In re: Department of Labor, Proposed fiduciary rule, RIM 1210-AB79

COMMENT

I am a financial advisor with a large, mid-west based firm, and I have been in the financial services industry for 16 years. I chose my employer for its high sense of corporate ethics, and my both employer and I are in full support of doing what is in the client's best interest.

However, it is my considered opinion that the proposed fiduciary rule emphatically does not necessarily do that. In my opinion, those who advocate depriving clients of the right to choose a transaction based account over a fee based account are doing those clients a disservice. In my opinion, such advocates are either: uninformed, misinformed, or deliberately pursuing a misguided agenda for purposes which I cannot fathom. Let me explain with some examples.

In September, 1974, President Ford signed the law which created Individual Retirement Accounts (IRAs). At that time, the maximum allowable contribution was $2000 per year. (ROTH IRAs did not come into being until later, as both increased contribution levels and the so-called "catch up" contribution for persons age 50 or older. So for my comparative illustrations, we will use September, 1974 as our starting point, and an annual contribution of a constant $2000 thus ignoring the possibility of higher contribution levels which came along later).

Our client (we'll call him Saver) is a 25 year old college graduate and a veteran of military service. Saver served in Viet Nam and because some of Saver's pay was tax free, Saver managed to exit the military with a small nest egg. Saver is employed, but Saver's employer has no retirement plan in place, so Saver, upon hearing about these new retirement accounts, decides to participate. Saver's first contribution to a newly opened IRA takes place on September 30, 1974 and is repeated on that date every year through September 30, 2016.

For his investment in this example, Saver chooses Washington Mutual Investor's Fund, a large-cap, primarily domestic, stock mutual fund. Saver knowingly chooses the Class A shares, which hold back some of the yearly contribution to pay up-front sales charges. The mutual fund company keeps a portion of the sales charge, and sends the rest to Saver's brokerage firm. The firm then sends some of what it gets to the financial advisor as compensation for working with Saver.

In return for choosing the A share, and its up-front sales charges, the fund allows Saver to 1) exchange into other A share funds in the same fund family (American Funds is the family) and do it for free; 2) reinvest any dividends and capital gains generated within the fund and do it for free; 3) and sell any or all shares, for free, at any time and without a mandatory holding period (exception noted below).

So how did it turn out for Saver? (NOTE: PAST PERFORMANCE IS NOT PREDICTIVE OF FUTURE PERFORMANCE. Numbers below come from using the Morningstar Hypothetical tool.) In the above example, Saver's contributions totaled $86,000. His sales charges totaled $2525, which included receiving reduced sales charges when his account reached $25,000, and again at $50,000, and again at

$100,000, and again at $250,000, and again at $500,000, and again at $750,000, and when the account reached $1,000,000, there were no sales charges, in return for a 1 year holding period on those shares. (Any sale within the holding period would incur a 1 percent back end sales charge).

In sum, for operating the IRA as a transaction based account we see the following:

Contributions totaled $86,000.

Sales charges totaled $2525

Reinvested dividends and capital gains totaled $1,126,817

Beginning value was $2000 and ending value (on 09/30/2016) was $1,951,404 for a

Cumulative return of 9,868.14% or an average of 11.57% per year.

Let's contrast that same example using a fee based account charging 1 percent annually.

Same starting date and same ending date for the above example

Same initial contribution of $2000 with subsequent contributions of $2000 yearly

Sales charges are Zero (because in this example, Saver is using a fee based account)

Total fees, at 1% of the account value, totaled $178,896, deducted from the account

Beginning value was $2000 and ending value (on 09/30/2016) was $1,440,012 for a

Cumulative return of 6,721.43% or an average of 10.57% per year.

HAD BOTH PATHWAYS (TRANSACTIONAL AND FEE BASED) BEEN AVAILABLE AT ACCOUNT OPENING AND FUNDING, WHICH WOULD HAVE, OVER TIME BEEN THE WISER CHOICE?

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Now let's vary the scenario. Saver has access to an employer sponsored plan beginning on September 30, 1974. Saver decides to use that plan instead of opening an IRA. Input is the same ($2000 per year, on the anniversary of his first contribution), and results have been good. On December 21, 1994 (20 years with the same employer) his retirement plan has a total value of $238,392.

Saver now changes jobs, and after considering his options, elects to rollover his $238,392 into an IRA which is transaction based. How did it turn out?

Starting date was January 1, 1995 for $238,392.

Sales charges on the above amount were a one-time $8344 (not inconsequential)

Saver did not add to this account (his was using his new employer's retirement plan instead)

By September 30, 2016, (Saver's date of retirement), his rollover IRA had:

Reinvestment of dividends and internally created capital gains of $936,401

An ending value on September 30, 2016 of $1,778,752 for a

Cumulative return of 646.14% or an average of 9.68%

What if Saver was forced into a fee based account with his $238,392 rollover?

Starting date of January 1, 1995 for $238,392

Sales charges of Zero

Reinvestment of dividends and internally created capital gains of $859,980

Total fees, based on 1% of the account value yearly, totaled $170,989

Ending account value on September 30, 2016 in a fee based account: $1,482,824 for a

Cumulative return of 522.01% or an average of 8.76%

WHICH OF THE TWO SCENARIOS ABOVE WOULD HAVE BEEN MORE BENEFICIAL TO SAVER OVER TIME?

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Remembering that Saver was 25 years old in 1974, we know he was born in 1949. In September, 2016, Saver is now 67, which is full retirement age. He decides to retire and live on his Social Security and a part time job for income, postponing his Required Minimum Distribution (RMD) for three years, when he reaches age 70. Would it be in Saver's best interest to have his account (regardless of value) subject to a 1% fee annually for those three years, and then on through the rest of the account's life? Or would Saver be better off having absorbed the sales charges and not have his account quietly depleted by an on-going annual fee? Hopefully, my examples above would lead to the conclusion that a fee based account is NOT in Saver's best interest.

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If a fiduciary standard is honestly applied, if the client's best interest must be served above all else, then having clearly defined choices between transactional and fee based accounts have to be offered. That would include the possibility of using mutual funds for their diversification, potential break points, exchangeability both to and from other funds in the same family and same share class, and no cost reinvesting of dividends and/or capital gains.

In my opinion, the shrill voices who so stridently advocate for a fiduciary standard (which is clearly the moral "high ground"), need to consider all the facts, not just the ones they believe support their strident stances, asserting that people, such as myself and the vast majority of my colleagues, cannot possibly be placing the client's interest above ours if we offer transactional based accounts as an alternative to fee based.

OTHER DEFICIENCIES IN THE PROPOSAL

It is interesting that the proposed rule calls (called?) for an effective date of April 10, 2017. Consider that many IRA and ROTH IRA contributors do not have guidance from their tax preparer until the very last minute, which the Treasury Department has determined to be April 15 for contributions allowed to retroactively fund the previous calendar year. Thus, an April 10 "deadline" would force contributors into a fee based account situation.

Another issue apparently not addressed (at least according to the information I have from my employer) is whether or not a contributor using a systematic purchase arrangement in place prior to the proposed deadline would later be allowed to increase monthly (for example) contributions to take advantage of increased contribution limits. That same question would also apply for a client reaching the age of 50 during the year. Could a systematic contribution be adjusted upward to allow full participation in both the contribution level and the "catch up" contribution?

RECOMMENDATION

I would urge a complete reworking of the proposed rule taking into account ALL relevant factors, and, as an exercise in oversight, for the Department of Labor to begin a serious examination of firms which do only fee based retirement accounts or which are mandating the conversion of existing transactional accounts to a fee based platform, to determine if fee based, in general, or the exclusion of mutual funds from the range of choices is TRULY in the clients' best, interest for accounts with long time horizons. Thank you for your time with my comments.

John A. Walters

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