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**STATEMENT**

**OF**

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**BEFORE THE**

**U.S. HOUSE OF REPRESENTATIVES**  
**COMMITTEE ON FINANCIAL SERVICES**  
**SUBCOMMITTEE ON CAPITAL MARKETS AND GOVERNMENT-SPONSORED**  
**ENTERPRISES**

**AND**  
**SUBCOMMITTEE ON OVERSIGHT AND INVESTIGATIONS**

**ON**

**PRESERVING RETIREMENT SECURITY AND INVESTMENT CHOICES FOR ALL**  
**AMERICANS**

**SEPTEMBER 10, 2015**

## EXECUTIVE SUMMARY

The key points covered in the body of my statement are summarized below.

### The Department's Proposed Rule Is Fundamentally Flawed

- **The Institute supports a best interest standard.** The Institute fully supports the principle at the heart of the Department's proposal—financial advisers should act in the best interests of their clients when they offer personalized investment advice. But the added layers of unwarranted complexity and ambiguity that the Department proposes to pile on top of that simple best-interest principle creates the risk that many savers—and particular, lower- and middle-income individuals and small businesses—will receive *no* advice or service, or none that they can afford. We expect that the proposed rule, if adopted, will make retirement saving *more* challenging and costly for many retirement savers, particularly those with modest balances.
- **The Department's proposed rule will adversely impact retirement savers.** Under the Department's proposed rule even the most basic information—such as that offered in many common call-center and web-based interactions—could trigger ERISA fiduciary status and prohibited transactions. To provide a workable framework for its proposed rule, the Department must allow service providers to continue to offer meaningful investment education to retirement savers without inadvertently triggering fiduciary status.
- **The Best Interest Contract (BIC) exemption is unworkable.** The Department purportedly designed the proposed BIC Exemption to permit broker-dealers and others to continue to receive variable compensation, such as commissions and front-end loads, notwithstanding their status as an ERISA fiduciary. Under the BIC Exemption, however, a financial services provider must comply with a series of unworkable conditions. Through the BIC Exemption, the Department proposes to convert the fiduciary principle into a series of compliance traps and barriers for financial advice professionals and their firms. Further, the “grandfather” rule for existing transactions included in the BIC Exemption would unnecessarily harm investors by prohibiting ongoing advice on assets acquired prior to the rule's applicability date. Finally, we cannot emphasize enough that the proposed applicability date does not provide sufficient time for the extensive system and policy changes needed to comply with the BIC Exemption. If the Department moves forward with this rulemaking, it must propose a workable structured implementation of the Exemption's conditions over an appropriate number of years and must adopt a “good faith” compliance mechanism, consistent with previous regulatory initiatives.
- **The Institute has provided the Department with constructive recommendations for fixing the proposal's flaws.** The Institute fears that the Department's proposal as currently drafted will create real harm—a loss of access to information and advice—to America's retirement

savers. The Institute has counseled the Department in detailed comment letters on the many serious flaws that collectively make the Department's proposal simply unworkable and has provided numerous constructive suggestions for improving the rules as proposed.

### **The Department's Regulatory Impact Analysis, like the Proposed Rule, Is Fatally Flawed**

- **The Department's claims that broker-sold funds "underperform" are not supported by the very academic studies on which it relies.** The Department relies on certain academic studies to support its claims that investors are harmed by their use of brokers. None of these academic studies actually compares the outcomes of investing with a financial adviser that is a fiduciary to the outcomes of investing with a broker or other financial adviser that is not a fiduciary. Further, these studies rely upon outdated data (from the 1990s to roughly 2004) that fail to reflect fundamental changes in the market for broker-sold funds in the past 10 years. Finally, the Impact Analysis misapplies the findings of a key study, leading to a vast overstatement of the potential benefits of the rule.
- **Investors' actual experience with broker-sold funds contradicts the Department's claims.** Specifically, publicly available data from 2007 through 2013 demonstrate that, contrary to the Department's claims, investors who own funds that are sold with front-end loads actually have concentrated their assets in funds that outperform—not underperform—their Morningstar category. On a sales-weighted basis, investors buying front-end load shares in those years outperformed the average for share classes in the same Morningstar category by 27 basis points. Similarly, publicly available data show that investors concentrate their purchases in front-end load share classes with lower expense ratios and that pay brokers lower-than-average loads—further contradicting the Department's claims that brokers are systematically not acting in the best interests of clients.
- **The RIA ignores the economic impact of moving investors to fee-based accounts.** The total annual cost for the services provided by brokers and their firms to investors in front-end load funds is about 50 basis points a year. By way of contrast, a recent study by Cerulli Associates finds that fee-based accounts—the most likely alternative to brokerage accounts—cost investors 111 basis points per year on average, in addition to fund expenses. We estimate that moving investors to fee-based accounts will have a net cost, cumulatively over 10 years, of \$47 billion.
- **The RIA fails to account for the societal harm of investors losing access to advice and guidance.** Fee-based accounts may not be available to low- and middle-income IRA investors who cannot meet minimum account balance requirements (frequently, \$100,000). Over time, investors who no longer have access to advice are likely to experience lower returns because of poor asset allocation and market timing, or because they incur tax penalties by taking early withdrawals. We calculate that the 10-year cost of lower returns caused by such errors would be

\$62 billion. Indeed, the Institute estimates that retirement investors' returns could be reduced, conservatively, by \$10.9 billion a year—or \$109 billion over 10 years—as a result of the additional fees and lost returns they will incur.

## I. INTRODUCTION

My name is Paul Schott Stevens. I am President and CEO of the Investment Company Institute<sup>1</sup> and I am pleased to appear before the Subcommittees today to discuss our shared objective of promoting retirement security and preserving investment choices for all Americans. In particular, my statement will address the nature and implications of the U.S. Department of Labor’s proposal to redefine the term “fiduciary” in the context of providing investment advice under the Employee Retirement Income Security Act of 1974 (“ERISA”). Chairmen Garrett and Duffy and Ranking Members Maloney and Green, thank you for this opportunity to share our views and for the attention that you and your colleagues are paying to this rule proposal and the way in which it will impact the efforts of millions of working Americans to save and invest for retirement.

The mutual fund industry is especially attuned to the needs of retirement savers because mutual funds hold about half of retirement assets in defined contribution (DC) plans and individual retirement accounts (IRAs).<sup>2</sup> While we certainly embrace the principle at the heart of the Department’s proposal – that all financial advisers must be held to act in the best interests of their clients – the proposal itself is deeply flawed. Regrettably, if adopted in anything like its current form, the rule would do great harm to retirement savers by drastically limiting their ability to obtain the guidance, products, and services they need to meet their retirement goals. It also will increase costs, particularly for those retirement savers who can least afford it.

As it reviews the Department’s rule proposal, this House Financial Services Committee also is considering H.R. 1090, the “Retail Investor Protection Act,” a bill introduced by Representative Wagner and Chairman Garrett. H.R. 1090 reflects a commonsense goal of ensuring that federal agencies work to adopt a harmonized fiduciary duty for all investors and that they do so in a manner that does not jeopardize investor access to personalized and cost-effective investment advice. Simply put, H.R. 1090 reflects a strong purpose – one shared by the Institute – to get the fiduciary rules right.

In an array of letters and comments, Members of Congress from both parties have expressed concern with numerous aspects of the Department’s rule proposal and urged a variety of important

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<sup>1</sup> The Investment Company Institute (ICI) is a leading, global association of regulated funds, including mutual funds, exchange-traded funds (ETFs), closed-end funds, and unit investment trusts (UITs) in the United States, and similar funds offered to investors in jurisdictions worldwide. ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of funds, their shareholders, directors, and advisers. ICI’s U.S. fund members manage total assets of \$18.2 trillion and serve more than 90 million U.S. shareholders.

<sup>2</sup> At the end of the first quarter of 2015, U.S. retirement assets totaled \$24.9 trillion, DC plan assets were \$6.8 trillion, and IRA assets were \$7.6 trillion. Investors held \$3.6 trillion of IRA assets and \$3.8 trillion of DC plan assets in mutual funds. See Investment Company Institute, *The U.S. Retirement Market, First Quarter 2015* (June 2015), available at [https://www.ici.org/info/ret\\_15\\_q1\\_data.xls](https://www.ici.org/info/ret_15_q1_data.xls).

changes.<sup>3</sup> Labor Secretary Thomas E. Perez has touted the proposal as a principles-based approach to the issue.<sup>4</sup> Were that so, the Institute might be supportive. In fact the Department chose a very different path—it has proposed a set of convoluted, inflexible, and highly prescriptive rules that in no way resembles what Secretary Perez has described.

The many problems with the Department’s proposal may well be explained by the fundamental errors apparent in the Department’s Regulatory Impact Analysis seeking to justify the massive overhaul of the retirement marketplace it would impose. In particular, this rulemaking – which has been ongoing for years – should have been preceded by a comprehensive cost-benefit analysis. Such an analysis should have sought to demonstrate, among other things, that any restriction on future access to guidance, products, and services is justified in light of a clear problem best solved by an expansive redefinition of fiduciary duty.<sup>5</sup> It also should have considered whether or not less burdensome regulatory alternatives could remedy the problem. The Department’s Regulatory Impact Analysis does none of this. Indeed, it altogether fails to consider publicly available data that contradict its conclusions. It likewise fails to consider the significant harm to retirement savers that is sure to result if the Department adopts the rules as currently drafted.

My testimony today focuses on two key points: First, I will discuss the highly adverse impact the Department’s rulemaking proposal will have on the ability of retirement savers—particularly low- and

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<sup>3</sup> See, e.g., Letter from Reps. Ann Wagner (R-MO) and David Scott (D-GA) *et al.*, to the United States Department of Labor, dated July 29, 2015; Letter from House Committee on Education and the Workforce Chairman John Kline (R-MN) and Subcommittee on Health, Employment, Labor and Pensions Subcommittee Chairman Phil Roe (R-TN), *et al.*, to the United States Department of Labor, dated July 21, 2015; Letter from Sens. Jon Tester (D-MT) and Angus King (I-ME), *et al.*, to the United States Department of Labor, dated August 6, 2015; Letter from Sen. Claire McCaskill (D-MO), to the United States Department of Labor, dated August 5, 2015; Letter from Senate Finance Committee Ranking Member Ron Wyden (D-OR) and Sen. Debbie Stabenow (D-MI), *et al.*, to the United States Department of Labor, dated August 7, 2015.

<sup>4</sup> In recent testimony, Secretary Perez asserted that the Department, in its proposals, sought to follow a “principles-based approach [that] obligates the adviser to honor the interests of the plan participant or IRA owner, while leaving the adviser and the employing firm with the flexibility and discretion necessary to determine how best to satisfy these basic standards in light of the unique attributes of their business.” Statement of Thomas E. Perez, Secretary, Department, Before the Health, Employment, Labor and Pensions Subcommittee, Committee on Education and the Workforce, U.S. House of Representatives (June 17, 2015), at p. 4, available at [edworkforce.house.gov/uploadedfiles/testimony\\_perez.pdf](http://edworkforce.house.gov/uploadedfiles/testimony_perez.pdf).

<sup>5</sup> In several letters sent to the Department after the 2010 rule proposal was shelved, Congressional policymakers uniformly expressed the importance of ensuring that any re-proposal of ERISA’s fiduciary provision be preceded by a comprehensive regulatory impact analysis. See, e.g., Letter from Reps. James Himes (D-CT), Richard Neal (D-MA), and Carolyn McCarthy (D-NY), *et al.*, to the United States Department of Labor, dated November 7, 2011; Letter from Reps. Gregory Meeks (D-NY) and Gwen Moore (D-WI), *et al.*, to the United States Department of Labor, dated March 15, 2013; Letter from House Committee on Education and the Workforce Chairman John Kline (R-MN), House Committee on Ways and Means Chairman Dave Camp (R-MI), Senate Committee on Health, Education, Labor and Pensions Ranking Member Michael Enzi (R-WY) and Senate Finance Committee Ranking Member Orrin Hatch (R-UT), to the United States Department of Labor and the United States Department of the Treasury, dated April 14, 2011.

moderate-income savers—to obtain the guidance, products, and services they need to meet their retirement goals. In this connection, I will describe the changes that the Institute has recommended to the Labor Department in order to make the proposal workable and one that will better serve the interests of retirement savers.

Second, my testimony will demonstrate why the Department’s Regulatory Impact Analysis utterly fails to justify its expansive proposal and why, if its rule is adopted, it will do significant net societal harm. Significantly, if the Department adopts the proposed rules without very substantial changes, the Institute estimates that retirement investors’ returns could be reduced, conservatively, by \$10.9 billion a year—or \$109 billion over 10 years—as a result of the additional fees and lost returns they will incur. As we have counseled the Department, we believe strongly that if the Department reassesses its Impact Analysis in light of our comments, it will make policy choices that meet its goals while making its rule simpler, more workable, and better for investors.

## **II. THE DEPARTMENT’S RULEMAKING WILL HURT – NOT HELP – MILLIONS OF AMERICANS SAVING FOR RETIREMENT**

Some of the practical, human implications of the Department’s proposal are underscored for me by an experience I recently had helping one of my adult children through a job transition. This is something some of you may have experienced. My son is in his 20s and recently left his first full-time job to take a position with a new company halfway across the country. He was a liberal arts major in college, more a student of history than of finance. And young as he is, his personal financial experience is limited as yet. After he got settled in his new job, we discussed what he might do with the 401(k) balance he had in his former employer’s plan. The amount was modest – less than \$10,000 – but it was hard earned and if well managed over a long investing horizon it might amount to much more later in his life. Clearly, he wanted to do the right thing but was not sure exactly what that would be. In particular, he needed information that would help him to make a good decision for himself.

I suggested that we call a mutual fund company for information about its products and services, and my son agreed to have me sit in on the conversation. (I suggested a fund company knowing that the amount in question, while important to my son’s future, was too small to interest a fee-based investment adviser.) The call center representative of the mutual fund company patiently walked my son through various options, outlining factors relevant to keeping the account in the former employer’s plan or rolling it over to an IRA. He explained important investment considerations, like asset allocation and the need for diversification. He also described the various kinds of funds that the fund company offers and how they might help meet my son’s savings goals. The conversation with the call center representative certainly validated my son’s instinct to keep his modest balance at work for his retirement. But at no time did the representative cross the line and presume to act as an adviser, and the

interaction clearly did not create the relationship of trust and confidence that is characteristic of a fiduciary.

Although my son spent close to an hour talking to the call center representative, the information and help came at no cost to him. But it equipped him to make a good decision, in light of his own situation and preferences. Ultimately, my son decided to rollover his 401(k) plan assets into an IRA and invested those assets in one of the mutual fund company's target date funds, which best matched his decision to concentrate his balances in a single product offering a diversified portfolio of stocks and bonds that adjusts over time.

There are hundreds of thousands of retirement savers like my son in your home states and across our country – young men and women just starting out, people with less financial sophistication for whom help and information are critically important, workers trying to make the most of small accounts. It is essential to ask: how will the Department's proposal impact them?

The answer: the wide net cast by the Department's proposal threatens to eliminate or severely reduce these very types of commonplace exchanges of information—provided at no cost to millions of retirement savers through call centers, walk-in centers, and websites. Particularly troubling, the proposal would require firms that offer primarily proprietary investment products to forego the ability simply to explain to a retirement saver—like my son—how their products and services may meet the retirement saver's needs.

In the future, such exchanges would have to take place under a cumbersome and convoluted contractual relationship required by the so-called “Best Interest Contract” exemption. As described below, this so-called exemption gives every appearance of having been devised in such a manner that it would never be used. Certainly, it will pose very significant barriers to the type of commonplace interactions described above and no doubt would occasion substantial additional costs.

To be clear, the Institute has been and remains ready to assist the Department in every way possible to get its fiduciary proposal right. We have provided the Department three detailed comment letters on the proposed rule defining the term “fiduciary,”<sup>6</sup> the proposed exemptions in connection with that definition,<sup>7</sup> and the Regulatory Impact Analysis justifying the Department's proposals.<sup>8</sup> A fourth letter I sent to Secretary Perez highlights the key areas of the rule proposal that we believe make it

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<sup>6</sup> Letter from David Blass and David Abbey, ICI, regarding the proposed fiduciary rule (July 21, 2015), available at [www.ici.org/pdf/15\\_ici\\_dol\\_fiduciary\\_def\\_ltr.pdf](http://www.ici.org/pdf/15_ici_dol_fiduciary_def_ltr.pdf).

<sup>7</sup> Letter from David Blass and David Abbey, ICI, regarding the proposed best interest contract exemption (July 21, 2015), available at [www.ici.org/pdf/15\\_ici\\_dol\\_fiduciary\\_best\\_interest\\_ltr.pdf](http://www.ici.org/pdf/15_ici_dol_fiduciary_best_interest_ltr.pdf).

<sup>8</sup> Letter from Brian Reid and David Blass, ICI, regarding the Department's Regulatory Impact Analysis (July 21, 2015), available at [www.ici.org/pdf/15\\_ici\\_dol\\_fiduciary\\_reg\\_impact\\_ltr.pdf](http://www.ici.org/pdf/15_ici_dol_fiduciary_reg_impact_ltr.pdf).



unworkable and conveys at a high level the changes we urge the Department to make to the proposed rules.<sup>9</sup> The letters spell out the many serious flaws in the rule proposal that collectively make it hopelessly unworkable. The letters also advance numerous constructive suggestions for improving the rules as proposed. While I summarize the key changes we recommend later in my testimony, it is instructive to first appreciate just how damaging the Department’s rulemaking will be on the ability of savers, like my son, to engage in even the most commonplace of financial interactions.

**A. The Department’s Overly Expansive and Ambiguous Fiduciary Definition Will Impede Commonplace Financial Interactions That Retirement Savers Now Take For Granted**

The Department has proposed criteria for triggering fiduciary status that are far too intrusive and unnecessarily ambiguous. The criteria fails to distinguish between circumstances in which individuals and fiduciaries have a reasonable expectation of fiduciary service and those interactions where there can be no such reasonable expectation. This is a matter of the deepest concern.

ERISA is a uniquely prescriptive statute. It expressly prohibits an ERISA “fiduciary” from engaging in many routine transactions. Most importantly, ERISA prohibits a fiduciary from performing services as a fiduciary that affect the compensation that the fiduciary receives. This prohibition applies regardless of whether the outcome resulting from such services is in the best interest of the recipient. Rules governing what activities give rise to a fiduciary relationship must accordingly provide genuine clarity about who does or does not have that status.<sup>10</sup> These rules must not impede commonplace financial interactions, like the one with my son, and they must allow plans and retirement savers to obtain investments that meet their needs and to gather a range of market input on which to base decisions.

**B. The Department’s “Best Interest Contract” Exemption (BIC Exemption) Will Not Mitigate The Harm Caused By Its Overly Expansive And Ambiguous Fiduciary Definition**

The Department suggests that the impact of its expansive fiduciary definition—like the inability to engage in the kind of helpful interaction that my son experienced—will be mitigated substantially by the BIC Exemption proposed along with its rule proposal. We strongly disagree. That exemption as currently drafted is quite useless because of the multitude of ambiguous and impractical conditions to which it is subject. Thus, for example, the BIC Exemption would require that my son negotiate a three-party written contract and be provided with a mountainous disclosure document before engaging in any conversation with the call center representative. This hardly would create an

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<sup>9</sup> Letter from Paul Schott Stevens, ICI, to Thomas E. Perez, Secretary, U.S. Department of Labor (July 21, 2015) available at [www.ici.org/pdf/15\\_ici\\_dol\\_fiduciary\\_overview\\_ltr.pdf](http://www.ici.org/pdf/15_ici_dol_fiduciary_overview_ltr.pdf).

<sup>10</sup> Testimony of Paul Schott Stevens before the Department (March 1, 2011), available at [www.ici.org/policy/ici\\_testimony/11\\_dol\\_fiduciary\\_tmny](http://www.ici.org/policy/ici_testimony/11_dol_fiduciary_tmny).

environment that would encourage a young saver to seek out information from providers about products and services needed to make informed investment choices.

Indeed, it is unlikely that a financial service firm would be inclined to subject itself to the multitude of ambiguous and impractical conditions required of those who wish to rely on the BIC Exemption. The exemption's requirement of a prior contract, its requirements for voluminous fee reporting and disclosure, and its overwhelming data creation and retention requirements, not to mention the substantial threat of unwarranted litigation, all totally compromise the usefulness of the exemption. The result will be far reaching. Savers who today rely on brokers and other commission-based advisers for investment services will no longer be able to do so. They will be forced either to engage fee-based advisers, significantly increasing their investment expenses, or to go without information and guidance—the most costly course of all.

Indeed, adopting the current proposals could well reduce the current level of competition in the market by making it more difficult for investors to switch from one fund manager to another or from one financial adviser to another. This outcome would harm not help investors who need and want financial advice to make informed investment decisions—potentially setting back the success of generations of retirement savers and putting at risk our nation's progress on retirement security.

### **C. “Robo advice” is Not a Panacea for an Unworkable Fiduciary Rule**

Secretary Perez insists that it's no problem that financial services firms might find it impossible to continue serving small savers because of new costs and legal risks. He contends that such small savers might be better off working with “robo advisers”—computer-programmed advice delivered on-line—than with human representatives of financial services firms. While online guidance may have a helpful and growing role to play in helping savers, it is dangerous to conclude that such services are a suitable substitute for human interactions in many circumstances. Take my son's situation. He needed someone to take him through the considerations relevant to keeping his account in the plan or rolling it over to an IRA, the concepts of diversification, asset allocation and rebalancing, the various products offered by the provider, and how such products might help meet his savings goals. The exchange of information and ideas offered by a human representative was exactly what he needed.

It is also unlikely that “robo advice” would be a good substitute for the guidance offered by human representatives at financial services firms in times of market downturns or stress. ICI's members reported sharp increases in the volume of investor contacts through their call centers during the sharp swings in equity markets in late August and early September of this year. During episodes such as this or the fall of 2008, an email, text message, or website alert from a “robo adviser” may well not suffice to keep millions of concerned savers from selling into a stressed market, with devastating consequences for their nest eggs.

## D. The Institute Recommends Revisions to the Department's Rule Proposal

The Institute's detailed comment letters highlight the many serious flaws that collectively make the Department's proposal simply unworkable. The letters also advance numerous constructive suggestions for improving the rules as proposed. The key recommended changes identified in our comment letters are as follows:

1. **Draw a commonsense – and clear – line between the provision of fiduciary advice and that of information and education.** Chief among our recommendations is greater clarity regarding what results in the provision of fiduciary advice. The Department must craft the definition of fiduciary advice more carefully to capture only individualized recommendations that are intended for a retirement saver to rely on to take a specific action. We provided alternative text in our comment letter that would accomplish this goal.
2. **Do not treat selling an investment product or service as a fiduciary act.** Small employers, as well as retirement savers generally, should have the option to choose among a wide range of investment products and services. Service providers should be able to provide investors with information and data about those options, both during the sales process and on an ongoing basis. As we demonstrate in our comment letters, there is compelling evidence that Congress did *not* intend for ERISA to disrupt the lawful functioning of the securities markets, to prevent retirement investors from accessing investments, or to turn the “ordinary functions of consultants and advisers” into fiduciary activities.<sup>11</sup> The Department's proposals, at a minimum, should conform to Congress's clear intent in the underlying statute and provide a meaningful seller's exception that covers all savers and applies to true marketing and sales activities.
3. **Modify the “Best Interest Contract” or “BIC” Exemption.** As explained above, and in detail in our comment letters, the BIC Exemption's requirement of a pre-advice contract, its voluminous fee reporting and disclosure requirements, and its overwhelming data creation and retention requirements, not to mention the substantial threat of unwarranted litigation, all threaten the usefulness of the exemption. A better approach is to heed Secretary Perez's call to give sufficient flexibility and discretion to allow fiduciaries to determine how best to satisfy their duties in light of the unique attributes of their businesses and, I would add, the needs of investors. If it actually intends the BIC Exemption

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<sup>11</sup> See ERISA Conference Report, P.L. 93-406, at 323 (“...the ordinary functions of consultants and advisers (other than investment advisers) may not be considered as fiduciary functions...”).

to have any practical value, the Department should simplify it as follows:

- ***Take a truly principles-based approach.*** The BIC Exemption will work only if the Department strips it of excessive conditions. A starting point would be eliminating the proposed contractual warranties and representations. They are not needed to protect investors and only serve to expose firms to significant new litigation risk.
  - ***Streamline the required disclosures.*** The proposed disclosures needed to qualify for the BIC Exemption are redundant, granular, costly, and unreasonable. As proposed, these disclosures would serve only to overwhelm retirement investors, in the unlikely event that investors actually read them. The Department should revise the disclosure conditions to align them with the far more workable precedents the Department has adopted under ERISA sections 408(b)(2) and 404(a).
  - ***Expand the scope of coverage of the BIC Exemption.*** The BIC Exemption contains exclusions and limitations that needlessly harm broad classes of retirement plans and savers. The BIC Exemption takes a “legal list” kind of approach—long ago abandoned by mainstream trust law—in proposing a list of certain favored investment choices and eschewing other investment choices not on the list. As a result, the proposed rules would unnecessarily and inappropriately restrict retirement investors’ choices. This is, quite simply, an altogether improper role for the Department or any other regulator, and it should have no place in a final rule. In addition, the Department must expand the BIC Exemption to cover advice provided to all small employers. There is absolutely no sound policy justification for refusing sponsors of small plans access to information and advice about the retirement plans they sponsor and administer.
  - ***Eliminate compliance traps.*** The proposed written policies and procedures requirement for “material conflicts of interest” pose insuperable compliance hurdles for advice providers. The Department must clarify and simplify these requirements.
4. **Avoid retroactive application of the rules.** The Department must modify the proposed exemption so that it does not unnecessarily harm retirement savers by prohibiting ongoing advice on assets acquired prior to the rules’ implementation dates. Savers who bought investments using the services of a broker, for example, already have paid some form of fee for the advice they received. It would be an absurd, and quite harmful, outcome if the Department’s rule results in those savers receiving no further advice for those investments or paying twice for advice (which would be the case if the Department effectively requires

moving the assets, which have already incurred a commission, to an account with ongoing fees).

5. **Provide a meaningful and orderly implementation period.** Even if the Department makes the changes needed to make its rule workable, the rule will be a challenge to implement in an orderly fashion. We strongly recommend that the Department provide an implementation period that allows financial services firms to work with the millions of retirement savers to arrive at an account choice that works best for those savers.
6. **End speculation about special rules for products the Department finds worthy.** The preamble accompanying the proposed BIC exemption suggests that the Department might craft a “streamlined” exemption from ERISA’s prohibitions for so-called “high-quality low-fee” investment products is both premature and disconcerting. Not only has the Department failed to provide sufficient information about this aspect of its proposal to allow the public to comment in any meaningful way, but its assumption that a durable, universal definition of investment quality can or should be determined by a federal agency is troubling.

### III. THE DEPARTMENT’S REGULATORY IMPACT ANALYSIS DOES NOT SUPPORT ITS PROPOSAL

Given the massive new restrictions on future access to guidance, products and services that would result from the Department’s significant regulatory expansion, the Department’s Regulatory Impact Analysis (RIA) might be expected to provide compelling and unequivocal evidence of a market failure necessitating an expansive new definition of fiduciary status as well the lack of less burdensome alternatives for remedying the problem. In fact, the Department’s RIA is fatally flawed: it simply does not support the Department’s assertion that there is a “substantial failure of the market for retirement advice.”<sup>12</sup> It also does not properly consider how the proposal actually could limit retirement savers’ access to guidance, products, and services, or how such limits could affect savers—particularly lower- and middle-income savers with smaller account balances.

The Department’s RIA is based narrowly on the contention that broker-sold funds “underperform,” “possibly due to loads that are taken off the top and/or poor timing of broker sold investments.”<sup>13</sup> The Department’s analysis does not, however, provide a benchmark for returns against which it measures this claim of “underperformance.”

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<sup>12</sup> DOL, *Fiduciary Investment Advice Regulatory Impact Analysis* (Apr. 14, 2015), available at: [www.dol.gov/ebsa/pdf/conflictsofinterestria.pdf](http://www.dol.gov/ebsa/pdf/conflictsofinterestria.pdf), at p. 7.

<sup>13</sup> *Id.*, at p. 98.

The Department uses a confusing array of claimed loss estimates. It presents different assessments of what underperformance could cost IRA mutual fund investors based on alternative calculations. Under one calculation, it contends that such underperformance could cost IRA mutual fund investors \$18 billion per year<sup>14</sup> – a number close to the claim made by the White House Council of Economic Advisers (CEA) and often cited by Department leadership that “conflicted advice costs Americans about \$17 billion in retirement earnings each year.”<sup>15</sup>

Regardless of the number used – \$17 billion or \$18 billion per year – the claims have no basis. The calculations underlying these numbers misinterpret and incorrectly apply the findings of the very same academic research cited as the foundation of the claims, and do not consider the significant harm to retirement savers that is sure to result if the Department adopts the rules as currently drafted. In fact, these assertions do not stand up when tested against actual experience and data.

Correcting for the Department’s many errors and omissions, we find that the Department’s proposal, if adopted, will result in net losses to investors of \$109 billion over 10 years.

**A. The Department’s Claims that Broker-Sold Funds “Underperform” Are Not Supported by the Very Academic Studies on Which it Relies**

The RIA points to a set of academic studies to buttress its claims that investors are harmed by their use of brokers,<sup>16</sup> but these studies do not support its sweeping claims.

**1. The RIA’s statement that “[a] wide body of economic evidence supports a finding that the impact of these conflicts of interest on investment outcomes is large and negative”<sup>17</sup> is not supported by the academic research.**

There are three overarching problems with using the research cited in the RIA to argue that investors using brokers earn lower returns than if they received advice from a fiduciary.

First, none of these academic studies actually compares the outcomes of investing with a financial adviser that is a fiduciary to the outcomes of investing with a broker or other financial adviser

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<sup>14</sup> *Id.* at p. 93.

<sup>15</sup> CEA, *The Effects of Conflicted Investment Advice on Retirement Savings*, (Feb. 2015), p. 21. The CEA white paper is available at: [www.whitehouse.gov/sites/default/files/docs/cea\\_coi\\_report\\_final.pdf](http://www.whitehouse.gov/sites/default/files/docs/cea_coi_report_final.pdf).

<sup>16</sup> In our comment letter on the Regulatory Impact Analysis (“RIA Letter”), we discuss each of the articles cited by the Department and explain why they do not support these statements. *See* RIA Letter, at pp. 11-16. For reasons of brevity, we do repeat that discussion here. Because it is instrumental to the claims advanced in the RIA, a paper by Christoffersen *et al.* – that purports to measure the cost to investors of investing in funds sold through brokers – is describe in detail below.

<sup>17</sup> *Id.* at p. 7.

that is not a fiduciary. Thus, the findings of underperformance cited in the RIA do not actually measure—and cannot measure, based on these studies—whether an investor using a fee-based ERISA fiduciary adviser would experience a different investment outcome than an investor using another financial adviser that is not an ERISA fiduciary.

Instead, these studies seek to measure indirectly how investors fare when receiving assistance from financial professionals who are not fiduciaries, by comparing the performance of funds sold through brokers (“broker-sold” funds) with that of funds sold directly to investors (“direct-sold” funds). The inference that these studies make is that any difference in performance by investors using brokers could be the result of the brokers’ conflicts of interest. This is a leap of logic and is not a direct test of the outcomes of using a financial professional that is not a fiduciary (as compared with using one that is a fiduciary).

Second, most of the studies measure the relative performance of broker-sold funds using data from the 1990s and early 2000s. Fundamental changes in the mutual fund markets since that time have made these studies out of date. Fifteen to twenty years ago, mutual fund markets were segmented, with little head-to-head competition between broker-sold funds and direct-sold funds or funds that did not charge a load (“no-load” funds). Several of the academic papers argue that this segmentation led to broker-sold funds having weaker competitive pressures to produce returns.<sup>18</sup>

Reliance on these studies ignores significant changes in the mutual fund markets. For example, in 2000 only about half of the funds with a front-end load share class also had no-load share classes (Illustration 1).<sup>19</sup> By 2010, however, 90 percent of funds with a front-end load share class also offered a no-load share class. These no-load share classes are available on investment-only 401(k) platforms, at discount brokerages, and through fee-based advisory firms. This head-to-head competition between broker-sold funds and no-load funds has transformed the market for mutual funds.

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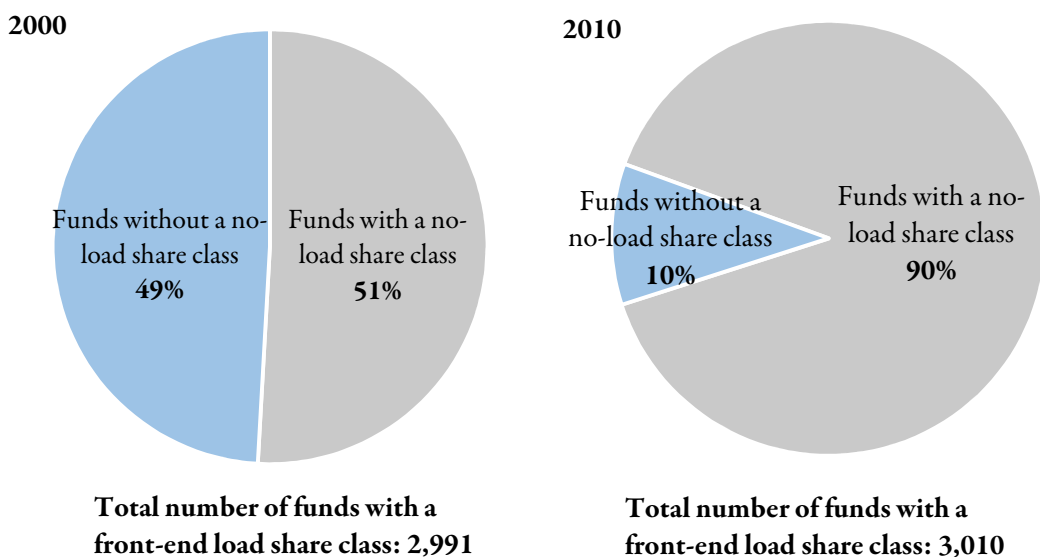
<sup>18</sup> See Daniel Bergstresser, John Chalmers, and Peter Tufano. “Assessing the Costs and Benefits of Brokers in the Mutual Fund Industry.” *Review of Financial Studies* 22, no. 10 (2009): 4129-4156; Diane Del Guercio, and Jonathan Reuter. “Mutual Fund Performance and the Incentive to Generate Alpha.” *Journal of Finance* 69, no. 4 (2014): 1673-1704; and Christoffersen, Evans, and Musto (2013).

<sup>19</sup> Throughout the comment letter, we exclude money market funds, variable annuities, and funds of funds. Money market funds constitute less than 0.1 percent of front-end load fund assets at year-end 2014. Including funds of funds would have created double counting in some of analysis, so we excluded them in all of the analysis. Funds of funds account for 6.6 percent of the front-end load fund assets.

## Illustration 1

### Front-End Load Funds with No-Load Share Classes Have Risen Since 2000

Percentage of funds with a front-end load share class; 2000 and 2010



Note: The analysis includes equity, balanced, and bond mutual funds with at least one share class with a front-end load, excluding mutual funds available as investment choices in variable annuities and mutual funds that invest primarily in other mutual funds (funds of funds).

Sources: Investment Company Institute and Lipper

A third challenge with the literature is that only one study that the RIA cites (Bergstresser *et al.*) assesses the performance of investors using broker-sold funds on an asset-weighted basis. By contrast, the other studies look at individual fund performance. Asset-weighted and sales-weighted returns provide a superior measure of overall market impact by showing how the average dollar invested with a broker-sold fund performs. Another reason for using asset- or sales-weighted returns is that the RIA seeks to measure the proposal's impact on a market-wide basis. Asset- or sales-weighted measures of performance are necessary to make such calculations.

Asset- and sales-weighted performance measures also are useful for determining if brokers are directing investors to lower performing funds. If the asset- and sales-weighted performance of broker-sold funds is below the returns on the average fund, that would provide evidence of brokers steering investors to funds with weaker performance. If, instead, the asset- and sales-weighted performance of broker-sold funds is higher, then brokers are directing clients to funds that outperform, and this would cast doubt on the argument that there is a widespread market failure.

These three problems with the academic literature highlight why it is inaccurate for the RIA to claim that “[a] wide body of economic evidence supports a finding that the impact of these conflicts of



interest on investment outcomes is large and negative.”<sup>20</sup> Furthermore, the academic literature does not support the statement that a “careful review of this data ... consistently points to a substantial failure of the market for retirement advice”<sup>21</sup> and “that IRA holders receiving conflicted investment advice can expect their investments to underperform by an average of 100 basis points per year over the next 20 years.”<sup>22</sup>

## 2. The RIA’s reliance on Christoffersen *et al.* is misplaced.

The RIA rests heavily on a paper by Christoffersen, Evans, and Musto (2013).<sup>23</sup> As discussed in detail in our comment letter on the RIA,<sup>24</sup> this paper has two fundamental errors that the RIA repeats. These errors present a false impression of the relationship between fund performance and the payments of front-end loads to brokers. Christoffersen *et al.* finds evidence that a subset of funds—those whose front-end loads result in higher broker compensation than can be explained by the average of similar funds—underperformed the average return of their fund category during the next year. The Department, based on an incorrect assumption that all IRA assets that are invested in front-end load funds suffer the same underperformance, erroneously applies this result from a small subset of load funds to all load funds. Once these errors are corrected, the sweeping statements in the RIA about brokers’ incentives and investor harm collapse.

These errors, on top of certain other misinterpretations made in the Christoffersen paper, invalidate the RIA’s assertion that the typical investment in a broker-sold fund underperforms by 100 basis points. In turn, that claim of 100-basis-point underperformance is the foundation for the Department’s claim that, unless it adopts its proposed rules, investors in front-end load funds will lose

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<sup>20</sup> See RIA at p. 7.

<sup>21</sup> *Id.*

<sup>22</sup> *Id.*

<sup>23</sup> Susan Christoffersen, Richard Evans, and David Musto. “What Do Consumers’ Fund Flows Maximize? Evidence from Their Broker’s Incentives.” *Journal of Finance* 68 (2013): 201-235. Christoffersen *et al.* claims to find that funds that compensated brokers with higher-than-average loads, adjusting for a set of fund features, earned lower returns than funds in the same Morningstar category. As with the other papers that the RIA cites, Christoffersen *et al.* do not measure or test whether these returns were lower than what investors would have received had they used a fiduciary adviser. Nor does the paper provide asset-weighted or sales-weighted returns to demonstrate how investors who use broker-sold funds performed as a group relative to those using similar funds in their Morningstar category. Finally, the sample period used in the paper extends from 1993 to 2009, relying largely on fund performance that is 10 to 20 years old.

<sup>24</sup> See RIA Letter at pp. 13-15.

\$500 billion to \$1 trillion in foregone returns during the next 20 years.<sup>25</sup> In fact, that claim is mere hyperbole, unsupported by the data.

## **B. Investors' Actual Experience with Broker-sold Funds Contradicts the Department's Claims**

The RIA does not contain any independent analysis of fund performance to support its claim of underperformance arising from investors' use of brokers that are not fiduciaries. We are not aware of any data available to measure directly how investors using brokers fare relative to investors using fiduciaries. Instead, given the shortcomings of the academic literature and flawed analysis the RIA relies on to support its claims of "underperformance," we undertook our own analysis of the recent actual performance of fund investors in broker-sold funds. As discussed below, our findings contradict the RIA's "underperformance" claims. We find that front-end load funds outperform the average fund with the same investment objective and only slightly underperform the sales- or asset-weighted returns on retail no-load funds.

### **1. Contrary to the Department's claims, investors who own funds that are sold with front-end loads actually have concentrated their assets in funds that outperform—not underperform—their Morningstar category.**

To measure the experience of investors in broker-sold share classes, we use gross sales and assets of front-end load share classes from 2007 through 2013. The reason for focusing on the more recent time period is that the mutual fund market has changed significantly in the past twenty years, as we discussed above.<sup>26</sup> We then calculate fund returns, net of fund fees, based on Morningstar data.<sup>27</sup>

Using sales data from 2007 through 2013, we find that front-end load share classes tended to perform better than their Morningstar category average, and that investors concentrated their purchases (*i.e.*, fund sales) in better performing front-end load share classes. As Illustration 2 shows, weighting each share class's relative return by its previous year's gross sales as reported by funds to the ICI, the sales-weighted one-year relative return was 27 basis points. In other words, investors buying front-end load shares in those years outperformed the average for share classes in the same Morningstar category by 27 basis points. The average front-end load share class outperformed its Morningstar category average by 13 basis points during this period. The fact that the sales-weighted average exceeds

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<sup>25</sup> *Id.*

<sup>26</sup> Our analysis begins in 2007 because the shift to direct competition between broker-sold and direct-sold funds continued to occur in the mid-2000s. The analysis ends with funds' performance in 2014, the last full year of performance data.

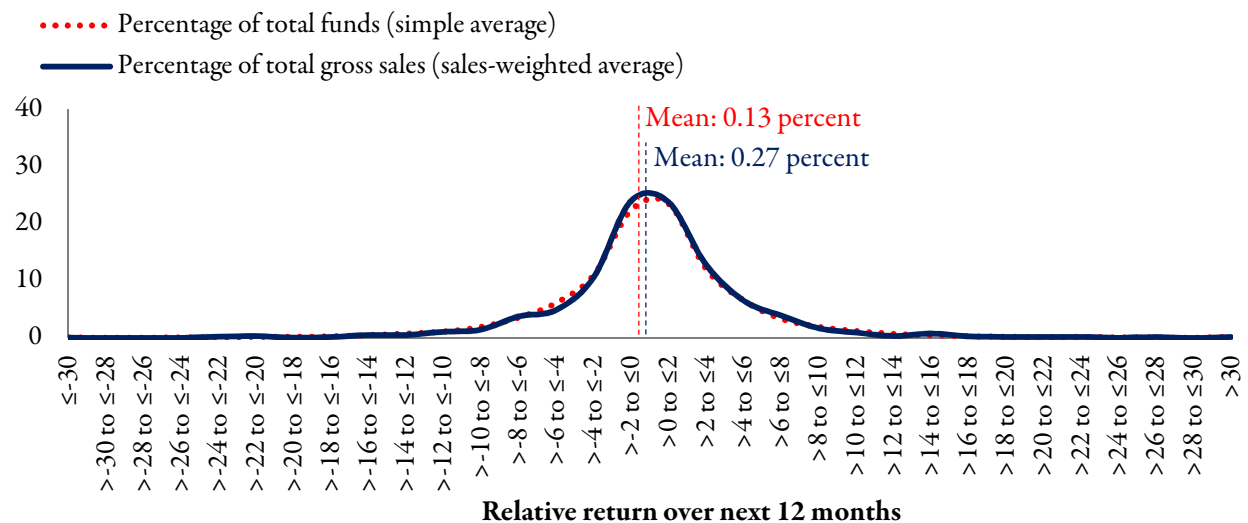
<sup>27</sup> The ICI maintains a survivorship-bias free database of Morningstar data.

the simple average suggests that brokers tended to guide their clients to funds that subsequently slightly outperformed, not underperformed, the average front-end load share class.

## Illustration 2

### Annual Returns on Front-End Load Share Classes Relative to Their Morningstar Category Returns

2008–2014



Note: The relative return is calculated by taking the one-year return of a share class of a fund (net of expenses) less the one-year return on the share class's Morningstar category (net of expenses) for each year from 2008 through 2014. The results are then placed into bins and plotted by summing each share class's gross sales in each prior year as a percentage of gross sales over the entire 2007–2013 period. The analysis includes equity, balanced, and bond mutual funds with at least one share class with a front-end load, excluding mutual funds available as investment choices in variable annuities and mutual funds that invest primarily in other mutual funds.

Sources: Investment Company Institute and Morningstar

Some academic studies, seek to measure the outcomes of investors using brokers by comparing returns on broker-sold funds with no-load or direct-sold funds,<sup>28</sup> under the assumption that no-load or direct-sold funds capture how investors using broker-sold funds might perform if their brokers could use funds outside the broker-sold universe.

On a three-year relative return, the difference in returns between front-end load and retail no-load share classes is 27 basis points.<sup>29</sup> Some of this difference is accounted for by 12b-1 fees, which compensate brokers and their firms for the services that they provide to their clients. Investors would

<sup>28</sup> Direct-sold funds are funds sold *directly* by a fund company, in contrast to funds that are sold *indirectly* by intermediaries to a fund company – like brokers.

<sup>29</sup> See RIA Letter, Figure 4 and accompanying text, at pp. 20-21.

have to pay for services whether they used a broker or a financial adviser that was an ERISA fiduciary. When 12b-1 fees are added back to measure the performance before compensating the brokers and their firms, the difference in returns between front-end load funds and retail no-load funds drops to 6 basis points on a sales-weighted average and 7 basis points on an asset-weighted average. These differences are less than one-tenth the 100 basis point “underperformance” that the RIA asserts.<sup>30</sup>

### Illustration 3

#### Three-Year Returns on Front-End Load Share Classes and Retail No-Load Share Classes Relative to Their Morningstar Category Returns

*Percent; selected periods*

Year	ICI sales-weighted average		Morningstar asset-weighted average	
	Front-end load	Retail no-load	Front-end load	Retail no-load
2007	-0.09	-0.03	0.20	0.45
2008	0.07	0.56	0.07	0.56
2009	0.14	0.33	0.23	0.55
2010	0.39	0.62	0.62	0.77
2011	0.41	0.70	0.67	0.88
<i>Average:</i>				
2007–2011	0.17	0.44	0.37	0.65
Memo: Sales- and asset-weighted 12b-1 fee over given period				
2007–2011	0.23	0.03	0.23	0.02

Note: The relative return is calculated by taking the three-year return of a share class of a fund (net of expenses) less the three-year return on the share class's Morningstar category (net of expenses) for each year from 2010 through 2014. These relative returns are then matched to their three-year prior gross sales or assets. For example, the 2007 sales-weighted averages report the three-year relative return for the period 2008–2010 weighted by gross sales in 2007. The analysis includes equity, balanced, and bond mutual funds with at least one share class with a front-end load, excluding mutual funds available as investment choices in variable annuities and mutual funds that invest primarily in other mutual funds.

Sources: Investment Company Institute and Morningstar

#### 2. The data also show that investors concentrate their purchases in front-end load share classes with lower expense ratios and that pay brokers lower-than-average loads.

There is further evidence that brokers do not systematically steer their clients to poor-performing funds with higher loads or fees. We examined data from Strategic Insight Simfund, which

<sup>30</sup> Using a three-year relative return introduces a small survivorship bias because some share classes are in the one-year returns but not in the three-year returns. On average, 1.6 percent of the front-end load sales in each year have no three-year return and 2.0 percent of retail no-load sales, on average, have no three-year return.

contains N-SAR data from 2010 to 2013 showing loads paid to brokers, measured as a percentage of total fund sales subject to a load.<sup>31</sup> If brokers are skewing investors to funds that pay the brokers higher loads, then we should expect sales-weighted average loads to be higher than the simple average load paid. Instead, for each fund investment group, the sales-weighted average load paid to brokers is less than the simple average load paid. These data on loads contradict the notion that brokers are systematically steering their clients to funds that pay above-average loads.

**3. Sales of front-end load share classes are skewed toward those with below-average expense ratios – further contradicting the notion that brokers systemically are not acting in the best interests of their clients.**

Fund expense data also show strong market forces at work driving investors to funds with below-average expenses. Sales of front-end load share classes are skewed to those with below-average expense ratios, measured as either the total expense ratio (which includes the 12b-1 fee) or the fund expenses used to operate the fund (the total expense ratio minus the 12b-1 fee). Sales-weighted and asset-weighted expense ratios for front-end load share classes are below the simple average total expense ratios or operating expense ratios for front-end load share classes.<sup>32</sup>

Investors in front-end load share classes are paying fund expenses that are in line with retail no-load share classes. Sales-weighted and asset-weighted expense ratios are higher for front-end load share classes than for retail no-load share classes, but a large portion of the difference is that expenses of front-end load share classes include 12b-1 fees used to pay brokers or intermediaries for their services. Focusing on the expenses used to operate the fund (“operating expense ratios”), investors in front-end load share classes generally are paying operating expenses near what investors in retail no-load share classes are paying. And the asset-weighted and sales-weighted operating expense ratios for front-end load share classes are below the simple average operating expenses charged by the average retail no-load share class in all but one case (the sales-weighted taxable bond). These figures undermine the Department’s contention that investors “pay insufficient attention to expenses.”<sup>33</sup>

In conclusion, our analysis shows that the experience of investors in front-end load funds since 2007 is dramatically different from the RIA’s description of the experience of investors using front-end load funds. We find no evidence to support the RIA’s assertion that there is a “substantial failure of the market.”<sup>34</sup> Furthermore, as we discuss below, the RIA overstates the benefits of the Department’s proposal by failing to consider all of its costs. Under the proposal’s current design, investors with small

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<sup>31</sup> See RIA Letter, Figure 6 and accompanying text, at pp. 22-23.

<sup>32</sup> See RIA Letter, Figure 7 and accompanying text, at pp. 23-25.

<sup>33</sup> See RIA at p. 97.

<sup>34</sup> See RIA at pp. 3, 7, and 211.

balances could potentially pay more for their services from financial advisers, be shut out of the advice market, or be faced with much larger switching costs. In fact, the net impact of the fiduciary proposal as it is currently designed could be negative for many IRA investors.

### **C. The RIA Ignores the Economic Impact of Moving Investors to Fee-Based Accounts**

The Department's evaluation of the impact of the fiduciary proposal focuses solely on the costs of advice and assistance paid through a fund—pursuant to an up-front sales charge and 12b-1 fees, for example. But the Department fails to consider how these costs compare to the costs that investors incur when they pay a financial adviser directly for advice (for example, using an asset-based fee that an investor pays directly to a financial adviser) rather than paying through a fund with a front-end load or a 12b-1 fee. In doing so, the Department exaggerates the benefits from lower loads resulting from its proposal and ignores possible costs that investors could incur if they move to fee-based advice.

The RIA calculates that IRA investors currently pay between 26 and 28 basis points per year in front-end loads, in addition to fund expenses. Most front-end load funds have a 12b-1 fee which also is used to compensate the broker and the brokerage firm for their services. The average 12b-1 fee for front-load funds, on an asset-weighted basis, is about 24 basis points. Adding together both the annualized load costs of 26 to 28 basis points and the 12b-1 fees, the total annual cost for the services provided by brokers and their firms to investors in front-end load funds is about 50 basis points a year.

The Department predicts that its BIC Exemption will induce brokers to reduce loads substantially over 20 years.<sup>35</sup> As the Institute points out in its comment letters, the BIC Exemption is unworkable; even if it could work, it would impose prohibitive costs on brokers. Brokers subject to the Exemption's many new limitations, burdens, and costs, as well as its increased exposure to liability, are likely to seek to move many of their clients to fee-based accounts. Such accounts, however, require much greater level of time and engagement through frequent rebalancing of investors' accounts a level of service that is unnecessary for an investor with a modest balance who is typically better off as a buy-and-hold investor. This additional ongoing engagement results in higher and ongoing expense for the investor.

A recent study by Cerulli Associates finds that fee-based accounts—the most likely alternative to brokerage accounts—cost investors 111 basis points per year on average, in addition to fund expenses.<sup>36</sup> As detailed in ICI's comment letter to the Department of Labor, it is reasonable to assume that IRA investors with balances will migrate to fee-based advisers and thus pay more. Even allowing

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<sup>35</sup> See RIA at p. 113.

<sup>36</sup> See Cerulli Associates, Inc., *Cerulli Report RIA [Registered Investment Advisor] Marketplace 2014* at 20. The average asset-based fee includes high-net worth accounts, which typically are charged lower asset-based fees. Accounts of average or smaller size may pay higher fees.

for an increase in performance equal to that of investors in no-load funds relative to broker-sold funds over the past few years, if all IRA investors in broker-sold funds with balances of at least \$100,000 migrate to fee-based accounts, we estimate that they will pay higher fees and thus earn lower returns totaling \$47 billion over 10 years.

#### **D. The RIA Fails to Account for the Societal Harm of Investors Losing Access to Advice and Guidance**

In its estimates of the cost of its proposed rule, the Department focuses only on administrative or compliance costs. It does not measure any harm that can occur if it adopts the proposed rule—including the risk that at least some retirement savers could lose access to advice and information they currently rely on to meet their savings goals.

If the problems with the proposed fiduciary definition and the BIC Exemption are not addressed, we expect that significant numbers of investors should be expected to lose access to the guidance, products, and services that they currently receive from brokers. Financial advisers, regardless of their standard of care, are unlikely to work in an environment of greater costs, limitations, and exposures to liability for less compensation. Indeed, many broker-dealers are likely to exit the market for retirement advice under the proposed rule. The Department thus ignores the impact of its proposed rule on the quality and appropriateness of investment choices that retirement savers must make.

ICI research finds that IRA investors rely on financial professionals to assist with rollovers, creating a retirement strategy, and determining withdrawal amounts.<sup>37</sup> We also find a positive correlation between investors' use of financial professionals and investors' willingness to take financial risk.<sup>38</sup> Indeed, in its justification of an earlier rule change, the Department said that retirement investors who do not receive investment advice are twice as likely to make poor investment choices as those who do receive that advice.<sup>39</sup> The benefits of advice—and, conversely, the harm of losing access to advice—are significant.

Retirement investors may be left with no choice but to seek asset-based fee accounts to obtain the investment assistance that they need. But as we have already established, the cost of investing through those accounts can be greater—not less—than the cost of investing with brokers.

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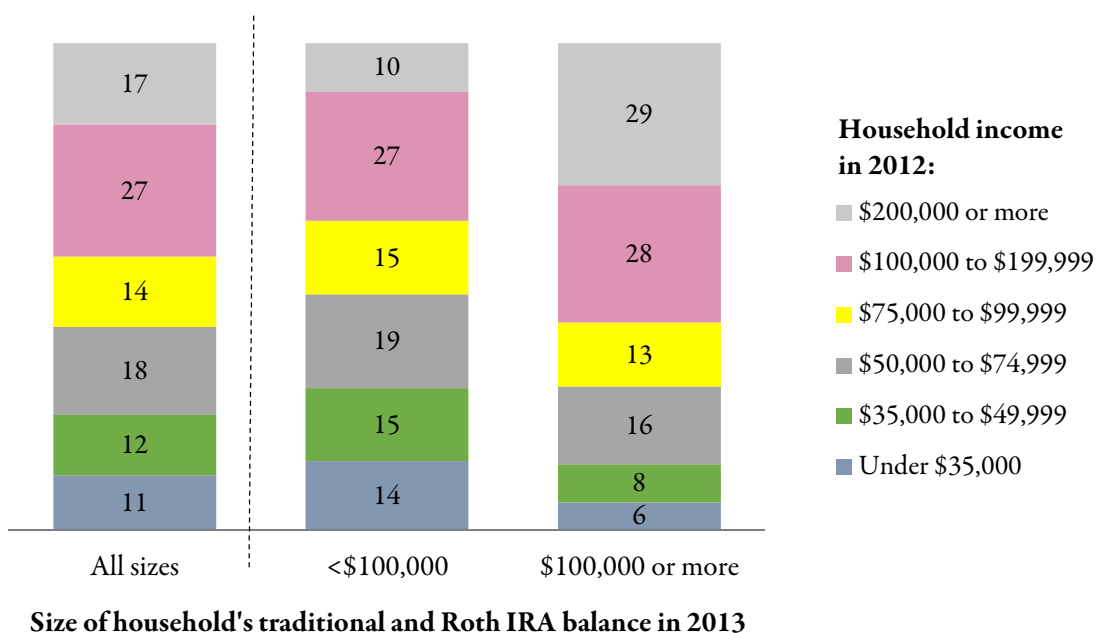
<sup>37</sup> See Sarah Holden and Daniel Schrass. 2015. "The Role of IRAs in U.S. Households' Saving for Retirement, 2014." *ICI Research Perspective* 21, no. 1 (January), available at [www.ici.org/pdf/per21-01.pdf](http://www.ici.org/pdf/per21-01.pdf).

<sup>38</sup> See Daniel Schrass, "Ownership of Mutual Funds Through Investment Professionals, 2012," *ICI Research Perspective* 19, no. 2 (February 2013), available at [www.ici.org/pdf/per19-02.pdf](http://www.ici.org/pdf/per19-02.pdf)

<sup>39</sup> See Investment Advice—Final Rule. 76 Fed. Reg. 66136, 66152 (October 25, 2011).

Moreover, fee-based accounts may not be available to low- and middle-income IRA investors who cannot meet minimum account balance requirements. Currently, fee-based advisers often require minimum account balances of \$100,000 because, even with a 1 percent fee, accounts with fewer assets generate too little income to make the provision of ongoing advice profitable. Significantly, 75 percent of all IRA accounts in The IRA Investor Database have less than \$100,000 in them. And low- and middle-income households are more likely to have IRA balances below \$100,000, as shown in Illustration 4.

**Illustration 4**  
**Households Owning Traditional and/or Roth IRAs**  
*Percentage by household income and household IRA balances*



Note: In 2013, 65 percent of households with traditional or Roth IRAs had balances of less than \$100,000 and 35 percent had balances of \$100,000 or more.

Source: ICI Tabulation of Federal Reserve Board 2013 Survey of Consumer Finances

Other market participants may seek to overcome the proposed rule’s barriers and find ways to serve retirement savers who now rely on broker-dealers. It is entirely foreseeable, however, that many IRA investors would no longer be able to obtain advice under the proposed rule. If these investors, over time, lose access to advice and service, their accounts are likely to earn lower returns in the future. These lower returns could occur, for example, through poor asset allocation decisions, poorly timed investment decisions, penalties for early withdrawals, or incorrectly calculated required minimum distributions. Even if these individuals no longer have to pay for services, the net loss on their accounts would have a negative impact.

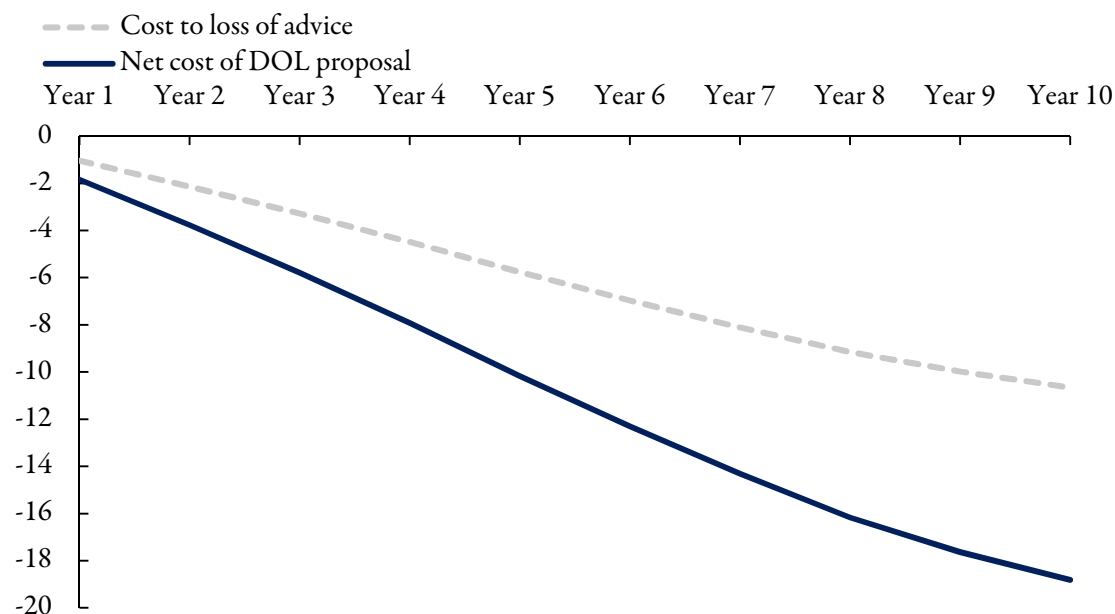


Assuming that investors with less than \$100,000 in IRA balances no longer have access to advice because the BIC Exemption is not workable, then over time these investors are likely to experience lower returns because of poor asset allocation and market timing, or because they incurred tax penalties by taking early withdrawals. Factoring in the lower performance for these investors, and adding to the additional costs for the other 81 percent of IRA assets that would shift to fee-based accounts, it is possible that the net loss from the proposal, if adopted, could impose annual losses to investors amounting to nearly \$19 billion a year within 10 years (Illustration 5).

**Illustration 5**

**Annual Effect on Investors If They Lose Access to Financial Advice**

*Billions of dollars a year*



Source: Investment Company Institute

The losses that investors would likely incur under the Department’s proposal stand in stark contrast to the benefits that the CEA and the Department claim. The reason that the CEA and the Department can claim that the proposal would have a net benefit to investors is that their analysis shares several common errors, including: (a) overestimate of the “underperformance” of broker-sold funds; (b) misapplication of the academic research underlying the estimates; (c) failure to acknowledge the added costs borne by investors forced to move from commission-based to fee-based accounts; and (d) failure to acknowledge lost returns suffered by investors with small accounts who forego advice altogether due to loss of the commission-based option.

Correcting for these errors and omissions, we find significant net costs to investors, whether calculated on an annual basis using the CEA’s methods or for the first 10 years after implementation by the Department’s methods. Indeed, correcting for the Department’s many errors and omissions, we

find that the Department's proposal, if adopted, will result in net losses to investors of \$109 billion over 10 years.

We are, of course, unable to quantify other significant potential costs resulting from the Department's proposed rules. As we discuss above and in our comment letters, the consequence of an expansive and ambiguous fiduciary definition combined with an unworkable BIC Exemption will be that investors —particularly investors with small account balances— will find significant barriers for seeking out advice and assistance, even outside the broker market. Increasing information barriers and transaction costs certainly would reduce the ability of IRA investors, like my son, to move from one adviser to another or from one fund provider to another, further harming investors.

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On behalf of the Institute and all of our members, thank you for the opportunity to offer this statement. I look forward to answering any questions of the Subcommittees.