumentType=1
[17] Del Guercio and Reuter, "Revisiting the Performance of Broker-Sold Mutual Funds" (November 2015), available at https://www2.bc.edu/jonathan-reuter/research/brokers_revisited_201511.pdf.
[18] Oliver Wyman, The Role Of Financial Advisors In The Us Retirement Market 6, 16 (Jul. 2015), available at http://fsroundtable.org/wp-content/uploads/2015/07/The-role-of-financial-advisors-in-the-US-retirementmarket-Oliver-Wyman.pdf.
[19] See LIMRA, Advisors Positively Influence Consumers' Behavior and Sentiment Toward Preparing for Retirement (Jul.11, 2012), http://www.limra.com/Posts/PR/News_Releases/LIMRA__Advisors_Positively_Influence_Consumers__Behavior_and_Sentiment_Toward_Preparing_for_Retirement.aspx.

savings account, life insurance, long-term care insurance, annuities, and mutual funds. That same study also found that African-Americans who worked with a financial advisor were more financially confident than those who did not.[20]

- A 2013 Morningstar study found that by working with a financial advisor, a retiree can be expected to generate 22.6% more certainty-equivalent income (the guaranteed amount of money that an individual would view as equally desirable as a risky asset). This has the same impact on expected utility as an annual return increase of 1.59%, which represents a significant improvement in portfolio efficiency for a retiree.[21]
- Per a 2012 study by the Investment Funds Institute of Canada and a 2010 survey by the ING Retirement Research Institute, individuals who spent at least some time working with a financial advisor had saved, on average, more than twice the amount for retirement than those that had not worked with an advisor.[22]
- An April 2014 study by Quantria Strategies found that retirement savings balances are 33% higher for individuals who have access to financial services; employees are less likely to take cash withdrawals out of their retirement savings if they discuss their distribution options with a financial advisor; and limiting access to this assistance could increase annual cash outs of retirement savings for employees leaving a job by $20-32 billion, thus reducing the accumulated retirement savings of affected employees by 20-40%.[23]
- A study by TIAA-CREF showed that those with high financial literacy prepare for retirement and have double the wealth of people who are not financially literate. Conversely, people who have a lower degree of financial literacy tend to borrow more, accumulate less wealth, and pay more in fees related to financial products. They are less likely to invest, more likely to have trouble with debt, and less likely to know the terms of their mortgages and other loans.[24] Financial advisors provide the crucial tools of education and guidance for the investors who would otherwise be overwhelmed.

Collectively these studies demonstrate that investors who receive professional assistance are better prepared, net of the costs of that assistance, for retirement and other financial needs than their peers who do not work with a financial advisor. We discuss below the reasons why that it is the case.

The RIA makes much of the fact that such investments underperform comparable investments purchased without the assistance of a financial advisor by roughly the cost of that advice, but ignores the benefits of that same advice. It erroneously focuses on hypothetical investor returns on investments purchased with professional advice. Clearly the RIA is flawed in

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[20] THE PRUDENTIAL INSURANCE COMPANY OF NORTH AMERICA, THE AFRICAN AMERICAN FINANCIAL EXPERIENCE (2014), available at http://www.prudential.com/media/managed/aa/AAStudy.pdf.

[21] DAVID BLANCHETT & PAUL KAPLAN, MORNINGSTAR INVESTMENT MANAGEMENT, ALPHA, BETA, AND NOW . . . GAMMA 16 (Aug. 28, 2013), available at http://corporate.morningstar.com/ib/documents/PublishedResearch/AlphaBetaandNowGamma.pdf

[22] JON COCKERLINE, THE INVESTMENT FUNDS INSTITUTE OF CANADA, NEW EVIDENCE ON THE VALUE OF FINANCIAL ADVICE (2012), available at https://www.ific.ca/wp-content/uploads/2013/08/New-Evidence-on-the-Value-of-FinancialAdvice-November-2012.pdf/1653/; ING Retirement Research Institute, Working with An Advisor: Improved Retirement Savings, Financial Knowledge And Retirement Confidence! 6 (2010), available at http://voyacdn.com/file_repository/5151/help_wanted_wp.pdf.

[23] Quantria Strategies, Access to Call Centers And Broker Dealers And Their Effects on Retirement Savings (Apr. 2014), available at http://quantria.com/DistributionStudy_Quantria_4-1-14_final_pm.pdf.

[24] See the TIAA Institute-GFLEC Personal Finance Index: A New Measure of Financial Literacy available at https://www.tiaainstitute.org/publication/personal-finance-index-new-measure-financial-literacy

many respects, but most particularly because it completely ignores the empirical evidence quantifying the benefits to consumers of financial advice.

E. The costs to the industry of complying with the Fiduciary Rule are materially understated in the RIA

Finally, the DOL estimated the cost to comply with the Fiduciary Rule will be between $10 billion and $31.5 billion over ten years, with the most likely figure being $16.1 billion. The Department expects $5 billion in first-year costs and $1.5 billion in annual costs after that.[25] However, new studies have shown the Fiduciary Rule will end up increasing consumer costs by $46.6 billion, or $813 annually per account, in addition to the $1500 in duplicative fees for retirement savers that have already paid a fee on their commission-based accounts. Furthermore, the Rule could force 28 million Americans out of managed retirement accounts completely. Even with a minimum account balance of $5,000, over 13 million would lose access to managed retirement accounts.[26]

In 2015, FSI engaged Oxford Economics to Conduct a study on the "Economic Consequences of the DOL Fiduciary Rule" (2015 Oxford Economics Study). The 2015 Oxford Economics Study 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 once the Rule takes hold. The 2015 Oxford Economics Study Rule estimated the Fiduciary Rule would result in startup costs ranging from $1.1 million to $16.3 million per firm, depending on firm size.[27] This is based on firm survey results that ranged from $930,000 to $28 million, with the largest firms expected to incur the highest costs.[28] A significant point to take from the 2015 Oxford Economics Study report is that their estimates exceed the DOL's totals by significantly larger margins for small and medium sized firms – specifically, 4.6-5.1 times as high; as for large firms – 3.3 times as high. This is due to the DOL's inaccurate estimate of costs for small and medium-sized firms. Where the Department estimates that medium firms' costs will be only 13.3%, and small firms only 4.8% of large firms' costs, Oxford estimates they are significantly larger at 20.6% and 6.9%, respectively.[29]

In 2017, FSI engaged Oxford Economics to conduct another study, "How the Fiduciary Rule Increases Costs and Decreases Choice" (2017 Oxford Economics Study) to update their economic analysis on the impact of the Fiduciary Rule since it has been proposed in its final form. The findings of the 2017 Oxford Economics Study report are based the actual experience of implementing compliance with the Fiduciary Rule, not assumptions or projections, which makes these figures far more reliable than the RIA's figures.[30] This new report found that even their own

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[25] *See* "Fiduciary Rule hits BDs Budgets" *available at http://www.thinkadvisor.com/2016/08/18/dol-fiduciary-rule-hits-bds-it-budgets-product-lin*

[26] Meghan Milloy, "The Consequences of the Fiduciary Rule for Consumers" (April 2017) available at https://www.americanactionforum.org/research/consequences-fiduciary-rule-consumers/.

[27] See Oxford Economics Study, *available at* http://www.financialservices.org/uploadedFiles/FSI_Content/Advocacy_Action_Center/DOL/FSI-OE-Economic-Impact-Study.PDF

[28] See Oxford Economics Study, *available at* http://www.financialservices.org/uploadedFiles/FSI_Content/Advocacy_Action_Center/DOL/FSI-OE-Economic-Impact-Study.PDF

[29] *Id.*

[30] Oxford Economics 2017 Report, "How the Fiduciary Rule Increases Costs and Decreases Choice" (April 2017), available at http://www.financialservices.org/uploadedFiles/FSI/Advocacy_Action_Center/The_Fiduciary_Rule_Increases_Costs_And_Decreases_Choice.pdf

2015 predictions of the cost of the Fiduciary Rule were significantly underestimated, as FSI members have already spent nearly half of the predicted $400 million implementation cost.

Once implemented, these firms expect to pay an additional $230 million per year in recurring costs complying with the DOL requirements. This recent study found that FSI members have already spent $190 million preparing for Rule implementation and will continue to spend an additional $205 million in preparation costs if the Fiduciary Rule was to go into effect. This means that start-up costs of the regulation are roughly 20 times higher than even the updated DOL RIA estimated. Whether because DOL's 2016 revisions to their 2015 proposed rules were not as effective at cost reduction as it thought, or because Oxford's original cost estimates were too low, the new estimates of total start-up costs are roughly 1.8 to 3.0 times higher than the DOL's most recent estimates. If the FSI members' experiences were extrapolated to the universe of all broker-dealers, the total implementation costs to the industry will likely approach $1.8 billion. Furthermore, DOL's revised RIA also did not provide a new detailed estimate of recurring costs, relying on the 2015 RIA, while Oxford estimates the actual recurring costs to be 16.4 to 41.5 times higher than what the DOL has estimated.[31] Based on these results for startup and recurring costs, Oxford calculated the total 10-year costs of the Rule to the Broker-Dealer industry to be approximately $14.2 billion.[32] Taken together, these figures demonstrate that the costs of complying with the Rule are not only higher than what the DOL has predicted, but are significantly higher than what the industry originally predicted. These figures further demonstrate that the RIA is considerably flawed.

As compliance costs rise, fees for investors will rise. A study by A.T. Kearney also found that implementing the Fiduciary Rule for retirement accounts will cost the brokerage industry $11 billion over the next four years.[33] Among broker-dealer firms, there is clear evidence of significant increases in compliance costs because of the Fiduciary Rule. The increase in compliance costs will be passed on to investors, who will see a rise in fees. The following is a summary of public statements made by firms quantifying the compliance burdens they are facing because of the Fiduciary Rule:

- As of September 2016, Raymond James reported that they spent $28 million to prepare to comply with the Fiduciary Rule.[34]
- Primerica believes it will spend between $4 million and $5 million every year to keep compliant with the Rule. That is in addition to the $8 million it expects to spend between now and the end of 2017.[35]
- Ameriprise Financial, a financial services firm with a network of 10,000 financial advisors and extensive wealth management and asset management capabilities, has already spent $11 million on DOL-related compliance activities as of September 2016.[36]
- Principal Financial Group, a company with retirement, insurance, and asset management solutions, not to mention $572.2 billion in assets under management, commented that it will likely spend between $18 million and $24 million over the

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[31] *Id.*
[32] *Id.*
[33] A.T. Kearney Study, "The Fiduciary Rule and its Impact on the Wealth Management Industry" (Oct. 2016) available at https://www.atkearney.com/financial-institutions/dol-fiduciary-rule
[34] *See http://www.investmentnews.com/section/video?playerType=INTV&bctid=5288954879001&date=20170126*
[35] See *https://www.finextra.com/blogposting/13139/what-it-costs-to-comply-with-the-dol-fiduciary-rule*
[36] *Id.*

next two years, and then an additional $5 million to $10 million, once the Rule is fully in effect.[37]

From an economic perspective, the full cost of the Rule may be far larger than just the amount spent on compliance, although that alone could be extremely costly. The cost of the uncertainty caused by the Rule could be far greater, as firms are forced to direct resources and forego opportunities because of the risk of litigation.[38] For example, firms may give up on product lines or exit the retirement savings market altogether. The DOL assumes that Error and Omission (E&O) insurance costs for some broker-dealer representatives will increase by 10%. This appears to be a gross underestimation of both the potential costs of litigation and the uncertainty caused by the Fiduciary Rule.[39]

Finally, as discussed in more detail below, the direct litigation costs that are the inevitable result of the Fiduciary Rule - because it is structurally designed to be enforced through private litigation – have not been fully vetted or considered in the RIA. This will ultimately lead to increased costs to the consumer, in the form of fee increases (directly affecting return on investment) and limitations in investor access to investment advice because firms will have to allocate their resources to litigation rather than other areas where investors are better served. Due to these increased direct and opportunity costs of the Fiduciary Rule, which were not sufficiently factored into the RIA, the Fiduciary Rule should be rescinded.

Based upon the 2017 Oxford Economics Study, recent studies, and media reports, we continue to believe that the RIA provides an inadequate basis for this rulemaking, which DOL should carefully consider in its review of the Fiduciary Rule commissioned by the Presidential Memorandum.

II. The anticipated applicability of the Fiduciary Rule will harm investors due to a reduction of Americans' access to certain retirement savings offerings, retirement product structures, retirement savings information, and related financial advice

The Presidential Memorandum instructed the DOL to determine whether the Fiduciary Rule would, "harm investors due to a reduction of Americans' access to certain retirement savings offerings, retirement product structures, retirement savings information, or related financial advice."[40] The Fiduciary Rule implicates each of these concerns and will have a devastating impact on retirement investors' access to guidance on retirement products and services. Restricting investor access to retirement planning services is particularly problematic because research from a variety of sources has shown that investors who work with financial advisors save more, are better prepared for their retirement, and have greater confidence in their retirement planning.[41] We explain in greater detail below.

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[37] *Id.*

[38] Oxford Economics 2017 Report, "How the Fiduciary Rule Increases Costs and Decreases Choice" (April 2017), available at http://www.financialservices.org/uploadedFiles/FSI/Advocacy_Action_Center/The_Fiduciary_Rule_Increases_Costs_And_Decreases_Choice.pdf

[39] *Id.*

[40] *See "Presidential Memorandum" at https://www.whitehouse.gov/the-press-office/2017/02/03/presidential-memorandum-fiduciary-duty-rule*

[41] Oliver Wyman, The Role Of Financial Advisors In The Us Retirement Market 6, 16 (Jul. 2015), available at http://fsroundtable.org/wp-content/uploads/2015/07/The-role-of-financial-advisors-in-the-US-retirementmarket-Oliver-Wyman.pdf.

A. The Fiduciary Rule reduces investor access to retirement savings offerings and product structures

The Fiduciary Rule, particularly the new exemption regime, forces a new and complex regulatory structure upon the existing market. This complexity, with its subjective compliance standards (such as undefined 'reasonable compensation standards'), naturally results in favoring those products which fit more neatly within the new structure rather than products for which the road to compliance is more uncertain. In addition, biases built into the Rule further drive professionals to limit products and services to avoid potential liabilities.

1. The Fiduciary Rule is limiting retirement investors' access to certain product offerings that might otherwise be in their best interest

The pending application of the Fiduciary Rule is already having a consequential impact on the industry that will result in reduced access to savings offerings appropriate for retirement investors. For example,

- The Fiduciary Rule has caused firms to consider whether they must eliminate A-share mutual fund offerings,[42] which would severely limit investors' ability to make the personalized investment choices that are best for them by presenting fewer options in the market.[43] Many firms have already announced that they will no long offer such mutual funds in brokerage IRA accounts.[44]
- Others will no longer be offering any IRA brokerage accounts, reducing the availability of commission based retirement accounts.[45]
- Other firms are eliminating or greatly reducing the alternative investments, such as non-traded REITS, that are available for retirement investors while others have announced that they will no longer be able to offer variable annuities, fixed indexed annuities, actively managed funds, and funds offered by small mutual fund families.[46]
- The Fiduciary Rule would also make it much more difficult for consumers to receive advice on the purchase of annuities. For some annuities, the definition of "commission" for purposes of PTE 84-24 would be limited, making reliance on the exemption challenging. Annuities are the only product that can guarantee a lifetime income.[47]

These changes to the industry will create a smaller pool of savings options for investors to choose from, ultimately damaging their ability to save for retirement and resulting in a one-size fits all approach to retirement investing.

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[42] A Shares are a class of mutual fund shares that are usually characterized by a loaded fee structure. A shares will commonly have a front- or rear-end load, to compensate for the sales person's commission. Not all fund companies follow this class structure although it is the prominent method of distinction.
[43] See "Ameriprise Kills Shares" available at https://advisorhub.com/ameriprise-kill-shares-12-b1-fees-ceo-says/
[44] *Id.*
[45] *Id.*
[46] See DOL pending fiduciary rule remains flawed, negatively impacting the marketplace available at http://thehill.com/blogs/congress-blog/economy-budget/318816-dol-pending-fiduciary-rule-remains-flawed-negatively.
[47] See Financial Advisors Say DOL Rule Would Reduce Access to Advice and Harm Client Relationships available at http://www.naifa.org/news-publications/press-room/news-releases/financial-advisors-say-dol-rule-would-reduce-acces

2. The Fiduciary Rule favors passive investment advice to the detriment of investors and the U.S. capital markets

As discussed in Section II.A. above, the Fiduciary Rule reduces investor access to investment products because it favors passive investments over active investment advice. The Fiduciary Rule makes it easier for broker-dealers to meet their requirements under the law if they sell passive, low-cost index funds, which do not require active management and present simpler compliance. This shift will guide investors to a narrower range of products and providers. The DOL's endorsement of passive investment is damaging to investors and capital markets, because it presents a regulatory opposition to active investing - an important and valuable investment strategy.[48]

Financial advisors involved with actively managed accounts play an important role by working with their clients to understand their investment objectives and risk tolerance. They use this information to create an investment plan with risk and return goals, define an investment philosophy, select an appropriate performance benchmark, choose an asset mix, determine ways to select securities to populate the portfolio, and allow for course adjustments in response to results and changing circumstances of the investor.[49] Active management with the support of a financial advisor is important for investors because they typically underperform their investment potential by not saving and investing regularly, by not matching the investment risk of their portfolio to their natural risk capacity, by not diversifying sufficiently, through poor market timing, and many other common mistakes.[50] Investment counselling and active management decisions are needed to mitigate the biggest threats to investment performance investor behavior.[51]

Active management helps investors reach their personal investment objectives, including retirement security. Restricting advice to only index or other passive funds will result in investors losing access to personalized advice. Passive investment has a role in the industry, but it cannot be the sole means of investing. Vanguard, the inventor of index funds, published a report that found that while passive funds have become synonymous with low cost, the historical data shows a more nuanced reality. Vanguard concluded that low-cost active investment can outperform; and that investors, to the extent they stick with a disciplined approach, can be successful using actively managed funds.[52] Because the Fiduciary Rule promotes passive investments at the expense of actively managed investments, it limits investor access to active investment management, failing yet another test of the Presidential Memorandum and requiring its rescission.

3. The Fiduciary Rule steers low and middle income investors, and early retirement savers, to robo-advice, much to their detriment

The Fiduciary Rule also reduces investor access to investment services because it encourages "robo-advice" over professional investment guidance. The studies discussed in Section II of this letter demonstrate that having access to professional financial advice from a qualified financial advisor benefits anyone wanting to save for retirement. For low- to middle-income investors and those just starting to plan for retirement, the Fiduciary Rule would give preference to

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[48] Investment New, Trump adviser Anthony Scaramucci promises to 'repeal' DOL fiduciary rule (Oct. 2016), available at http://www.investmentnews.com/article/20161018/FREE/161019925/trump-adviser-anthony-scaramucci-promises-to-repeal-dol-fiduciary.

[49] Financial Times, Active management's many benefits are poorly understood (May 2015), available at, https://www.ft.com/content/05957a4c-fe19-11e4-9f10-00144feabdc0

[50] *Id.*

[51] *Id.*

[52] Vanguard Research, "The case for Vanguard active management: Solving the low-cost/top-talent paradox?" (January 2013) available at, http://www.vanguard.com/pdf/s356.pdf.

online, algorithm-based allocation and rebalancing tools which would encourage the displacement of one-on-one, holistic investment advice delivered by a trusted professional. In practice, this would deny investors choices regarding who and how they want to receive and pay for financial advice and detrimentally impact the amount saved in retirement plan solutions.[53] While robo-advice can inarguably be an important avenue for investors, the Rule mistakenly favors this business model. The consequences of a loss of access to retirement advice, products, and services will fall most heavily on smaller investors because firms will abandon these accounts and leave them no choice but to resort to robo-advisors, their own research or chance. For this reason, it is essential for public policy to promote investor access to retirement advice through all available means.

Although robo-advisors may one day serve an important role in the industry, they are a recent innovation and hardly the only way to effectively invest. This is particularly important because some investors, particularly the elderly, may not have access to a computer or trust or even understand algorithmic trading. They might insist on a relationship with a human advisor or may never plan for retirement because of a lack of education and support from a financial advisor. In addition, the SEC[54] and FINRA[55] have both published guidance warning investors of the challenges of investing with a robo-advisor. Both the SEC and FINRA warned investors that, while there is a place for robo-advice in the industry, it presents unique challenges because robo-advisors cannot build relationships with their clients, cannot encourage the client to increase their retirement investing, and cannot talk them out of pulling money out of their retirement account to meet immediate desires. These services are vital for maximizing investor return, which is why many investors choose to invest with a human advisor.

Additionally, the DOL assumes that robo-advisors, a relatively new business model that has not been tested in an economic downturn, will be commonplace and widely available to investors. However, that is not necessarily the case. It is possible to see how robo-advisers can effectively assist with asset allocation once an investor is in the retirement system; it is much less clear that robo-advice can bring investors into the system and otherwise serve holistic consumer needs as well as professional advisers. If not, as the industry evolves, robo-advisors will not meet the financial needs of investors or the business objectives of the industry, and may be altered or scrapped to favor personalized, human-led financial advice.[56]

B. The Fiduciary Rule reduces investor access to retirement savings information

The Fiduciary Rule reduces investor access to retirement savings information by reducing their access to investment advice, education, and other guidance. Without access to a financial advisor, investors lose an important source of financial education. Financial advisors provide an important service for investors who are often overwhelmed by the investment choices available to them. This is particularly true for the lower and middle class investors, and it is imperative that they have access to financial education and guidance.[57]

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[53] We also note that retirement investors who chose to work with investment professionals tend to have larger retirement savings than those who do not. See, e.g., *Id.*
[54] See SEC Guidance on Robo Advisors, available at https://www.sec.gov/investment/im-guidance-2017-02.pdf.
[55] See FINRA Guidance on Digital Investment Advice available at http://www.finra.org/newsroom/2016/finra-reports-effective-practices-digital-investment-advice
[56] See, "Robo-Advisors Face Potential Collapse, Says FinTech CEO (March 2017)," available at http://www.fa-mag.com/news/robos-the-wrong-answer-for-advisors--says-fintech-ceo-32091.html
[57] See SEC Study Regarding Financial Literacy Among Investors, available at https://www.sec.gov/news/studies/2012/917-financial-literacy-study-part1.pdf

The DOL relied on selective academic research and anecdotes to support the Fiduciary Rule, despite the large body of quantitative research and evidence that demonstrates the essential and constructive role played by independent broker-dealer firms in this market.[58] This approach ignores the importance of a holistic investment approach to saving for retirement and other important needs, particularly for low-income savers. Financial advisors can assist clients with all their investment needs, not just retirement. Retirement is an essential aspect of an investors' financial security and although technology firms can create tools and services to automate asset allocation or portfolio rebalancing at a modest price point, they cannot take into consideration the individual circumstances with respect to the life events of their clients and tailored financial planning services designed to bring employers and participants into the retirement system and keep them there. For example, financial advisors:

- **Provide holistic financial guidance and solutions**: Financial advisors assist clients with decisions related to a whole host of needs including not just retirement but college planning, estate planning, tax considerations, paying off debt, and other vital financial planning to make clients' assets last through their retirement.
- **Help clients plan for major life disruptions**: Financial advisors offer their skill and expertise to help clients navigate major financial pressures imposed by events such as medical concerns, bankruptcy, deaths in the family, and caring for aging family members.
- **Protect clients from financial devastation due to loss of a family member**: Financial advisors assist clients in providing for other types of financial needs, such as life insurance, to provide security to clients' family members as well as lifetime income and longevity protection in retirement.
- **Draw investors into the retirement system**: Financial advisors encourage employers to offer retirement plans and educate employees on the importance of participating in those plans to build and retain retirement savings.
- **Help clients weather market volatility and avoid making emotional decisions**: Financial advisors are instrumental in helping clients weather market volatility. Inexperienced retail investors often make impulsive and ill-informed decisions such as buying securities at market highs and selling at market lows. Financial advisors have the expertise and experience to help their clients avoid this common pitfall. [59]
- **Prevent leakage from clients' accounts**: Financial advisors protect clients from the mistake of cashing out their retirement accounts for short-term needs and help prevent retirement asset "leakage."[60] Financial advisors serve an important role in protecting their clients' assets from leakage, because they understand the rollover process and are aware of the tax consequences of cashing out. Financial advisors they can properly advise their clients on how to best protect their assets to serve their future retirement goals.

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[58] Oxford Economics for the Financial Services Institute, The Economic Impact of FSI's Members (2016) available at https://www.oxfordeconomics.com/recent-releases/the-economic-impact-of-fsi-s-members

[59] For example, the knowledge of how each asset class has performed in the past is an important tool when setting up an initial portfolio. The proper setup helps clients deal with market volatility over the long term.

[60] *See "Plan leakage: A study on the psychology behind leakage of retirement plan assets"* available at http://www.dciia.org/assets/Publications/2016/dciia_leakage_research_brief_final_020316.pdf.

The Fiduciary Rule has had a chilling effect on these services, due to concerns that providing any financial education or guidance will be deemed to cause the financial advisor to be considered a fiduciary.[61]

The 2017 Oxford Economics study cited above found that because of the cost burdens that will result from the Rule, 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. Thus, only investors with substantial assets will have access to financial advisors.[62]

In our discussion above of the RIA, we detailed the empirical evidence demonstrating the benefits realized by retail consumers in their retirement preparation and savings from working with a financial advisor under the regulatory structure predating the Fiduciary Rule. Without rescission or modification of the Fiduciary Rule, those benefits will be lost.

C. Conclusion

The Fiduciary Rule has already and will continue to reduce investor access to savings offerings and product structures, as well as investor access to retirement savings information and financial advice. Under the direction of the Presidential Memorandum, the Fiduciary Rule must be rescinded.

III. The anticipated applicability of the Fiduciary Rule has resulted in dislocations or disruptions within the retirement services industry that adversely affect investors and retirees

The Presidential Memorandum instructed the DOL to determine whether the Fiduciary Rule would "result in dislocations or disruptions within the retirement services industry that may adversely affect investors or retirees."[63] Preparation for the Fiduciary Rule has already caused disruptions in the retirement savings industry, forcing firms to alter their business strategies in ways that would limit the investment vehicles and services they offer to investors and retirees. The overextension of ERISA fiduciary status has the potential to create significant disruption in the retirement services industry. Which is why, when the question of the ERISA investment advice fiduciary definition was first considered in 1974, the SEC itself expressed on the record its serious concern about the risk of disruption to the U.S. capital markets if ERISA fiduciary status was overextended.[64] Those concerns are becoming a reality today because of the Fiduciary Rule.

With current assets of approximately $19.5 trillion, the U.S. private retirement system provides substantial equity and debt capitalization for the U.S. economy. The retirement service industry is an integral part of the U.S. capital markets.[65] When there is a shift in one aspect of the industry, those impacts will be felt throughout. Since the banking, insurance, and securities

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[61] Oxford Economics 2017 Report, "How the Fiduciary Rule Increases Costs and Decreases Choice" (April 2017), available at http://www.financialservices.org/uploadedFiles/FSI/Advocacy_Action_Center/The_Fiduciary_Rule_Increases_Costs_And_Decreases_Choice.pdf

[62] *Id.*

[63] *See "Presidential Memorandum" at* *https://www.whitehouse.gov/the-press-office/2017/02/03/presidential-memorandum-fiduciary-duty-rule*.

[64] *See DOL Re-proposes Expanded ERISA Fiduciary Definition and Revised Complex of Exemptions available at* *http://www.martindale.com/employee-benefits-law/article_Sutherland-Asbill-Brennan-LLP_2202486.htm*

[65] *Id.*

industries participate in the retirement market, they must all be restructured because of this Rule promulgated by the DOL, rather than by the appropriate regulators with the direct responsibility and the expertise in those industries.[66] This restructuring will directly cause disruption in the retirement savings industry. The Fiduciary Rule is a seismic shift that is intended to create vast dislocations and disruptions within the retirement services industry with the expectation that they will benefit investors. However, these disruptions are instead altering the business models of industry participants, limiting investor access to financial advice, and limiting investors' options for investment vehicles. We discuss these concerns in more detail below.

A. The Fiduciary Rule will disrupt the retirement savings industry by altering the business models of industry participants away from commission-based brokerage accounts to fee-based accounts

The Fiduciary Rule has caused industry members to significantly alter their business models, to the detriment of investors. The original 2015 Oxford Economics Study [67] identified several areas where the compliance with the Fiduciary Rule would cause industry disruption that would adversely impact retirees, including: disruptions to sales models, for example shifting clients from commission to fee-based account without regard for clients' needs; the opportunity cost of selling fewer, more commoditized products, and reductions in payments from third-party vendors, representing costs that would otherwise be absorbed by plans or participants.[68] The Fiduciary Rule will severely disrupt the retirement services industry by forcing industry participants to change their business models, which will negatively impact investors by limiting their choices among investment products, retirement planning services, and financial advisors. The latest research contained in the 2017 Oxford Economics Study demonstrated the Fiduciary Rule has already caused reduced access to investment advice (especially among small investors), reduced investor choice in asset types, imposed disproportionate burdens on small firms, resulted in general consolidation in the industry, and dramatically increased litigation risk.[69]

Of concern to FSI members and the clients they serve is the Fiduciary Rule's de facto extinguishment of commission-based accounts. Per a February 2017 DOL Special Report by JD Power, there is significant resistance among those commission-based clients to being forced to migrate to fee-based accounts.[70] More than half (59%) of investors who pay commissions say they either "probably will not" (40%) or "definitely will not" (19%) be willing to stay with their current firm if it means being forced to move to a fee-based retirement account.[71] According to a study by Cerulli Associates, 47% of 7,800 households surveyed prefer paying commissions,

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[66] *Id.*
[67] See Oxford Economics Study, *available at* http://www.financialservices.org/uploadedFiles/FSI_Content/Advocacy_Action_Center/DOL/FSI-OE-Economic-Impact-Study.PDF
[68] See Oxford Economics Study, *available at* http://www.financialservices.org/uploadedFiles/FSI_Content/Advocacy_Action_Center/DOL/FSI-OE-Economic-Impact-Study.PDF
[69] Oxford Economics 2017 Report, "How the Fiduciary Rule Increases Costs and Decreases Choice" (April 2017), available at http://www.financialservices.org/uploadedFiles/FSI/Advocacy_Action_Center/The_Fiduciary_Rule_Increases_Costs_And_Decreases_Choice.pdf
[70] See Wealth Management Fiduciary Roulette, available at http://www.jdpower.com/resource/wealth-management-fiduciary-roulette
[71] Wall Street Journal, "SEC Targets 'Reverse Churning' by Advisors", Feb. 24, 2014, available at http://www.wsj.com/articles/SB10001424052702304610404579403251590760602.

compared with 27% that would rather pay a fee-based on assets.[72] Our financial advisor members are experiencing this push back from their own retirement focused clients.

Commission-based advisors serve an important role in the industry, because they are more likely to serve smaller clients, and as demonstrated above, investors actually prefer them over their fee-based counterparts.[73] These investors are correct to resist being forced to advisory accounts. Commission-based accounts are more cost effective for many investors. For example commission-based accounts are often most effective for accounts that are self-directed, trade infrequently, and that are small accounts because the active management services typically associated with fee-based compensation are less easily supported by low account balances. As discussed in previous sections, this creates a disparate impact on low- to middle-income investors. The SEC and FINRA have also expressed their view that in many circumstances, commission-based accounts are in fact in the best interest of investors. Former FINRA CEO Rick Ketchum said the Fiduciary Rule would create a bias against financial products with higher fees, even if they are the best recommendation for a client, and that it could force firms to inappropriately move to a fee-based rather than commission business model, to the detriment of investors.[74] In fact, the SEC had previously been scrutinizing fee-based accounts because of their penchant for fraudulent transactions, such as "reverse churning" schemes.[75] The SEC is concerned that the industry will migrate from commission based accounts to fee-based accounts, because commission based accounts are not in every investors' best interest.[76]

While the DOL has stated that it does not intend to mandate level fees, it notes that level fees would be a satisfactory way for firms to comply with the BICE. An endorsement of level fees suggests a predilection for fee-based investment advisor accounts. More importantly, the BICE distinguishes between level fee and commission or transactional based compensation models in a critical way – the level fee fiduciary is not required to enter into a best interest contract and thereby is not subjecting itself to a substantially increased litigation risk. In addition to investment recommendations, under securities laws financial advisors also are required to assess the suitability of account types. As such, it is even more important to ensure that any exemption reflect a workable framework that will protect retirement investors while ensuring that broker-dealers do not run afoul of the federal securities laws. Clearly, there is established recognition that a level fee system is not in the best interest of all investors.

Due to the cost of complying with the Fiduciary Rule, firms have shifted their business model towards fee-based advising and create a minimum asset threshold for accepting client accounts or they will substantially increase their fees. This will serve to further reduce investors' access to retirement advice for those whom a fee-based option is not affordable or suitable. In addition to the likely cost increases on retirement products and advice that retail investors will incur, the research conducted by Oxford Economics shows that the costs of compliance will result in the regulatory burden falling disproportionately on smaller firms who cannot take advantage of

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[72] See, "No Doubt Which Investors Prefer" *available at* http://www.investmentnews.com/article/20110608/FREE/110609950/fee-vs-commission-no-doubt-which-investors-prefer

[73] See Wealth Management Fiduciary Roulette, available at http://www.jdpower.com/resource/wealth-management-fiduciary-roulette.

[74] See "Finra's Ketchum criticizes DOL fiduciary rule" (May 2015) available at http://www.investmentnews.com/article/20150527/FREE/150529942/finras-ketchum-criticizes-dol-fiduciary-rule.

[75] See "SEC Targets 'Reverse Churning' by Advisers" (February 2014) available at https://www.wsj.com/articles/SB10001424052702304610404579403251590760602.

[76] See, "U.S. regulator intensifies scrutiny of fee-based accounts" (December 2013) available at, http://www.reuters.com/article/us-sec-churning-idUSBRE9BB16P20131212.

scale. Small firms will also bear the proportionally higher pass-on costs from their clearing brokers.[77]

Similarly, another segment of the industry that will be impacted is the direct-to-fund business (Direct Business) where both the broker and the client may deal directly with their fund rather than relying on an intermediary for communications and service questions. This is a significant issue because investors will lose out on the option to engage in Direct Business, which is often a low-cost opportunity for investors to purchase securities products. Many firms are moving away from the Direct Business because of compliance costs related to the Fiduciary Rule.[78]

Traditionally, more complex or higher yielding products commanded higher fees than simpler or lower yielding products and this relationship is typical for products across the yield spectrum of each specific asset class. Many firms have adapted the position that this spectrum of choice invites litigation risk because an advisor might properly recommend a potentially higher yielding product (possibly at higher commission) that fails to perform as expected. This is a common investing risk but the standards adapted by DOL will invite class action lawsuits.[79] The solution for many of firms is to narrow the range of options (products) from which an investor might choose.[80]

The Fiduciary Rule has already resulted in industry changes that are not in the best interest of investors, such as the consolidation and elimination of product choice.[81] Limiting product choice means that investors have less opportunity to optimize their portfolio. The elimination of product choice is a development that is fundamentally at odds not only with the President's priorities, but with the mission of many independent broker-dealers who serve a vital role in providing independent financial advice about a wide range of suitable investment products to investors.

B. The Fiduciary Rule is causing the consolidation of the retirement services industry, which will negatively impact investors

In order to respond to the Presidential Memorandum, the DOL has asked whether the Fiduciary Rule has or will lead to consolidation of firms and products and thereby reduce access to financial advice or products. The evidence overwhelming demonstrates that consolidation has already begun in response to the Rule, and is likely to continue once the Rule becomes effective. Consolidation in general would be expected to reduce access to services, but the nature of the consolidation caused by the Rule will have a particularly adverse effect on investors with low account balances because it is the small broker-dealers who are most affected.

Per a 2015 report by Cerulli Associates, small broker-dealers face the greatest financial risk under the Fiduciary Rule.[82] Unable to bear the new Rule's increased compliance costs, many will seek to merge with larger companies that enjoy economies of scale. The result will be a further consolidation of financial services providers and assets under management. Broker-dealers

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[77] See Oxford Economics Study, *available at* http://www.financialservices.org/uploadedFiles/FSI_Content/Advocacy_Action_Center/DOL/FSI-OE-Economic-Impact-Study.PDF

[78] See "LPL to End Direct Fund Business" *available at* *http://www.fa-mag.com/news/lpl-to-end-direct-fund-business-26636.html*

[79] Oxford Economics 2017 Report, "How the Fiduciary Rule Increases Costs and Decreases Choice" (April 2017), available at http://www.financialservices.org/uploadedFiles/FSI/Advocacy_Action_Center/The_Fiduciary_Rule_Increases_Costs_And_Decreases_Choice.pdf

[80] *Id.*

[81] *Id.*

[82] See http://www.lifehealthpro.com/2016/12/20/dol-rule-will-force-consolidation-of-broker-dealer

with less than $10 billion in assets under management account for more than 80% of broker-dealer sales volume, but less than 10% of advisor-managed assets.[83] The report concludes the Fiduciary Rule could cut the number of firms in the industry in half, leaving fewer advisors to serve those who need their services most: low- and middle-income clients.[84] We have seen these effects in the industry. In 2010 before the Fiduciary Rule was initially imposed, FINRA Membership was at 4,600 firms.[85] By 2015, FINRA membership had shrunken to under 4,000 firms.[86] Industry consolidation will result in fewer firms for investors to choose from and is a major concern for the retirement services industry.

Consolidation will impact investors by depriving them access to much needed retirement guidance. The 2017 Oxford Economics Study, discussed above concluded that the consolidation resulting from the Fiduciary Rule would restrict professional investment advice to only high net-worth investors.[87] The Oliver Wyman study discussed above estimated that 7.2 million IRA account holders would lose access to services because of account minimums.[88] Furthermore, they found that 98% of small investors (defined as having IRA accounts with $25,000 or less) had a brokerage relationship, but the Fiduciary Rule will force broker-dealers to close many of those accounts because continuing the service will become cost-prohibitive.[89] The Fiduciary Rule has failed the test laid out in the Presidential Memorandum as it has promoted consolidation that has reduced investor access to investment advice. Correspondingly, the Rule should be rescinded.

C. The Fiduciary Rule limits access by causing industry job loss and improperly and inexplicitly restricting recruiting within the Industry

In addition to reducing the number of qualified firms and advisors for investors to choose from, consolidation also leads to job loss. When corporations combine, the acquiring company often must reduce the number of employees due to duplication of similar job roles.[90] Consolidation will naturally cause the newly formed companies to cut positions that are redundant, leaving many out of work. This is particularly important for FSI members, who create 482,100 jobs for the workforce.[91] As consolidation in the industry occurs due to the Fiduciary Rule, many of the jobs created by FSI members will be lost.

Moreover, after finalization of the Rule, the DOL issued answers to a set of frequently asked questions, one of which states that asset and production thresholds to earn recruiting bonuses will be considered an "acute conflict of interest" that cannot merely be mitigated and must be avoided.[92] In other words, all the typical contingencies that broker-dealers attach to the back end of recruiting negotiations will be banned in the future. With no advance notice, this

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83 *Id.*
84 *Id.*
85 *See FINRA 2010 Annual Report, available at,* https://www.finra.org/sites/default/files/Corporate/p123836.pdf.
86 See FINRA 2015 Annual Report, available at, https://www.finra.org/sites/default/files/2015_YIR_AFR.pdf.
87 See "Oxford Economics Study on the Economic Consequences of the U.S. Department of Labor's Proposed New Fiduciary Standard." Available at http://www.financialservices.org/uploadedFiles/FSI_Content/Advocacy_Action_Center/DOL/FSI-OE-Economic-Impact-Study.PDF
88 See "Oliver Wyman Study" *available at https://www.dol.gov/sites/default/files/ebsa/laws-and-regulations/rules-and-regulations/public-comments/1210-AB32/oliverwymanreport.pdf*
89 *Id.*
90 *See "Mergers and Acquisitions: How the May Impact You" available at,* http://www.americasjobexchange.com/career-advice/impact-of-mergers-and-acquisitions
91 *See* "The Economic Impact of FSI's Members" *available at http://www.financialservices.org/uploadedFiles/FSI_Content/Newsroom/Publications/Research/FSI-Impact-Report-Final.pdf*
92 *Id.*

prohibition became effective on the date of the guidance without benefit of notice and comment. Because of this policy announcement, broker-dealer recruiting has ground to a halt, as firms need to substantively re-assess what they can realistically offer while recruiting.

In the independent channel, recruitment payments are an important tool because they are often used to reimburse advisors and their clients for the direct and indirect costs they incur by moving their business between firms.[93] Advisors change firms to gain access to better products and services, access to better compliance, marketing, and benefits such as cheaper trading costs, among others. Allowing advisors to change firms promotes competition which leads to innovation and cost reductions, both of which benefit investors.

Firms may also use recruitment compensation to assist an advisor taking over the business of a retiring colleague as part of a succession plan. As older advisors retire, there are not enough young advisors to take their place and firms are not seeing a growth in the people entering the industry, which is cause for concern. Because of the challenges of the market in 2000-2001, the financial crisis of 2008, and the negative media coverage around the financial services industry (mainly "Wall Street" and Bernie Madoff), many millennials are avoiding entering the industry.[94] As demonstrated above, financial advisors are a vital resource when planning for retirement, and the Fiduciary Rule is inhibiting the next generation of advisors from joining the workforce. This crisis has already begun to disrupt the industry and the Fiduciary Rule will further exacerbate this very real problem.

D. The disruptions in the industry caused by the Fiduciary Rule negatively impacts firms in the best position to assist low- to middle-income investors, resulting in institutionalization of income disparity

The Fiduciary Rule's endorsement of fee-based accounts will reduce access to investment advice for many Americans. The endorsement of fee-based accounts has caused consolidation in the broker-dealer industry and has made it nearly impossible to provide affordable retirement advice to low- and middle-income investors. For many low- and middle-income investors, fee-based accounts are unsuitable for their investment needs, so as commission-based accounts become scarce, they will not have access to commission-based accounts that would be in their best interests.[95] The Fiduciary Rule will cause these types of clients to be priced out of access to retirement advice. Because of these unintended consequences, FSI maintains that the Fiduciary Rule will indeed disrupt the retirement savings industry by altering the business models of industry participants that provide essential access and services to these investors in particular.

As stated earlier, the Fiduciary Rule favors fee-based accounts which in turn favors high net worth investors. A consequence of the disparate impact is that low- and middle-income investors may be disproportionately minority and single parent households.[96] DALBAR, Inc.'s 20th Annual Quantitative Analysis of Investor Behavior 2014 Advisor Edition not only confirms this, but reveals the gap between those with an advisor and those without an advisor to be especially wide. Over the past 30 years, the S&P 500 returned 11.11% per year while individual investors have

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[93] See FSI Letter on FINRA Recruitment Compensation Disclosure Rule Proposal available at http://www.financialservices.org/uploadedFiles/FSI_Content/Advocacy_Action_Center/Calls_to_Action/Recruitment-Compensation-Rule-Briefing.pdf

[94] *See "Tackling the Millennial Advisor Recruiting Problem" available at* *http://www.thinkadvisor.com/2015/01/12/tackling-the-millennial-advisor-recruitingproblem?slreturn=1487173978*

[95] *Id.*

[96] *Id.*

averaged only 3.69%.[97] Per the 2013 Survey of Consumer Finances, the median net worth for a white non-Hispanic family is $141,900 compared to $18,100 for nonwhite or Hispanic families.[98] A similar gap exists for single-parent families.[99] Couples reported a median net worth of $93,000 compared to $14,200 for single-parent households.[100] A recent study by Prudential found that while most African-Americans surveyed considered themselves knowledgeable about financial decisions, they did not see themselves as savers or investors.[101] Only 9% of African-American respondents categorized themselves as investors. This indicates that there is a tremendous need to expand investment services to African-American households – a need that will be made harder to satisfy after the Fiduciary Rule is fully implemented. Losing access to retirement advice, products, and service will make it even harder for these families to prosper. Wealthy investors will still be able to obtain the advice they need because they can afford the fee-based approach favored by the Fiduciary Rule, but low- and middle-income investors will be priced out. As an unfortunate result, the Fiduciary Rule will institutionalize the gap between the wealthy and the non-wealthy, who will be unable to benefit from personalized retirement planning

As demonstrated throughout this comment letter, the Fiduciary Rule reduces investors' access to investment advice, which in turn negatively impacts the retirement savings born by investors. These studies demonstrate that this negative impact will be especially burdensome on low- to middle-income investors which will have the unfortunate consequence of increasing income disparity in the U.S.

E. Conclusion

The Fiduciary Rule has already and will continue to cause disruptions and dislocations within the retirement services industry. These disruptions and dislocations will adversely affect investors by limiting their options for investment firms and professionals thus limiting investor access to professional financial advice. The alterations in the industry will disproportionately affect low- to middle-income investors with lower retirement savings potential. The directives of the Presidential Memorandum therefore demand a rescission of the Rule.

IV. The Fiduciary Rule will cause an increase in litigation with a resulting increase in the prices that investors and retirees must pay to gain access to retirement services

The Presidential Memorandum also instructed the DOL to determine whether the Fiduciary Rule would "cause an increase in litigation, and an increase in the prices that investors and retirees must pay to gain access to retirement services."[102] The short answer is yes, there will be an increase in litigation and those additional costs inevitably will be passed along to investors who will either pay more for retirement services or find that they can no longer afford those services.

A. The Fiduciary Rule by design will cause an increase in litigation, including costly class action litigation

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[97] See "How Advisors can help Clients stomach volatility" *available at* http://www.investopedia.com/articles/investing/111214/how-advisors-can-help-clients-stomach-volatility.asp
[98] *See* "Survey of Consumer Finance" *available at* https://www.federalreserve.gov/econresdata/scf/scfindex.htm.
[99] *Id.*
[100] *Id.*
[101] *See* "Prudential Study" *available at* http://www.prudential.com/media/managed/aa/AAStudy.pdf.
[102] *See "Presidential Memorandum" at* https://www.whitehouse.gov/the-press-office/2017/02/03/presidential-memorandum-fiduciary-duty-rule.

The Fiduciary Rule has created a regulatory regime that is intended to be enforced through litigation. The Fiduciary Rule's BICE – the enforcement mechanism of the Fiduciary Rule – is designed to lead to an increase in litigation. In fact, regulators have acknowledged that the BICE is constructed to use private litigation as the primary, if not sole, means of enforcement.[103] The cost of class action litigation was not adequately factored into the RIA. In order to respond to the Presidential Memorandum, the DOL has specifically asked for comments on the potential for abuse of class action lawsuits and the resulting increase of costs for plan participants. We believe those impacts will be substantial and we discuss these concerns in more detail below.

1. The potential for abuse of the class action system in ERISA litigation is already being seen before the applicability date of the Fiduciary Rule

The class action mechanism was originally developed as a means of addressing claims that might not be to be adequately redressed through individual lawsuits – for example, in the civil rights arena.[104] The focus of class action suits eventually shifted as law firms began to use these suits to target large corporations, which would be prone to classes with large populations and accompanying large payouts. Because class action attorneys generally charge a contingency fee, these attorneys have an incentive to seek out more lucrative lawsuits – those with potentially large settlement amounts.[105]

While the Fiduciary Rule allows for arbitration of individual disputes, it also clearly is intended to expose firms to class action litigation, which can be costly to defend even when there has been no wrongdoing. According to the 2017 Oxford Economics Study, the greatest concern of broker-dealers concerning the Fiduciary Rule is the potential costs of litigation.[106] The 2017 Oxford Economics Study demonstrates that FSI members are altering their business models because of the fear of class action litigation that is invited by the Fiduciary Rule.[107] These concerns are not unfounded. In discussing the Fiduciary Rule, SEC Commissioner Michael Piwowar stated, "To me, that rule, it [is] about one thing...enabling trial lawyers to increase profits."[108] Commissioner Piwowar's conclusion was bolstered when the American Association for Justice (formerly the American Trial Lawyers Association), the primary plaintiff's lawyer industry group, issued a press release shortly after issuance of the Final Rule stating that it "welcomes" the Rule.[109]

It is no revelation that class actions are complex and expensive to litigate.[110] 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 pursue a motion to dismiss range from $500,000– 750,000. Beyond

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[103] *See DOL Rule will have substantial effect, available at* http://thetrustadvisor.com/news/department-of-labors-fiduciary-rule-will-have-substantial-effect

[104] See, "Class actions" available at http://www.instituteforlegalreform.com/issues/class-actions.

[105] *Id.*

[106] *See DOL Rule will have substantial effect, available at* http://thetrustadvisor.com/news/department-of-labors-fiduciary-rule-will-have-substantial-effect

[107] Oxford Economics 2017 Report, "How the Fiduciary Rule Increases Costs and Decreases Choice" (April 2017), available at http://www.financialservices.org/uploadedFiles/FSI/Advocacy_Action_Center/The_Fiduciary_Rule_Increases_Costs_And_Decreases_Choice.pdf

[108] See "*Remarks at the "SEC Speaks" Conference 2017: Remembering the Forgotten Investor*" available at https://www.sec.gov/news/speech/piwowar-remembering-the-forgotten-investor.html.

[109] https://www.justice.org/news/aaj-welcomes-rule-restricting-conflicts-interest-investment-advice

[110] *See "An Introduction to Class Action Procedure in the United States," available at https://law.duke.edu/grouplit/papers/classactionalexander.pdf*

that, discovery costs alone can reach between $2.5 million and $5 million.[111] Class actions therefore more often end in settlements, even of unfounded claims, simply to mitigate the costs to defend. As a result, it has become economically rational for our members' to budget for the risk of incurring these expenses as a cost of doing business. And as with any other cost of doing business, firms may ultimately pass the costs to investors through fees for services.

A sampling of recent ERISA class action claims demonstrates that for many fiduciaries these days, no good deed goes unpunished:

- In one class action, a plan fiduciary undertook a process to identify lower-cost funds for its participants and to change the plan's investment options accordingly. It was rewarded with a breach of fiduciary duty complaint essentially alleging that the previous funds fees must have been too high, otherwise the plan fiduciary would not have replaced them.[112]
- Some plan fiduciaries have been sued for offering a stable value fund[113] and others have been sued for not offering a stable value fund.[114]
- Recent Vanguard funds class action suits demonstrate another example of being sued if you do demand lower cost investment vehicles[115] and sued if you don't.[116]

These examples illustrate what can be expected with the DOL's "enforcement through litigation" scheme. Any decision made by the financial institution or financial advisor can be challenged, generating the costs of defending and the possibly a costly settlement.

2. Ambiguities inherent in the Rule and the launching of a brand-new cause of action will create an environment ripe for further class action abuse

As the prior section demonstrates, the class action bar has already identified the financial services industry as a target for ERISA litigation, even prior to the Fiduciary Rule. With the benefit of a loose facts and circumstances standard and no court precedents to limit theories of liability under the BICE, class action lawyers can be expected to launch multiple theories in state court for alleged violations of "best interest" and "reasonable compensation" standards, which the current version of the Fiduciary Rule left vague and uncertain. Indeed, a recent analysis by a senior equity analyst estimated that "a long-term annual range for the industry from class-action settlements of $70 million–$150 million," with likelihood that near-term class-action lawsuit settlements could even exceed those figures.[117]

The industry itself has been struggling with the "reasonable compensation" standard, particularly in the context of the warranties required by the BICE. In response to comments requesting additional guidance as to what constitutes "reasonable compensation" under the Fiduciary Rule, the DOL repeatedly pointed to ERISA and the body of guidance surrounding it as having established such a definition. Current guidance however is in the context of a plan-level fiduciary who must make the determination that the services and investments it selects meet

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[111] Available at http://www.lockton.com/insights/post/fiduciary-liability-claim-trends.
[112] *Creamer v. Starwood Hotels,* Case No. 2:16-cv-09321, (C.D. Cal., filed 12/16/2016)
[113] *E.g., DeZelean v. Voya,* Case No. 3:16-cv-01251-VAB (D. Conn. July 26, 2016)
[114] *E.g., Creamer v. Starwood Hotels,* Case No. 2:16-cv-09321, (C.D. Cal., filed 12/16/2016)
[115] *E.g., Bell v. Anthem*
[116] *E.g. Leber v. Citigroup, Inc.,* No. 07 Civ. 9329 (SHS), 2010 U.S. Dist. LEXIS 25097, *11-12, 48 EB Cases (BNA) 2418 (S.D.N.Y. Mar. 16, 2010).
[117] "Morningstar expects up to $150M in annual class-action settlements under fiduciary rule" (March 2017) available at http://www.benefitspro.com/2017/03/16/morningstar-expects-up-to-150m-in-annual-class-act.

reasonable compensation standards. Indeed, that is the purpose of the Section 408(b)(2) disclosure regulations – to ensure that the fiduciary has all the information it needs to determine whether its service provider selection or retention is prudent and to enable a comparison of compensation in the marketplace. It is a far different requirement to ask that investment providers determine in a vacuum that its own compensation is "reasonable" and to contractually warrant that it is so. Any effort by the industry to collect information and data to determine what may constitute "reasonable compensation" could quickly run afoul of antitrust regulations. This leaves the industry in an untenable position without meaningful guidance from the DOL on what will be considered "reasonable compensation" and no means of developing an industry standard or to even collect the data needed to establish one. The ensuing confusion and uncertainty makes the industry vulnerable to speculative class actions.

This problem is compounded in the IRA space because the industry may be subject to different standards under the law that develops in fifty different states. It is conceivable that financial institutions will end up having to develop multiple compliance and operational structures to manage conflicting state requirements, significantly increasing compliance costs and subsequently the cost of advice to retirement investors. This contrasts with ERISA's carefully reticulated preemption structure which is intended to avoid this very result. Moreover, allowing state courts to interpret ERISA fiduciary standards of care is contrary to Congressional intent as reflected in ERISA § 514(a) and is likely to result in inconsistent interpretations that will be particularly problematic for financial institutions that conduct business in multiple states or that service employers with a multi-state workforce.

When such anticipated litigation, and its consequences, become a reality, it can be expected to further diminish investor access to financial advice. Firms that initially opt to continue to service their retirement investor clients may be forced by economic realities to re-evaluate the risks and potential liabilities. It may be impossible to operate efficiently in multiple states if separate administrative systems must be developed to meet multiple and varying legal requirements. This will lead to further industry consolidation, for example by geographic division, with all the negative consumer effects described above.

3. Participants do not benefit from increased class actions

Finally, enforcement through class action litigation frequently has negative consequences for retirement investors. The problem of class action settlements where the attorneys make millions, yet each of the class members receives a few dollars, if that, is well-documented.[118] This practice should not be encouraged in the retirement investor space. Class actions take time to litigate, and class members may have to wait years for any remedy.

Another trend indicating that class actions have negative consequences for plaintiffs, is the development of cy press judgments.[119] In these cases, the plaintiffs' counsel take their contingent fee from the award, and the remainder of the award is given to a non-profit rather than distributing small amounts to the class. A recent example is a class action brought against Facebook, alleging privacy breaches. Because it was impossible to determine which members of

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118 See, "Class Action Settlement Abuses" available at https://www.cato.org/blog/curbing-class-action-settlement-abuses.

119 The redistribution of settlement money from the victims to other uses is referred to as cy pres. "Cy pres" means "as near as possible," and courts have typically used the cy pres doctrine to reform the terms of a charitable trust when the stated objective of the trust is impractical or unworkable. The use of cy pres in class action settlements—particularly those that enable the defendant to control the funds—is an emerging trend that violates the due process and free speech rights of class members.

the class had suffered injury, the defendant was ordered to pay the settlement amount to a non-profit devoted to internet privacy education.[120] It is not a stretch to imagine a settlement in a Fiduciary Rule case in which a financial institution would be ordered to contribute funds to an investment education charity. Investment education is no doubt a worthwhile endeavor, but the costs should not be paid by unwitting retirement investors.

While class action litigation, through the BICE, is the prime enforcement mechanism of the Fiduciary Rule, the cost of such litigation was not effectively factored into the RIA. In addition to the economic costs, which will eventually lead to higher prices, the adverse effect out-of-control litigation will have on the ability for individuals to access important retirement education, advice, and products far outweigh the hypothetical benefits to investors articulated in the RIA.

B. There is an existing enforcement mechanism for the Fiduciary Rule

The new remedies created by the DOL under the Fiduciary Rule are the contractual claim for liability based on these fiduciary standards for IRA owners and other non-ERISA plans, and the curtailment of arbitration for class-action claims. There is, however, an existing structure for enforcing the Fiduciary Rule under ERISA and the Internal Revenue Code – the enforcement mechanism that Congress judged to be adequate when it enacted these fiduciary standards. Court claims under ERISA may be brought by both DOL and plan participants and certain other parties for breach of these standards in connection with ERISA plans. Violations of the prohibited transaction rules in connection with qualified retirement plans, IRAs, and the other non-ERISA arrangements to which these rules apply are enforced through the excise tax provisions of section 4975 of the Code.

In addition, it is entirely commonplace in FINRA arbitrations for claimants to contend that broker-dealers and their advisors are charged with fiduciary duties under state law, and we have every expectation that the Fiduciary Rule will be cited against our members in that setting as well.

C. Conclusion

The Fiduciary Rule, which has been designed to be enforced through private litigation, will certainly have its intended effect and will cause an increase in litigation. As a result, the Presidential Memorandum dictates that the Fiduciary Rule should be rescinded.

V. The Rule as written is inconsistent with the Administration's desire to empower Americans to make their own financial decisions and save for retirement

The Presidential Memorandum stressed that one of the guiding principles for financial services regulation is to "empower Americans to make their own financial decisions, to facilitate their ability to save for retirement and build the individual wealth necessary to afford typical lifetime expenses, such as buying a home and paying for college, and to withstand unexpected financial emergencies."[121] As discussed in detail above, the Fiduciary Rule is inconsistent with this guiding principle in that it limits investors' access to professional financial advice and education, limits the investment options available to them, increases costs to investors through its compliance burdens and the threat of class actions and other private litigation, and discourages investors from seeking professional financial advice to increase their individual wealth. The Fiduciary Rule

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[120] https://www.cato.org/blog/curbing-class-action-settlement-abuses

[121] *See "Presidential Memorandum" at https://www.whitehouse.gov/the-press-office/2017/02/03/presidential-memorandum-fiduciary-duty-rule.*

weakens Americans ability to make their own financial decisions and directs investors who need it the most to robo-advisors or passive investments, severely impeding their ability to withstand financial emergencies through the careful guidance of a professional advisor. As such, the Fiduciary Rule is inconsistent with this essential guiding principle of financial regulation and should be rescinded.

VI. Conclusion

The Presidential Memorandum directed the DOL to examine whether the Fiduciary Rule will result in harm to investors due to a reduction of Americans' access to certain retirement savings products and services, dislocations or disruptions within the retirement services industry, and whether the Fiduciary Rule is likely to cause an increase in litigation and an increase in the prices that investors must pay to gain access to retirement services. We conclude that the Fiduciary Rule fails each of these tests and will have a devastating impact on retirement investors' access to guidance on retirement products and services. Furthermore, the Rule is inconsistent with the Administration's priorities because it frustrates Americans' ability to make their own financial decisions and prepare for retirement.

As stated in FSI's original 2015 comment letter to the DOL on the Fiduciary Rule, FSI supports a carefully-crafted, SEC driven uniform fiduciary standard of care that would be applicable to all professionals providing personalized investment advice to retail clients.[122] In contrast, the Fiduciary Rule is based on flawed assumptions and creates a new regulatory regime that is too complex, too cumbersome, and far too costly to manage. Firms were provided a mere 12 months to develop policies, procedures, and educational materials to meet the requirements while reconfiguring revenue models and compensation structures and creating the necessary technology, electronic systems, and operational infrastructure to support these massive changes. FSI has stated throughout the rulemaking process that the Fiduciary Rule's applicability date would prove inadequate because our members would need a minimum of 36 months to put its requirements into place.

In the past, the DOL has provided much more time for the industry to prepare for less complex rulemaking. For example, the time between the publications of the Department's interim final guidance under ERISA section 408(b)(2) (a far more modest rule relating to the disclosure of fees) and the effective date of the final regulations was two years.[123] The DOL recognized the need for this extended implementation period even though the substance of the section 408(b)(2) rules changed very little between the interim final rule and the final rule. The Fiduciary Rule is far more complex and much larger in scope than the section 408(b)(2) guidance and, therefore, requires significantly more time for IBDs and independent financial advisors to implement.

To comply with the Fiduciary Rule, FSI members have had to substantially change their business practices and have had to spend significant time and money becoming compliant[124]. The

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[122] See *FSI DOL Fiduciary Rule Comment Letter July 21, 2015 available at* *http://www.financialservices.org/uploadedFiles/FSI_Content/Advocacy_Action_Center/DOL/FinancialServicesInstitute-DOL-Proposal-Comment-Letter2015-07-21.pdf*

[123] See Reasonable Contract or Arrangement Under Section 408(b)(2)—Fee Disclosure, 75 Fed. Reg. 41600 (July 16, 2010); Reasonable Contract or Arrangement Under Section 408(b)(2)—Fee Disclosure; Final Rule, 77 Fed. Reg. 5,632 (Feb. 3, 2012) (with final effective date of July 1, 2012).

[124] Oxford Economics 2017 Report, "How the Fiduciary Rule Increases Costs and Decreases Choice" (April 2017), available at http://www.financialservices.org/uploadedFiles/FSI/Advocacy_Action_Center/The_Fiduciary_Rule_Increases_Costs_And_Decreases_Choice.pdf

wide sweeping scope of the Rule required that firms re-engineer many of the key workflows within their organizations including the nature and content of discussions with clients, the information mailed to clients regarding their investment portfolios, and the products and services that firms offer. The enormous projects they have undertaken due to the Fiduciary Rule include drafting client contracts, creating enormously complex policies and procedures, reengineering compensation structures, creating new pricing models, updating contracts with product manufacturers, creating and implementing financial advisor training courses, drafting client communications and educational documents, changing guidelines for the management of existing accounts, developing elaborate web site disclosures, printing and distributing mass quantities of the required documents and disclosures and many, many more.

One of the biggest and most longstanding challenges for the industry continues to be the requirement that financial institutions determine that their own compensation structures meet "reasonable compensation" standards, without violating antitrust laws. The DOL did not provide adequate guidance on this point, forcing individual members of the industry to guess at ways to answer this for themselves, with the threat of massive liability if they were found to be outliers among their industry peers or to have fallen short of the expectations of a state court. The Fiduciary Rule requires significant changes in products and technology platforms by companies that are not subject to the Rule, but serve regulated entities such as FSI members. Those changes require SEC review and approval, and the backlog that is created because of the Fiduciary Rule further presents an unrealistic timeframe for compliance and is already resulting in enormous unforeseen consequences for our members and the industry as a whole.

The Fiduciary Rule will restrict investors' access to savings offerings, product structures, retirement savings information and financial advice, disrupting the retirement savings industry and limiting investors ability to properly plan for retirement. This disruption will force the industry to consolidate and to offer less personalized investment advice, leading to reduced competition in the industry, fewer qualified financial advisors entering the industry, and barriers to investors obtaining retirement advice. The Rule will also cause an increase in class action and private litigation, as litigation will be the primary means of enforcing the use of the BICE. All of this will result in the reduction of investors' access to retirement advice. This is particularly problematic as research has shown investors who work with financial advisors save more, are better prepared for their retirement, and have greater confidence in their retirement planning.

We have seen the real-life impact of the Fiduciary Rule on nearly every one of these concerns play out since the Rule was finalized and before it even became effective. Because of this, FSI cannot support the Fiduciary Rule and we assert the Rule should be rescinded as soon as possible as having failed each and every test outlined in the Presidential Memorandum.

Finally, we urge the DOL to reconsider its decision to adopt a piece-meal approach to implementing the Fiduciary Rule. The approach of making certain aspects of the Rule applicable while the DOL examines other aspects of the Rule frustrates the very purpose of the Presidential Memorandum, which was to conduct a thorough legal and economic analysis of the entire Rule. By not allowing a thorough legal and economic analysis to occur before the Rule becomes applicable, the DOL would thwart the entire function of the Presidential Memorandum and increase marketplace uncertainty. The harm that such a piece-meal approach will cause to both investors and the industry will be substantial and could perhaps permanently impact Americans' ability to save for their retirement.

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

Appendix

New or Updated Information Relevant to the Presidential Memorandum

Del Guercio and Reuter, "Revisiting the Performance of Broker-Sold Mutual Funds" (November 2015), available at https://www2.bc.edu/jonathan-reuter/research/brokers_revisited_201511.pdf.

- IRA holders receiving "conflicted" advice underperform index funds by 64 basis points rather than the 100 basis points asserted by the RIA. (See page 8)

Oliver Wyman, "The Role Of Financial Advisors In The US Retirement Market" (Jul. 2015), available at http://fsroundtable.org/wp-content/uploads/2015/07/The-role-of-financial-advisors-in-the-US-retirementmarket-Oliver-Wyman.pdf.

- Investors working with a financial advisor had a minimum of 25% more assets than non-advised individuals, irrespective of age and income levels. (See Page 9)

A.T. Kearney Study, "The Fiduciary Rule and its Impact on the Wealth Management Industry" (Oct. 2016), available at https://www.atkearney.com/financial-institutions/dol-fiduciary-rule.

- The Fiduciary Rule will cause as much as $20 billion in lost revenues (roughly 7 percent of the industry total) and up to $2 trillion in shifted assets across different players in the industry. (See Page 11)

Meghan Milloy, "The Consequences of the Fiduciary Rule for Consumers" (April 2017), available at https://www.americanactionforum.org/research/consequences-fiduciary-rule-consumers/.

- The Fiduciary 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. (See Page 2, 11)

Oxford Economics 2017 Report, "How the Fiduciary Rule Increases Costs and Decreases Choice" (April 2017), attached to this Appendix and also available at http://www.financialservices.org/uploadedFiles/FSI/Advocacy_Action_Center/The_Fiduciary_Rule_Increases_Costs_And_Decreases_Choice.pdf.

- The DOL Fiduciary Rule will increase costs to the industry and investors and decrease investor choice when planning for retirement. Furthermore, the DOL's RIA grossly underestimated the cost of the rule. (See Page 11, 17, 18, 25, 29)

Bruce Kelly, "DOL Fiduciary Rule to Cost the Securities Industry" (September 2016), available at http://www.investmentnews.com/article/20160921/FREE/160929978/dol-fiduciary-rule-to-cost-the-securities-industry-11b-by-2020-study.

- Implementing the Fiduciary Rule for retirement accounts will cost the brokerage industry $11 billion over the next four years (See Page 11).

Eugene Sefanov, "What it Costs to Comply with the DOL Rule" (September 22, 2016), available at https://www.finextra.com/blogposting/13139/what-it-costs-to-comply-with-the-dol-fiduciary-rule.

- To comply with the Fiduciary Rule, Raymond James reported that they spent $28 million, Primerica believes it will spend between $4 million and $5 million every year, and Ameriprise Financial has already spent $11 million on DOL-related compliance activities as of September 2016. (See Page 2, 11)

NAIFA, "Financial Advisors Say DOL Rule Would Reduce Access to Advice and Harm Client Relationships" (June 2015), available at http://www.naifa.org/news-publications/press-room/news-releases/financial-advisors-say-dol-rule-would-reduce-acces.

- The Fiduciary Rule would make it much more difficult for consumers to receive advice on the purchase of annuities. (See Page 13)

Financial Times, "Active management's many benefits are poorly understood" (May 2015), available at https://www.ft.com/content/05957a4c-fe19-11e4-9f10-00144feabdc0.

- Financial advisors involved with actively managed accounts play an important role by working with their clients to understand their investment objectives and risk tolerance. (See Page 14)

Vanguard Research, "The case for Vanguard active management: Solving the low-cost/top-talent paradox?" (January 2013), available at http://www.vanguard.com/pdf/s356.pdf.

- Active management can achieve outperformance; and investors, to the extent they stick with a disciplined approach, can be successful using actively managed funds. (See Page 14)

Christopher Robbins, "Robo-Advisors Face Potential Collapse, Says FinTech CEO" (March 2017), available at http://www.fa-mag.com/news/robos-the-wrong-answer-for-advisors--says-fintech-ceo-32091.html.

- Robo-advisors may not meet the financial needs of investors or the business objectives of the industry, and may be altered or scrapped to favor personalized, human-led financial advice.

Cerulli Associates, "DOL Rule will force the consolidation of Broker-Dealers" (December 12, 2016), available at http://www.lifehealthpro.com/2016/12/20/dol-rule-will-force-consolidation-of-broker-dealer.

- Small broker-dealers face the greatest financial risk under the Fiduciary Rule. (See Page 21)

OXFORD ECONOMICS

THE FIDUCIARY RULE INCREASES COSTS AND DECREASES CHOICE

A REPORT FOR THE FINANCIAL SERVICES INSTITUTE

APRIL 15, 2017

Oxford Economics

Oxford Economics was founded in 1981 as a commercial venture with Oxford University's business college to provide economic forecasting and modeling to UK companies and financial institutions expanding abroad. Since then, we have become one of the world's foremost independent global advisory firms, providing reports, forecasts, and analytical tools on 200 countries, 100 industrial sectors, and over 3,000 cities. Our best-of-class global economic and industry models and analytical tools give us an unparalleled ability to forecast external market trends and assess their economic, social and business impact.

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The Financial Services Institute (FSI) 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 successfully promoted a more responsible regulatory environment for more than 100 independent financial services firm members and their 160,000+ affiliated financial advisors—which comprise over 60 percent of all producing registered representatives. FSI effects change through involvement in FINRA governance as well as constructive engagement in the regulatory and legislative processes, working to create a healthier regulatory environment for its members so they can provide affordable, objective advice to hard-working Main Street Americans. For more information, please visit fnancialservices.org.

April 2017

All data shown in tables and charts is Oxford Economics' own data, except where otherwise stated and cited in footnotes.

The modelling and results presented here are based on information provided by third parties, upon which Oxford Economics has relied in producing its report and forecasts in good faith. Any subsequent revision or update of those data will affect the assessments and projections shown.

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EXECUTIVE SUMMARY

The Financial Services Institute (FSI), the representative member organization for independent broker dealers, commissioned Oxford Economics to interview and survey its members regarding their experience in preparing to implement the Department of Labor's fiduciary rule. This report follows a study completed by Oxford Economics in 2015, which estimated one-time and recurring compliance costs to firms. In this report, we describe the resulting costs imposed on firms, the resulting disruption to the independent broker-dealer industry, and how many of these changes will harm the retirement savers who rely on these firms for financial guidance.

FSI members will spend $394 million preparing for this rule.
Recurring costs are an estimated $230 million per year.

Through responses received from a detailed survey sent to FSI members, we estimate that affected independent broker-dealers have already incurred costs of $189 million preparing for the rule's implementation. We estimate that should the rule's implementation resume, these firms will spend an additional $205 million in preparation and compliance costs. Therefore, for FSI members the total implementation costs are an estimated $394 million. If the FSI experience were extrapolated to the universe of broker-dealers, the total implementation costs to the industry will likely approach $3.2 billion.

Moreover, if the rule were implemented, firms will have higher on-going operating expenses as a result. For FSI members, these recurring costs are an estimated $230 million. When extrapolated to the universe of brokers-dealers, this estimate suggests that the annual recurring cost to the industry will be $1.5 billion.

Based on these results for startup and recurring costs, we calculate the total 10-year costs of the rule to the Broker-Dealer industry to be approximately $14.2 billion using a 3% discount rate, almost three times the DOL's 2016 estimate.

The rule not only affects broker-dealer firms. Retirees and consumers of financial services are also adversely affected by the proposed DOL rule.

When applied to all broker-dealers, the FSI experience suggests for the industry; $3.2 billion in implementation cost and $1.5 billion in recurring annual expense.

The sweeping scope of the rule required that firms re-engineer many of the key workflows within their organizations including the nature and content of discussions with clients, the information mailed to clients regarding their investment portfolios, and the products and services that firms offer. Based on interviews with FSI member firms, we document the following impacts:

- Increased litigation risk.
- Decreased product choice for investors.
- Less access to financial advisors.
- Higher costs for many investors.

Our report will describe, in detail, how these changes have real consequences for Main Street investors. Before plunging into each specific change, however, let us briefly summarize what this rule might mean for a conservative buy and hold investor nearing retirement.

Our hypothetical investor might see their retirement account switched from commission to fee based. With retirement savings accumulated over a lifetime, and as one who does very little active trading, this change alone will produce higher costs. In addition, higher fees will be charged by the servicing agent on their account. In exchange for these higher costs, our investor will be offered less choice and less guidance. Conversations with their advisor will focus more on expense ratios and hidden fees; rather than be discussions on strategies to achieve their financial goals. Typical financial objectives will be more difficult to achieve because there are less products from which to choose. For example, the availability of annuity products that supplement income in retirement, will be sharply reduced. Moreover, our investor will be sorry to discover that the income-yielding low risk bonds favored by many retirees now cost more to purchase. Similarly, routine prudent actions such as occasionally rebalancing accounts will further add to costs. In sum, our investor will have higher costs, less choice, and less retirement planning services as a result of this rule.

In the report that follows, we examine all of these issues and the costs imposed on firms, in more detail. As our profiled example illustrates, each one of these changes will have real consequences for investors prudently preparing for a comfortable retirement.

1. INTRODUCTION

In a February 3, 2017 memorandum,[1] President Trump directed the Department of Labor (DOL) to examine its proposed Fiduciary Duty Rule. Specifically, the directive called for an examination of whether the proposed rule has, or may in the future, adversely affect the ability of Americans to gain access to financial products, investment education, advisory services and retirement planning services. The memorandum also calls for an assessment of any anticipated dislocations or disruptions within the retirement services industry that may affect investors or retirees, as well as any increased litigation costs. To help answer these questions on behalf of the independent broker-dealer community, the financial advisors they serve and their clients, the Financial Services Institute (FSI) commissioned this study by Oxford Economics.

The financial services sector generates significant value for the US economy. A subset of the financial services sector, comprising independent broker dealers and financial advisors, comprise more than 160,000 independent financial advisors. These advisors and firms contribute more than $48 billion to US GDP and support more than 482,000 jobs across the US—most notably across "Main Street" areas and rural economies, traditionally underserved by Wall Street firms.

The current Fiduciary Duty Rule was first proposed in April 2015, after a 2010 rule on this subject had been withdrawn. In response to the 2015 proposal, FSI commissioned Oxford Economics to study the likely effects of the then proposed rule, including an estimate of the costs to the industry.[2] Based on a survey of FSI members, that study estimated start-up costs of the regulation to be roughly 20 times as high as DOL estimates. Interviews with FSI members discussed in the report revealed a great deal of confusion and uncertainty about the likely impacts of the rule, but generally predicted that the rule would lead to:

- Reduced access to investment education and retirement planning, especially among small investors,
- Reduced investor choice in asset types,
- Disproportionate burdens on small firms, resulting in consolidation in the industry, and
- Dramatically increased litigation risk.

While the 2015 proposal was somewhat revised by DOL before the final rule was issued in 2016,[3] all of the concerns cited above remain. However, as firms became more familiar with the rule in preparation for implementation, the costs and

[1] Trump, Donald J. Presidential Memorandum on Fiduciary Duty Rule. February 03, 2017. Accessed February 24, 2017: https://www.whitehouse.gov/the-press-office/2017/02/03/presidential-memorandum-fiduciary-duty-rule.

[2] Oxford Economics, August 2015. "Economic Consequences of the US Department of Labor's Proposed New Fiduciary Standard." http://www.financialservices.org/uploadedFiles/FSI_Content/Advocacy_Action_Center/DOL/FSI-OE-Economic-Impact-Study.PDF.

[3] See https://www.dol.gov/agencies/ebsa/laws-and-regulations/rules-and-regulations/completed-rulemaking/1210-AB32-2 for a collection of documents associated with the rulemaking.

disruption have become better understood. This warrants a follow-on evaluation to the original study.

Similar to our 2015 study, information included in this study came primarily from FSI members. All members were asked to complete a detailed survey describing costs—both those already incurred and anticipated—associated with the implementation of this rule. Other members participated in confidential interviews during which detailed discussions were conducted regarding ways in which the firm's business model, product offerings and client service models changed in anticipation of the rule's implementation. In the appendix, we have described our methodology and survey findings in more detail.

1.1 THE INDEPENDENT BROKER-DEALER MODEL

Independent Broker-Dealer (IBD) firms operate a distinct business model that aims to help investors by providing comprehensive and affordable financial services. IBD affiliated financial advisors are self-employed business owners and often serve a distinct geographic region where they have strong community ties and a local reputation. An impact study completed in 2016 found that FSI affiliated financial advisors operate storefront businesses on the main streets of virtually every small to mid-sized city in the United States.[4] This proximity to clients allows FSI members to provide access to competent and affordable financial planning services and investment products to all investors regardless of their wealth level. FSI members and their affiliated financial advisors primarily engage in the sale of packaged products, such as mutual funds, variable insurance and annuity products. Investment advisory services are provided through either affiliated registered investment adviser firms or affiliated firms owned by their financial advisors.

The provision of these services to investors across the US, in turn, generates a significant amount of economic activity. With nearly 160,000 jobs directly employed within the sector, FSI's IBD members support nearly $48.3 billion in economic activity across the US, as well as an additional 322,400 jobs. Additionally, FSI member firms contribute more than $6.8 billion in federal, state and local taxes. In short, IDBs generate value to investors as well as contribute significant value to the US economy. Disruptions to the IBD model jeopardize this value creation. Appendix C provides summary data on the economic contribution of the industry.

This report evaluates the current and projected disruption to IBD firms by evaluating the myriad of costs and risks associated with the proposed DOL Rule. The report is divided into the following sections:

- Section 2 – Cost Estimate: Provides estimates of the hard and soft costs incurred to date in preparation for the rule's implementation; as well as estimates of recurring costs that would result if implementation occurred.

[4] The Economic Impact of FSI's Member. July 2016. Accessed 03-07-2017: http://www.financialservices.org/economicimpact/

- Section 3 – Industry Disruption: Examines how the rule has resulted in less product choice, more industry consolidation, and an acceleration of new industry fee structures that do not always serve investors' best interests.
- Section 4 – Provides concluding remarks
- Appendices – Provides more detail about our methodology in completing this analysis, detailed cost breakdowns and the economic contribution of the industry.

2. COST ESTIMATES

Nearly 50%

of the total costs to the financial sector—estimated by the DOL—has already been absorbed by FSI members

An additional $230 million is anticipated in order to fully *comply with the rule's* requirements.

FSI members only account for a fraction of the financial services industry affected by the rule.

Because the Fiduciary Rule has been scheduled since last year to go into effect on April 10, 2017,[5] firms have already incurred a great deal of the expense related to one-time start-up costs. The fact that the implementation of the rule is currently on-going means that firms were able to provide quite reliable, detailed cost estimates.

It is important to note that the cost estimates here generally do not include any estimate of expected litigation costs, which firms still report being unable to estimate reliably. For a discussion of litigation risk, see section 3.1.

2.1 TOTAL COSTS

Firms in our survey were asked to estimate:

- Start-up costs already incurred
- Remaining start-up costs, assuming the rule goes into effect
- Recurring annual costs, assuming the rule goes into effect

Fig. 1: below summarizes average total costs across these three categories by size of the responding firm.[6] These survey responses are then extrapolated out to the full universe of FSI member firms. Of note, member firms have already spent nearly half of the $400 million implementation cost. Once implemented, these firms expect to pay an additional $230 million per year complying with the rule's requirements.

[5] For the most part; certain disclosure provisions only take effect at the end of the current year.

[6] Total estimated costs for the Broker Dealer industry are based on the breakdown of number of firms by size category in the DOL Regulatory Impact Analysis, counting only BDs affected by the new rules (those providing retirement accounts). It's worth noting that our current firm size definitions, based on revenues, do not precisely match DOL's firm size definitions, which are based on capital. This may be partly responsible for our higher ratio, compared to DOL's estimates, of costs for medium sized firms than for small or large firms; however, our cost estimates are still significantly higher for all three size classes of firms. Only one of the medium sized firms in our sample had revenues between $250-$500 million.

Fig. 1: Summary of Total Cost Estimates

	Small BDs	Medium BDs	Large BDs	All BDs
Revenues	$0-50M	$50-500M	$500M+	
Share of FSI firms responding to survey	12%	9%	27%	12%
Total costs per firm				
Total implementation costs	$911,000	$3,787,000	$13,105,000	$3,619,000
Costs incurred	$367,000	$1,472,000	$8,354,000	$1,741,000
Remaining implementation costs	$544,000	$2,315,000	$4,751,000	$1,878,000
Recurring annual costs	$344,000	$2,407,000	$7,375,000	$2,113,000
FSI member estimated costs				
FSI members	42	56	11	109
Total implementation costs	$38,262,000	$212,072,000	$144,155,000	$394,489,000
Costs incurred	$15,414,000	$82,432,000	$91,894,000	$189,740,000
Remaining implementation costs	$22,848,000	$129,640,000	$52,261,000	$204,749,000
Recurring annual costs	$14,448,000	$134,792,000	$81,125,000	$230,365,000
Industry estimated costs				
Industry size (from DOL)	2,320	147	42	2,509
Total implementation costs	$2,113,520,000	$556,689,000	$550,410,000	$3,220,619,000
Costs incurred	$851,440,000	$216,384,000	$350,868,000	$1,418,692,000
Remaining implementation costs	$1,262,080,000	$340,305,000	$199,542,000	$1,801,927,000
Recurring annual costs	$798,080,000	$353,829,000	$309,750,000	$1,461,659,000

Source: Oxford Economics

COST CATEGORIES

Fig. 2: Description of cost categories

Cost category	Description
Additional vendor costs	Additional vendor costs (not hardware related)
Best interest contracts	Best interest contract implementation and monitoring
Client communications	Client communication letters (preparation, mailing, postage)
Commission systems changes	Commission systems changes or upgrades
Compliance oversight	Supervisory/compliance oversight modifications (typically more compliance officers)
Disclosure modifications	Disclosure modifications (website, forms, BIC contracts, advisory contracts, 84-24 disclosures)
E&O insurance	E&O insurance premiums (changes anticipated in response to heightened risks)
Payment to clearing house	Change in payment to clearing house/platform, if applicable
Planning & management	Planning and project management (management and staff time spent preparing)
Records retention	Changing records retention standards to comply with rule requirements
Reporting quarterly returns	Calculation and reporting of quarterly returns
System interfaces/feeds	Newly required system interfaces (external/internal feeds) for historic/performance data
Training / educational	Training/educational materials (for use by internal staff)
Transaction reporting	Transaction reporting costs
Vendor interface	Modifications to vendor interface
Website	Website (public view for direct/indirect payouts)
Other	Firms mentioned: legal, additional staff, outside counsel consultation, loss of revenue from AAM contract renegotiation to an annual platform fee, DOL/BIC Compliance Officer, additional operations and supervision resources to process FIAs, orphaned account advisor, level fee repricing, operational review & processing

Management and compliance planning make up 20% of current costs.

2.2 COST CATEGORIES

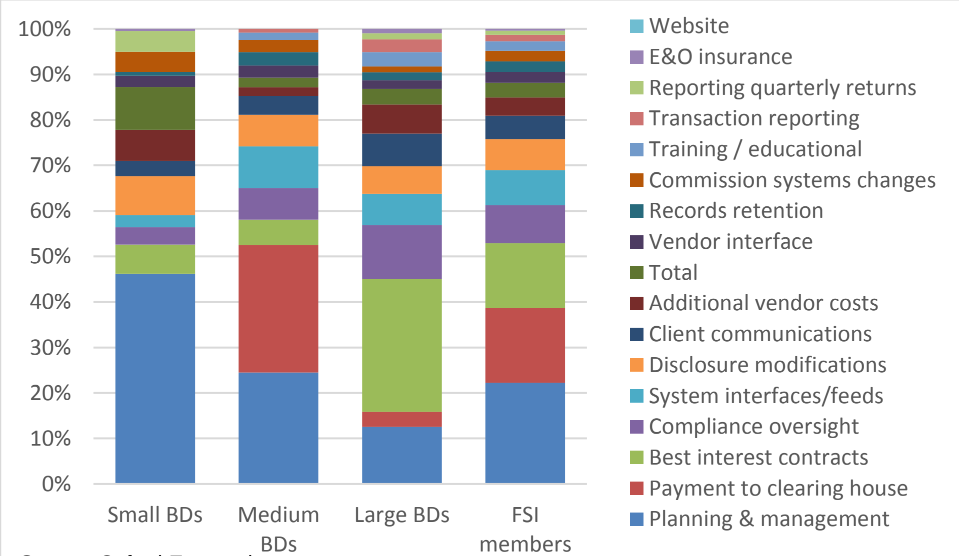
In addition to total costs, firms in our survey were asked to break their spend into sixteen detailed categories of cost (see Fig. 2: for a description of the categories). This section explores the categories of both start-up and recurring costs. Detailed tables of these costs can be found in the appendix.

2.2.1 Start-up costs

Fig. 3: provides a detailed examination of the types of start-up costs firms have incurred or expect to incur related to the final rule. An examination of Fig. 3: reveals that for the group as a whole, over 20% of the expense incurred was in planning and management. These survey results are consistent with what was reported during the interviews, wherein firms generally reported that large task forces were established within each company to comprehensively plan for the rule's implementation.

Since the rule was proposed, most firms reported that they have had little to no time to invest in any initiative at the corporate level other than compliance efforts associated with the final rule.

Fig. 3: Detailed breakout of start-up cost

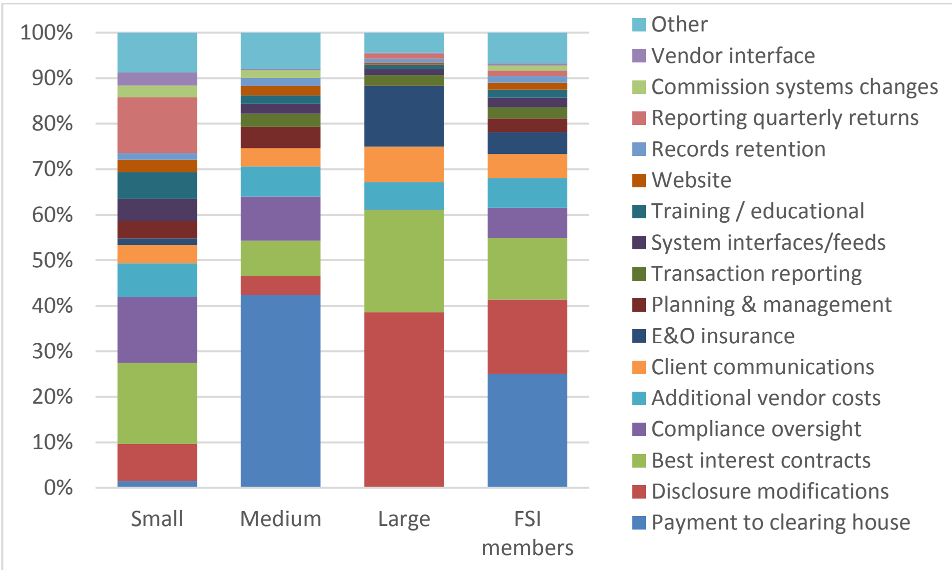


Source: Oxford Economics

2.2.2 Recurring costs

Firms participating in interviews and surveys had good insight into most of their expected recurring costs. We now have reliable estimates for the cost of data feed interfaces needed from product manufacturers and fund families, the number of additional compliance and regulatory officers that will be hired, and the cost of maintaining the BIC-compliant website. One important expense category that is still in flux is the payment relationship between the broker-dealer community and the clearing platforms that service their accounts. In our discussions with the broker-dealers it was reported that one major platform provider was negotiating pricing plans but that given the uncertain future of the rule, in most cases these negotiations are still on-going. Other firms using a different platform provider described being offered a wide range of compliance solutions. Once the rule is implemented, firms will select those solutions from the menu offered that are most suitable for their compliance and client needs. That process also remained unresolved. Different firms appear to be basing survey responses to this question either by projecting current payments going forward, or by anticipating that fundamentally new pricing would be in place.

Fig. 4: Detailed Breakout of Recurring Costs



2.3 COMPARISON WITH PAST ESTIMATES

A major focus of our 2015 report, like the current report, was to provide estimates of the anticipated costs of complying with the proposed DOL rule. When the prior estimate was calculated, however, there was uncertainty about the precise structure of the final rule. Firms now have substantially more knowledge about the rule’s requirements; compliance strategies; and compliance costs.

Fig. 5: below reviews multiple estimates of firm start-up and recurring costs for small, medium, and large BD firms. In the original 2015 Regulatory Impact Analysis (RIA) for the conflict of interest rule, the DOL estimated start-up costs of BD firms to vary between $53,000 and $1.1 million, depending on firm size. The DOL also provided a “high” estimate between $242,000 and $5,000,000. The DOL considered this an overestimate. In our 2015 report, based on surveys and interviews, we estimated start-up compliance costs would be between $1.1 million and $16.3 million depending on firm size, roughly 20 times the DOL’s preferred estimate in aggregate. In its 2016 revised RIA, the DOL presented updated start-up cost estimates based, in part, on the estimates in our 2015 report.

However, the DOL asserted that, in response to comments, it had simplified and clarified the rule, resulting in cost reductions relative to our estimates. Based on its view of the degree of simplification, the DOL concluded start-up costs would vary between $508,000 and $6.7 million per BD firm.[7]

Fig. 5: Comparison of cost estimates

	Per-firm costs			Total BD industry costs
	Small BD	Medium BD	Large BD	
Industry size (DOL)	2,320	147	42	2,509
Start-up costs				
DOL original estimates (Apr 2015)	$53,000	$145,000	$1,091,000	$190,097,000
DOL "high" estimates (Apr 2015)	$242,000	$663,000	$5,000,000	$868,901,000
OE/FSI 2015 report (Aug 2015)	$1,118,000	$3,350,000	$16,266,000	$3,769,382,000
DOL adjusted estimates (Apr 2016)	$556,301	$1,777,688	$7,366,036	$1,861,311,968
Current estimates (Apr 2017)	$911,000	$3,787,000	$13,105,000	$3,220,619,000
Ratio of current estimate to 2015 DOL estimate	17.2	26.1	12.0	16.9
Ratio of current estimate to 2016 DOL estimate	1.6	2.1	1.8	1.7
Recurring costs				
DOL original estimates (Apr 2015)	$21,000	$58,000	$436,000	$75,558,000
DOL "high" estimates (Apr 2015)	$97,000	$265,000	$2,000,000	$347,995,000
DOL adjusted estimates (Apr 2016)				$413,000,000
Current estimates (Apr 2017)	$344,000	$2,407,000	$7,375,000	$1,461,659,000
Ratio of current estimate to 2015 DOL estimate	16.4	41.5	16.9	19.3
Ratio of current estimate to 2016 DOL estimate				3.5

Source: Oxford Economics and DOL Regulatory Impact Analyses

Our estimate of nearly $1.5 billion in annual recurring costs to the industry is roughly 3.5 times DOL's

Whether because the DOL's 2016 revisions to their 2015 proposed rule was not as effective at cost reduction as it thought, or because our original cost estimates were too low, the current estimates of total start-up costs are roughly 1.7 times as high as the DOL's (revised) 2016 estimates for the industry.

Because the rule was so poorly understood at that time, our 2015 report did not estimate recurring costs, except by scaling up the DOL estimates by the ratio of our start-up cost estimates to the DOL's start-up cost estimates. The DOL's revised RIA also did not provide detailed breakout of recurring costs by size category, but estimated overall industry recurring costs at $413 million, about 5.5 times its 2015 estimate. Compared to this revised estimate, however, our result of

[7] https://www.dol.gov/sites/default/files/ebsa/laws-and-regulations/rules-and-regulations/completed-rulemaking/1210-AB32-2/conflict-of-interest-ria.pdf, see section 5.3, especially table 5-9. Several cost estimates are presented in that section; we focus here on the "FSI medium reduction scenario" estimates. Note that DOL updated its number of affected BDs slightly between the 2015 and the 2016 RIAs. In this table, we apply the new number of BDs to the old cost estimates, which accounts for the small differences with past total figures—costs per BD are identical.

nearly $1.5 billion in annual recurring costs for the BD industry is roughly 3.5 times higher than DOL's estimate.

Based on these results for startup and recurring costs, we calculate the total 10-year costs of the rule to the Broker-Dealer industry to be approximately $14.2 billion using a 3% discount rate, roughly 2.9 times higher than the DOL estimate (see Fig. 6:).[8]

Fig. 6: 10-year discounted costs of rule on Broker-Dealers

	10-year discounted costs ($ millions)	
	3% discount	**7% discount**
DOL adjusted estimates (Apr 2016)	$4,930	$4,255
Current estimates (Apr 2017)	$14,176	$11,910
Ratio of current estimate to 2016 DOL estimate	2.9	2.8

Source: Oxford Economics

[8] Ibid, table 5-12. We follow here the DOL convention of assuming start-up costs come in as a lump-sum at the end of year 1, and recurring costs are incurred once a year at the end of year 2 through the end of year 10.

3. INDUSTRY DISRUPTION

The Fiduciary Rule has caused sweeping reaction within the independent broker-dealer community. At times, industry trends that were already underway became accelerated more quickly than the market could effectively assimilate (for example, the emergence of T-Shares). In other instances, the rule has already resulted in industry changes that are not always in the best interest of investors. Probably the most important example of the later trend is in the consolidation and elimination of product choices. While all of these developments will be discussed in turn, the elimination of product choice is a development that is fundamentally at-odds with the mission of many independent broker-dealers. Providing independent financial guidance about a wide range of suitable investment products and options is the cornerstone of the independent financial advisor-client relationship.

Our examination of the rule’s likely consequences focuses on how firms have, or plan to, adjust practices and products to accommodate the new regulatory scheme proposed by DOL. All companies interviewed described the great difficulty they were experiencing trying to balance the rules requirements with the customer service they are committed to providing. As described throughout this section, firms are acutely aware that many of the changes being adapted to accommodate the rule are not always welcome changes for their customers and clients.

3.1 LITIGATION RISKS

The most pervasive concern expressed during all interviews conducted was that the Fiduciary Rule, if implemented, would invite class-action lawsuits. While the purpose of this paper is to analyze economic issues and not legal arguments, we note that those interviewed generally raised three broad concerns:

- Reasonableness as a standard is required but not adequately defined.
- Regulatory bias favoring the lowest cost product within each product class.
- Different standards apply to ERISA and non-ERISA accounts.

Firms reported that their response to these perceived risks has been to limit product choice; or to invest heavily to make sure that differences in pricing among products within a specific class are supported by the large amounts of data required by this regulation.

Even those firms that remain committed to offering as wide a variety of products as possible reported that, in fact, product choice was limited by the number of funds or families of funds for which the required data collection cost was justified.

Moreover, it should be noted that a great deal of the system infrastructure expense reported in the earlier chapter is attributable to concern over litigation risk. One consequence of the proposed fiduciary rule is that many investors would have funds in both retirement and non-retirement accounts that are subject to different fee structures and standards of care. In a typical example, a client's retirement account might be converted to an advisory fee, whereas their non-retirement account might remain commission-based. Due to these account differences, complex and expensive customer relationship management systems ("CRMs") have been implemented by several firms to carefully track communications provided regarding each of these specific accounts. Having different accountability standards is expensive to track, but failure to adequately document routine communications in such circumstances is now seen as inviting litigation risk.

In general, interviewees were still unable to estimate the potential costs of litigation arising out of the final rule. Importantly, both BDs and an insurer reported that as of April 2017, Errors & Omissions insurance premiums had not adjusted to reflect likely future costs, and that premiums likely will not adjust until cases begin to be filed and insurers are better able to price the risk. At that time, insurers will also likely adjust policy terms and exclusions.

3.2 LESS PRODUCT CHOICE AND LESS INNOVATION

The rule is causing firms to limit product choice for the following reasons:

- More choice among products in the same asset class invites litigation risk.
- High data costs to obtain required information to offer any financial product means that economies of scale can be obtained only by limiting choice to the products with the widest possible appeal. Specialized products and funds are being dropped in favor of products with mass appeal.

Traditionally, more complex or higher yielding products commanded higher fees than simpler or lower yielding products. This relationship is typical for products across the yield spectrum of each specific asset class. Many firms have adopted the position that this spectrum of choice invites litigation risk because an advisor might recommend a potentially higher yielding product (possibly at higher commission) that fails to perform as expected. This is a common investing risk and yet, under the standards adapted by the DOL rule, might invite class action lawsuits (at least in the opinion of the industry leaders whom we interviewed). The solution for many firms is to narrow the range of product options from which an investor might choose.

Choice matters. Investing is a personal decision about the most appropriate portfolio given an individual investor's risk preference, liquidity requirements, time frame, personal wealth and a whole host of other individualized variables. Specific products are tailored to meet the specific preferences for countless permeations of these variables. As a result of this proposed rule and the perceived litigation risks that it invites, fewer types of mutual funds, fewer REIT products, fewer annuities, etc. will be available to investors. The result is that investors are likely to receive one size fits all solutions instead of offerings individually tailored to their needs.

In addition to limiting product choice within a specific asset class, the rule would also result in less variety of products across classes. Annuities are an important example. By design, annuities are a bundle of (generally) income producing securities designed to accommodate different risk/reward profiles as well as the investment or income requirements of the specific investor. The complexity of obtaining the detailed performance and cost structure of each security bundled in each specific annuity is beyond the capabilities of all but the manufacturer of that particular annuity. The result is that fewer annuity products will be available for retirement accounts. Importantly, annuity products are often most suitable for retirement portfolios precisely because they can provide supplemental income payments during retirement and are not generally subject to volatility in the equity market.

Product choice is further limited in that only large families of products will survive. DOL rule compliance requires that data feeds be established with each family of funds offered by the independent broker-dealer. Several firms reported that they have already dropped smaller fund families and have concentrated product offerings only in the larger fund families. Similarly, within fund families, smaller funds are being dropped in favor of larger ones. In all of these examples, the motivation is to reduce the high transactional costs associated with obtaining, analyzing and reporting fund performance and cost data as required by the DOL. One unfortunate consequence for investors will be a reduction in competition for investor dollars and the efficiencies that competition creates.

Firms must now carefully weigh the high transaction costs of maintaining data feeds with funds and fund families against the size of the product being offered. Consequently, there is pressure to drop small funds from the product shelf offered to investors. Small funds, however, are precisely where new investment strategies or managers get tested in the marketplace. The consolidation of smaller funds into larger ones is a blow to innovation and will make it harder for new managers to get established or for new strategies to be explored.

It was also noted that the same pressure driving firms to consolidate product offerings into larger fund families is also causing consolidation in the number of firms operating in the industry. In part, the trend to consolidate into fewer larger broker-dealers was attributable to the higher costs imposed by rules such as the DOL's, and the resulting economies of scale in managing these new costs.

3.3 INCREASING RISK

As noted in our previous section, limiting product choice means that investors have less opportunity to optimize their portfolio, which increases risk into the financial system. Beyond limiting product choice, however, the DOL rule introduces additional risks into the financial system.

Levelling of fees as a result of the DOL rule was an outcome that most of those interviewed cited as making it more difficult for individuals to properly manage investment portfolios. To comply with the rule, many of the largest financial intermediaries and fund companies began offering new T-Share funds. These funds resemble traditional A-Share funds but offer a lower, 2.5% front-end loads and generally exclude rights of accumulation and breakpoint discounts. In practice, that means that the same fee is applied each time a share is purchased regardless of the size of the investment or the timing of the trade. This can harm individual investors in two ways. Long term investor who accumulate shares no longer receive attractive pricing on the additional shares purchased. This eliminates what is currently an important incentive for buy and hold investment strategies. Similarly, buy and hold long term investment is further discouraged because periodic rebalancing of portfolios now incurs a substantially higher transaction cost.

Of special note, many of those interviewed recognized the imperfections in the T-Share structure and noted this was a result of the industry rushing to address a wide-sweeping regulatory action that did not allow a reasonable time frame for market-based solutions to emerge that would address these shortcomings.

The pressure to adapt uniform pricing among products in the same asset class can encourage greater risk taking in product selection. Traditionally, higher risk funds with higher yields tended to charge higher fees than more conservative funds expected to return a lower yield. This relationship helped keep the lower yielding fund more attractive because the net return (expected yield minus commission cost) was kept artificially high through a subsidy from the pool of commissions earned on the (expected) higher earning fund. Without the cross subsidy of fees, the higher commission cost charged on the low yielding fund might discourage investors, who will shy away from the even lower net expected return. This combination of lower expected net return on conservative funds and higher expected net return on riskier funds might actually create incentive for investing behavior completely at odds with the apparent intention of the DOL rule.

An additional concern expressed is the apparent goal of the DOL rule to encourage more retirement assets to be invested in equity funds indexed to stock indices. As investors approach or reach retirement age, this may be an inappropriate strategy. This result would be an unintended consequence of the one size fits all investment approach that would result if the DOL rule were fully implemented.

3.4 INCREASING FEES ON RETIREMENT ACCOUNTS

The DOL rule requires fiduciaries to evaluate all revenue sharing payments received by transfer agents managing retirement accounts to ensure that these fees pose no conflict and are not excessive. As reported during our interviews, the complexity of satisfying this requirement is sufficiently difficult as to essentially result in the elimination of sub-transfer revenue fees (or 12b-1 fees). This change will matter to retirement savers but not necessarily in the way DOL presumably intended.

Traditionally, the individual retirement accounts managed by a specific broker-dealer were aggregated into an omnibus account managed by the servicing agent for that broker-dealer. The servicing agent would receive sub-transfer revenue fees from the mutual funds owned by investors in these retirement accounts. The fees received essentially paid for the cost of the servicing agent to manage the omnibus account. These arrangements leveraged cost efficiencies associated with aggregating accounts. Without the sub-transfer revenue fees, this arrangement collapses. It is reported that if the omnibus account is disaggregated, each retirement account will instead be charged an annual servicing fee (which will be passed along to the account holder). When fully implemented, the per account servicing fee was estimated at between $25 and $50 per year; a new cost to saving. Using the DOL's figure that 34 million households own an IRA, this would translate to costs of $8.5 to $17 million per year for this expense alone, assuming all accounts are subject to this type of fee, and discounting multiple accounts per household.[9]

3.5 IMPACT ON SMALLER INVESTOR

During all interviews, no firm indicated that it was going to adopt a specific policy of dropping investors below a particular account size threshold. However, it was widely reported that one consequence of the DOL rule would be that the economics of managing small accounts was going to cause these investors to lose access to financial planning services and investment education. Therefore, through overall attrition the number of smaller accounts served will decrease.

Complying with best interest contract requirements also results in a certain amount of fixed cost per account. With fee based revenue limited by the small account size, the reality is that for many small accounts, the fixed cost of servicing the account will exceed revenue that will be earned from that account. As a result, most firms reported that smaller investors will be offered robo-investing type account services and that these small (often entry level, novice investors) would lose access to personalized financial planning. While the definition of a small investor varied, firms generally estimated that the break-even point for servicing an investment account ranged from $35,000 to $75,000 in assets.

3.6 VALUE OF COMMISSION ACCOUNTS

All companies interviewed described the regulatory bias toward managing retirement accounts on a fee rather than commission basis. As more retirement accounts are moved to fee based compensation, the following two categories of investors are harmed.

- Accounts of smaller investors will be dropped from active management. This change means that more new investors with small account balances will lose access to financial advisors. If fees under management are less than the fixed cost of servicing the account, the account can no longer be actively served by the financial advisor.

- Buy and hold investors will be harmed by the move to fee based accounts and the nearer the investor is to retirement age (when balances are highest), the greater this harm will be. Long term buy and hold investors

[9] See www.dol.gov/sites/default/files/ebsa/laws-and-regulations/rules-and-regulations/completed-rulemaking/1210-AB32-2/conflict-of-interest-ria.pdf, p98. Of course, many households do have multiple accounts, either for separate individuals or multiple accounts per individual, suggesting an underestimate on the one hand, and non-advisory accounts may or may not be hit by these fees, suggesting an overestimate on the other.

with large balances are precisely the category of investor most likely to benefit from commission pricing.

3.7 INCREASED EXIT OF SMALL BROKER-DEALERS

According to several interviewees, increased costs and uncertainty associated with the fiduciary rule has led to an increase in broker-dealers exiting the industry. To be sure, some background level of turnover is to be expected in the broker-dealer industry, like most industries, at all times; and it is not surprising that some business owners, perhaps long planning an exit, might choose to accelerate these plans in response to significant changes in regulation or industry structure. The perception of several interviewees, however, is that the exits associated with this rule have exceeded base trends, and that they are generally concentrated among smaller players without the resources to respond to the final rule.

We have been unable to obtain hard data to quantitatively assess claims of consolidation and the exit of small players, but such assertions are consistent with the idea of high fixed costs of the final rule benefiting those with large scale operations. Moreover, as has been discussed above, the general impact of the rule has been to homogenize retirement products and services across firms, with clients shuttled into similar low-cost products. In such an environment, there is less role for smaller, independent financial advisors to play.

4. CONCLUSION

4.1 CLASSES OF INVESTORS

Industry disruptions will impact investors differently based upon portfolio size and investment strategies. In general, there is an inverse relationship between net worth and the proportion of investments held in retirement accounts. Hence, the rule's consequences will be proportionately more concentrated with smaller (and often younger) investors.

- Smaller investors will largely lose access to quality retirement planning services and investment products. Some will be retained by their advisors in relatively low-fee accounts, but given less access to human support services. Others will lose access to a financial advisor altogether. For new investors or those with low financial literacy, the lack of access to investment education and retirement planning services may lead to less savings or poorer investment decisions.

- Middle-tier investors will likely be proportionately the most impacted by the final rule because these are the investors with the means to engage in retirement plans and be more likely to have a high percentage of their available savings tied up in retirement accounts. Younger investors are more likely to benefit from buy and hold strategies that will now be potentially subject to higher fees (as accounts are switched from commission to fee based). Investors in or near retirement might find it more difficult to obtain products intended to guarantee or level income payments throughout their retirement years.

- High net worth investors will likely be the least impacted by the proposed rule. These are the investors least likely to be dependent upon retirement account savings to provide income payments throughout retirement years; and they generally have a higher percentage of net worth in non-retirement accounts (that are not subject to the DOL rule).

4.2 COSTS

Our report found that implementation costs for FSI member firms were 1.8 to 3.0 times higher than DOL's revised 2016 estimates. Moreover, our findings were largely in line with our survey estimates from 2015. Expected start-up costs for FSI members total approximately $394 million, of which just over half, $205 million, remains to be spent. The largest category of initial implementation cost has been in planning and management. This was followed by payments to clearing houses, and costs associated with requirements imposed by best interest contracts. Recurring costs for FSI members are expected to be approximately $230 million per year. The largest categories of recurring costs are expected to be payments to clearing houses, disclosure costs, and best interest contract costs.

The perceived threat of increased litigation risk resulting from this rule has dominated firms' responses ranging from client conversations to the types of products offered. Still, until the rule is implemented and experience gained, litigation costs (directly or as reflected in insurance premiums) are not yet quantifiable.

4.3 FINAL THOUGHTS

Two fundamental objections were raised about the DOL rule during our interviews:

- Only one regulatory framework (including one fiduciary standard) ought to apply to all investment accounts (retirement and non-retirement).

- The rule took a micro-management approach to addressing many product and pricing decisions best determined through market based solutions and competition.

As described throughout this report, the result is a rule that creates new problems for companies and investors more quickly than it addresses the perceived problems the rule was intended to correct. In doing so, the independent broker-dealer has incurred tremendous cost, with even greater cost to come should the final rule's implementation go forward. Most importantly, the investor whom the rule was intended to protect will, as a result of the rule, often experience a combination of higher costs, less product choice, and less access to financial guidance and education than would have been the case had the rule not been proposed in the first instance.

APPENDIX A - METHODS

SURVEY METHOD

In order to generate cost estimates for this report, Oxford Economics, in consultation with FSI, prepared and distributed a survey asking FSI member firms to estimate costs of the final rule, broken out across sixteen categories of expense type. In each category, estimates were sought for start-up costs incurred to date, expected future start-up costs if the rule goes into effect, and expected annual recurring costs. All FSI firms were invited to participate; fourteen ultimately did so (five small, five medium, and three large). One of these fourteen was not able to provide detailed cost breakouts, only total start-up and recurring costs. Because these totals were close to the average of other small firms, in order to maintain consistency between the total estimates and the category estimates, we excluded the results from this firm, leaving thirteen firms in our survey.

This survey is similar in form to the survey we conducted in our 2015 report, which asked FSI member firms to estimate expected start-up costs to comply with the final rule, broken out across seven categories of expense type. In the earlier work, as in this work, we presented both estimates of total firm start-up costs, as well as mean and median start-up costs for each of the seven categories. Because interpretations of cost categories differ, in that work, where firms provided no estimate for a particular cost category, we counted this as a zero in the total cost estimates, but as a missing observation in the category estimates. DOL apparently either did not understand this process, or understood and took issue with it, and described the results as a "data discrepancy" between our total cost estimates and our category estimates.[10]

In the current work, given the greater number of cost categories and thus the larger number of excluded categories in individual firm response, and to avoid similar misunderstandings, we treat missing category-level cost estimates as zeros in both the totals estimates and the category estimates. Nevertheless, it should be understood that firms may interpret cost categories somewhat differently, and the estimates by detailed category may be affected by this.

All results presented are simple averages across surveyed firms by size category. Total costs for FSI members are calculated by multiplying these averages by the number of FSI firms.

INTERVIEWS

In preparing this report, Oxford Economics conducted ten interviews of FSI member firms of varying sizes and specialties, and related industry players. Discussions were wide-ranging, including both prepared questions, and an open-

[10] https://www.dol.gov/sites/default/files/ebsa/laws-and-regulations/rules-and-regulations/completed-rulemaking/1210-AB32-2/conflict-of-interest-ria.pdf section 5.3.

ended invitation to provide any additional information. The interviews were documented but not recorded; however, anonymity was a precondition of those interviewed.

APPENDIX B – DETAILED COST TABLES

Below are detailed tables corresponding to the cost category graphs in section 2. Note that totals do not add precisely due to rounding.

Fig. 7: Start-up costs by detailed category

Category	Small BDs	Medium BDs	Large BDs
Planning & management	$394,000	$896,000	$1,557,000
Payment to clearing house	$0	$1,024,000	$409,000
Best interest contracts	$55,000	$203,000	$3,631,000
Compliance oversight	$32,000	$256,000	$1,459,000
System interfaces/feeds	$23,000	$333,000	$857,000
Disclosure modifications	$73,000	$255,000	$752,000
Client communications	$29,000	$151,000	$888,000
Other	$58,000	$130,000	$699,000
Additional vendor costs	$58,000	$69,000	$787,000
Training / educational	$80,000	$77,000	$429,000
Website	$21,000	$98,000	$238,000
Records retention	$7,000	$109,000	$217,000
Commission systems changes	$38,000	$97,000	$155,000
Transaction reporting	$0	$60,000	$398,000
Vendor interface	$0	$29,000	$345,000
Reporting quarterly returns	$39,000	$0	$167,000
E&O insurance	$4,000	$0	$118,000
Total	$911,000	$3,787,000	$13,105,000

Source: Oxford Economics

Fig. 8: Recurring costs by detailed category

Category	Small BDs	Medium BDs	Large BDs
Payment to clearing house	$5,000	$1,020,000	$2,000
Disclosure modifications	$28,000	$100,000	$2,842,000
Best interest contracts	$61,000	$186,000	$1,665,000
Compliance oversight	$50,000	$234,000	$0
Additional vendor costs	$25,000	$160,000	$445,000
Client communications	$14,000	$96,000	$576,000
E&O insurance	$5,000	$0	$984,000
Planning & management	$13,000	$113,000	$4,000
Transaction reporting	$0	$70,000	$171,000
System interfaces/feeds	$17,000	$52,000	$100,000
Training / educational	$20,000	$44,000	$69,000
Website	$10,000	$51,000	$30,000
Records retention	$5,000	$43,000	$66,000
Reporting quarterly returns	$42,000	$0	$83,000
Commission systems changes	$9,000	$40,000	$0
Vendor interface	$10,000	$7,000	$12,000
Other	$30,000	$192,000	$326,000
Total	$344,000	$2,407,000	$7,375,000

Source: Oxford Economics

APPENDIX C – ECONOMIC IMPACT OF FSI MEMBERS

AN INTRODUCTION TO ECONOMIC IMPACT ANALYSIS

A standard economic impact assessment identifies three channels of impact that stem from an activity:

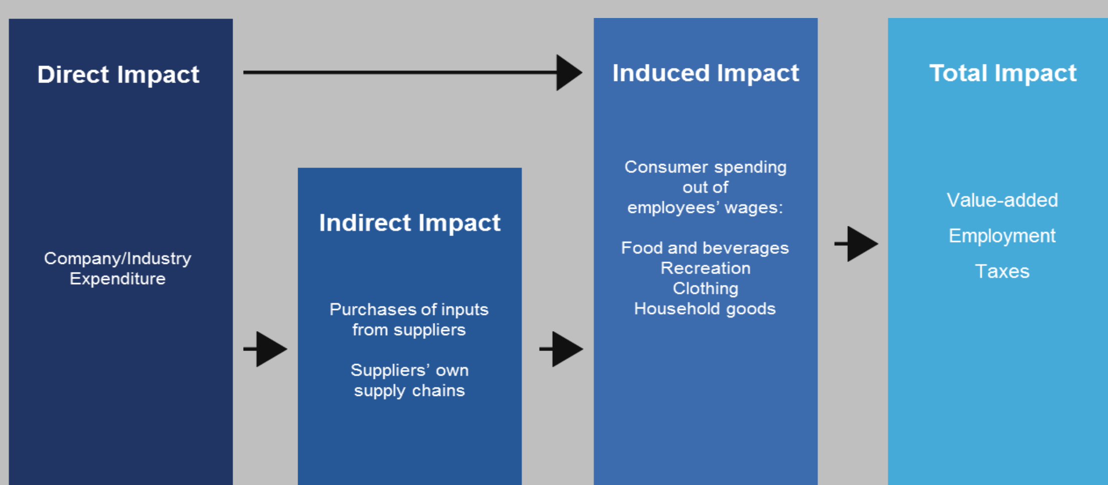
- **Direct effect**. These measures the economic benefit of FSI members' operations and activities in the US.
- **Indirect effect**. Encapsulates the activity driven by the supply chain as a result of FSI members' procurement of goods and services from other businesses.
- **Induced effect**. Captures the impact of workers spending their wages on locally-produced goods and services. This supports activity across the spectrum of consumer goods and services, and their supply chains. An example of this is the purchases a worker makes using his wages, including groceries, clothing, transportation, and utilities.

In accordance with standard economic impact assessments, the scale of the impact of FSI member firms is measured using three key metrics:

- **GVA** -The gross value added (GVA) contribution to GDP.
- **Employment** – Employment is generally measured in terms of headcount of workers.
- **Taxes** – Represents gross tax receipts paid at federal, state and local levels.

All monetary impacts are for 2015 and are presented in 2015 dollars.

Fig. 9: The channels of economic impact



ECONOMIC IMPACT OF FSI MEMBERS

Taking the direct, indirect (supply chain) and induced (wage spending) impacts together, the total impact of FSI members on the US economy amounted to $48.3 billion in 2015, equivalent to about 0.27 percent of the total US economy (US GDP was $17.9 trillion in 2015).

The total GVA impact (direct + indirect + induced) of FSI members is displayed in Fig. 10:. It is broken down into the major sectors of the US economy. FSI members' direct impact is entirely in the financial activities sector. Not surprisingly this is the sector where FSI members have the greatest overall national impact ($28.8 billion). In fact, 59.6% of FSI members' overall GVA impact is felt in the financial activities sector.

Still, 40.4 percent of FSI members' GVA impact is generated in a diverse set of sectors outside of financial activities. Other than financial activities, the three sectors where FSI members have the greatest impact are professional and business services (10.0%); trade, transportation and utilities (8.7%); and education and health services (5.8%).

Fig. 10: FSI members' GVA impact by sector

Sector	Direct	Indirect	Induced	Total
$ in millions				
Natural Resources and Mining	0	79	643	721
Construction	0	97	187	284
Manufacturing	0	333	1,623	1,955
Trade, Transportation, and Utilities	0	685	3,518	4,203
Information	0	954	931	1,885
Financial Activities	18,637	4,742	5,429	28,808
Professional and Business Services	0	2,833	2,014	4,847
Education and Health Services	0	2	2,787	2,788
Leisure and Hospitality	0	279	1,255	1,534
Other Services	0	213	874	1,087
Government	0	43	141	184
Total	18,637	10,260	19,400	48,297

Source: Oxford Economics, IMPLAN

The total employment impact (direct + indirect + induced) of FSI members is displayed in Fig. 11:. Similar to the GVA impacts, the employment impacts are concentrated in the financial activities sector, accounting for 46.7% of the total employment impact. This is followed by professional and business services (13.3%); trade, transportation and utilities (10.4%); and education and health services (9.7 %).

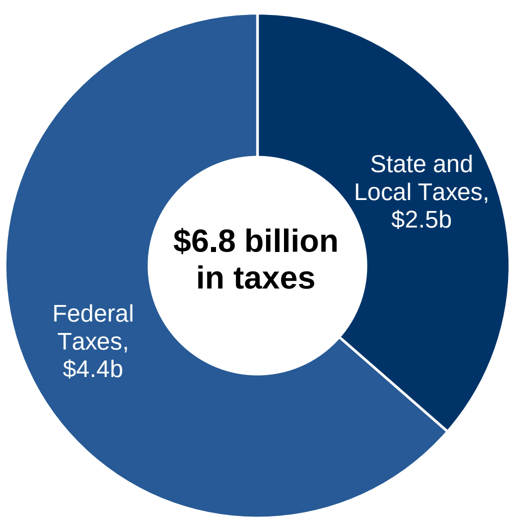
Fig. 11: Detail FSI members' jobs impact by sector

Sector	Direct	Indirect	Induced	Total
jobs in (000s)				
Natural Resources and Mining	0.0	0.4	5.2	5.6
Construction	0.0	1.3	2.6	3.9
Manufacturing	0.0	3.0	10.5	13.6
Trade, Transportation, and Utilities	0.0	7.5	42.7	50.3
Information	0.0	4.4	3.9	8.4
Financial Activities	159.7	39.4	26.3	225.4
Professional and Business Services	0.0	36.8	27.1	64.0
Education and Health Services	0.0	0.0	46.9	46.9
Leisure and Hospitality	0.0	7.8	32.6	40.4
Other Services	0.0	2.4	18.3	20.7
Government	0.0	1.0	2.0	3.0
Total	159.7	104.2	218.2	482.1

Source: Oxford Economics, IMPLAN

The direct, indirect, and induced economic activity supported by FSI member firms generated $4.4 billion in federal tax revenue in 2015 and an additional $2.5 billion in state and local tax revenue. In total, the economic activity that FSI member firms generated was worth over $6.8 billion in taxes for all levels of government (Fig. 12:). In total each job created by FSI activity results in $42,570 in additional tax revenue (from all sources).

Fig. 12: FSI members' tax impact



Source: Oxford Economics, IMPLAN

GEOGRAPHY OF IMPACTS

FSI members operate in every state in the US. Fig. 13: and Fig. 14: below provide two maps that show how FSI members' economic impact differs between large states and smaller states. Fig. 13: illustrates how FSI members make a disproportionately larger impact in smaller and mid-sized states. Nevertheless, as Fig. 14: illustrates, FSI members make their largest (absolute) economic impact in states hosting the largest financial sectors (e.g., New York, California, Texas). Taken together, these maps demonstrate that FSI members are an important component of the financial services industry in all 50 states but are a disproportionately important member of the financial services community in small and mid-sized states. Stated differently, FSI members make a disproportionately large economic contribution to communities that are traditionally underserved by other segments of the financial services industry.

Fig. 13: FSI member firms in small and mid-sized states

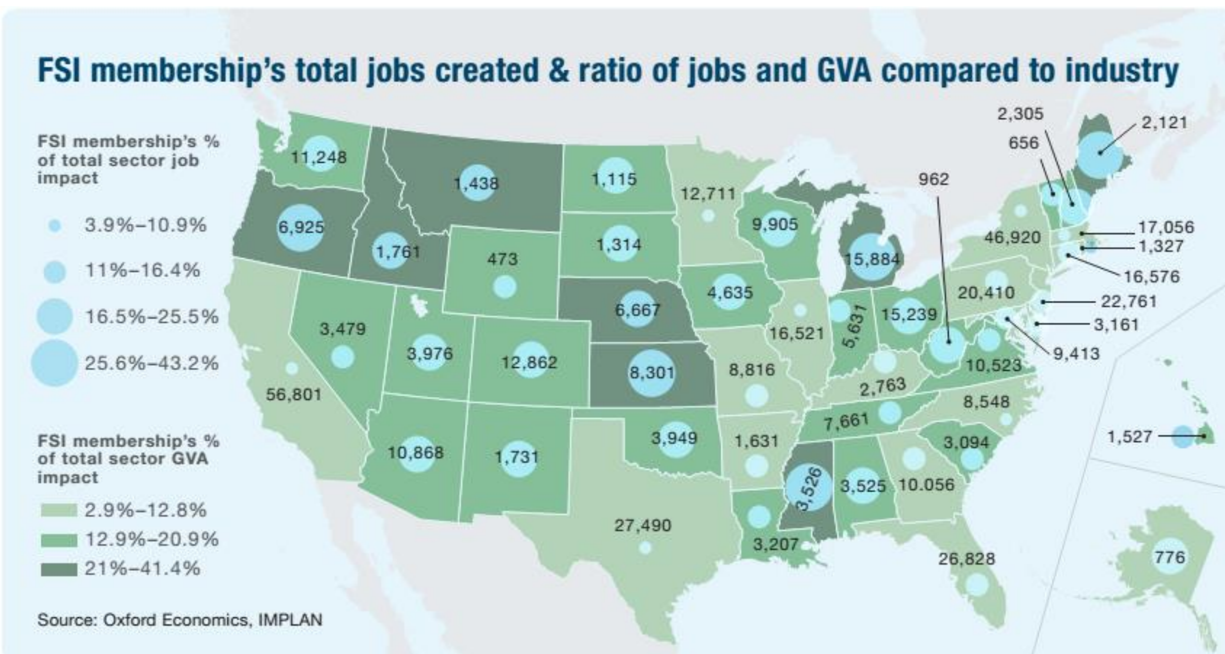


Fig. 13: highlights FSI members' disproportionate contribution to smaller and mid-sized states by measuring FSI contribution in that state relative to the financial services industry's overall contribution to that state. This relative comparison is done both for jobs attributed to FSI (the bubble in each state) and FSI members' contribution to state GDP (the background color of each state).

FSI members' GVA contribution relative to the overall industry's GVA contribution is greatest in states such as Mississippi (41.1%); Maine (36.4%); and Kansas (30.1%). When FSI members' employment contribution is compared to overall industry employment contribution then other smaller states also emerge near the top of the pack including Oregon (29.4%); Michigan (28.0%); and Montana (25.5%).

Fig. 14: FSI Member Firms in Large States

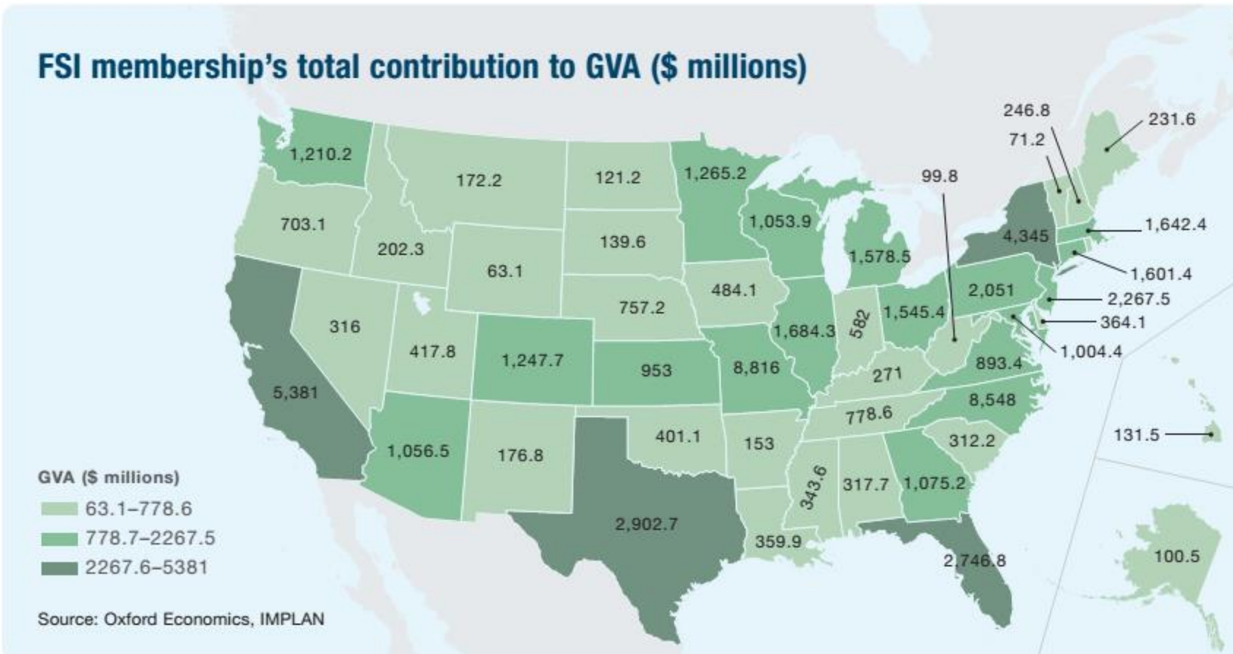


Fig. 14: demonstrates that in absolute dollar terms, FSI members' economic impact is greatest in those states with the largest financial sectors. The five states where FSI members had the greatest impact account for 35.5% of FSI member economic impact nationwide and these include California ($5.3 billion); New York ($4.3 billion); and Texas ($2.9 billion). Even in states with very large financial services sectors, FSI members make an important economic contribution.

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