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April 17, 2017

Employee Benefits Security Administration
Room N-5655
U.S. Department of Labor
200 Constitution Avenue
Washington, D.C. 20210

Attention: Fiduciary Rule Examination, RIN 1210-AB79

Gentlemen and Ladies:

On March 2, 2017, the Department of Labor (the "Department") solicited comment on a reexamination of the final regulation (the "Final Rule") [1] defining who is a "fiduciary" under section 3(21) (A)(ii) Employee Retirement Income Security Act of 1974, as amended ("ERISA"), and section 4975 of the Internal Revenue Code of 1986, as amended (the "Code"), as required by the directive in the Presidential Memorandum dated February 3, 2017.[2]

1 82 Federal Register 12320 (Mar. 2, 2017).

2 82 Federal Register 9675 (Feb. 7, 2017) (Presidential Memorandum on Fiduciary Duty Rule).

The Financial Services Roundtable ("FSR")[3] welcomes the opportunity to submit comments that will help inform a comprehensive reexamination of the Final Rule and the Regulatory Impact Analysis on which the Department relied in adopting the Final Rule. We believe a reexamination of the Final Rule in accord with the criteria set forth in the Presidential Memorandum should and will lead to the rescission or a material revision of this overly burdensome and disruptive regulation. We also urge the Department to postpone the June 9, 2017 applicability date of the Final Rule[4] until its consequences and effects can be, and are, thoroughly and fully examined in accordance with the Presidential Memorandum.

Support for Best Interest Standard. FSR unequivocally supports a best interest standard being applicable to all persons providing personalized investment advice and guidance to all retail investors, not just employee benefit plans, individual retirement accounts ("IRAs") and other entities treated as plans for purposes of the Code ("Retirement Investors"). Even before the adoption of the Final Rule, our members placed the interests of their clients first, and have provided advice and guidance intended to promote the financial well-being of their clients.

In commenting on the Final Rule, FSR is informed by its view that the regulation and oversight of investment advisers, broker-dealers and others engaged in providing personalized investment advice about securities to retail investors should be the primary responsibility of the Securities and Exchange Commission (the "SEC"). The SEC has the expertise, knowledge and authority to most effectively and efficiently coordinate the myriad of applicable laws and regulations pertaining to such investment activities. State

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3 As *advocates for a strong financial future*™, FSR represents the largest integrated financial services companies providing banking, insurance, payment, and investment products and services to the American consumer. Member companies participate through the Chief Executive Officer and other senior executives nominated by the CEO.

4 82 Federal Register 16902 (Apr. 7, 2017).

insurance authorities should take the lead on the regulation of annuities and insurance products, including life insurance companies and their agents or distributors.

EXECUTIVE SUMMARY

- The Presidential Memorandum raises three questions and directs the Department that, if any of the questions posited is answered in the affirmative, or the Department otherwise concludes that the Final Rule is otherwise inconsistent with empowering Retirement Investors to make their own financial decisions, to save for retirement or to build their wealth, the Department is to propose the rescission or revision of the Final Rule or amendments eliminating the adverse effects.
- The Department concluded that the Final Rule should take effect on June 9, 2017, and that the "Impartial Conduct Standards" of the Associated PTEs also would become applicable on June 9. However, the Department made this determination before it had completed the reexamination of the Final Rule and prepared an updated Regulatory Impact Analysis, as required by the Presidential Memorandum.
- The studies that have been conducted since the promulgation of the Final Rule, and the developments in the marketplace that have occurred as institutions have attempted to restructure their business operations to comply with the Final Rule and the Associated PTEs, indicate that each of the three questions posed in the Presidential Memorandum must be answered in the affirmative.
- The Final Rule's adverse impacts are especially pronounced on those struggling to save for retirement, because the rule limits access to financial advice, reduces service models and product availability, and ultimately raises the overall cost of saving for retirement. Thus, the Final Rule's impact interferes with Retirement Investors' ability to make their own financial decisions, to save for retirement and to build wealth.

- Advised households over a 15-year period "have about 290% more financial assets than non-advised households,"[5] even though half of these households had less than $25,000 in savings when they initially began to work with an adviser.[6] The harm to Retirement Investors resulting from the loss of advice far outweighs the Final Rule's speculative cost savings.
- The additional data that has become available following the promulgation of the Final Rule demonstrates that the Final Rule has had, and will continue to have, adverse consequences for Retirement Investors not anticipated by the Department in its prior Regulatory Impact Analysis.
- Such information requires that the Department conduct a new and thorough Regulatory Impact Analysis, consistent with the directives in the Presidential Memorandum.
- Following a thorough and fresh review of the rulemaking record and of the new information, FSR believes that the Department will conclude that it should rescind or materially revise the Final Rule.
- We urge the Department to postpone the June 9, 2017 applicability date of the Final Rule until its consequences and effects can be, and are, thoroughly and fully examined in accordance with the Presidential Memorandum.

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[5] Montmarquette and Viennot-Briot, *The Gamma Factor and the Value of Financial Advice*, CIRANO at 24 (Aug. 2016), *available at* https://cirano.qc.ca/files/publications/2016s-35.pdf.

[6] Pollara, *Canadian Mutual Fund Investors' Perceptions of Mutual Funds and The Mutual Fund Industry* at 5 (2016).

INTRODUCTION

The Final Rule limits access to financial advice, reduces service models and product availability, and raises the overall cost of saving for retirement.

The Department acknowledged that the Final Rule "treats persons who provide investment advice or recommendations for a fee or other compensation with respect to assets of a plan or IRA as fiduciaries in a wider array of advice relationships."[7] The Department coupled its expansive definition with exemptions that it noted "would broadly permit firms to continue to receive many common types of fees," if firms comply with standards for providing impartial advice in the best interest of their customers."[8] Despite the good intentions of the Department, ERISA is an imperfect instrument for addressing such conduct. As this letter sets forth in detail, attempting to address these important issues within the prescriptive parameters of the prohibited transaction provisions of ERISA and the Code has created a rule that is already adversely affecting Retirement Investors.

The Final Rule's adverse impacts are especially pronounced on those struggling to save for retirement, because the rule limits access to financial advice, reduces service models and product availability, and ultimately raises the overall cost of saving for retirement. Some firms have responded with changes to service models and product availability, including (a) moving clients to fee-based accounts, (b) eliminating commission-based IRAs; (c) raising investment minimums for commission-based IRAs; (d) eliminating variable annuity products; and (e) excluding certain products from

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[7] 81 Federal Register 20946 (Apr. 8, 2016).

[8] *Id*.

commission-based IRAs (*e.g.*, annuities, mutual funds, and exchange-traded funds).[9] One report notes that 35 percent of advisers surveyed "will move away from low-balance accounts" (*i.e.*, less than $25,000 in assets).[10] And "nearly one in four advisers said that they will likely increase their current client minimums as a result of the fiduciary rule, focusing their attention on higher-net worth clients and more profitable relationships."[11] Another report indicates that the Final Rule will result in additional charges to Retirement Investors of approximately $800 per account or over $46 billion in the aggregate.[12]

The Department's decision to make the Final Rule applicable prior to the conclusion of its reexamination of the rule and updated economic analysis is premature and inconsistent with the Presidential Memorandum.

As an initial step, the Department has adopted a 60-day delay of the applicability date of the Final Rule, and taken comparable action with respect to the applicability dates of the prohibited transaction exemptions promulgated or amended in connection with the adoption of the Final Rule (the "Associated PTEs").[13]

The Department also concluded that the Final Rule should take effect on June 9, 2017 at the expiration of that 60-day period, and that the "Impartial Conduct Standards" of the Associated PTEs would become applicable on such date. However, the Department made this determination prior to the conclusion of the comment period for

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9 *See*, Wursthorn, *New Retirement Rule Is Delayed, but Not Its Impact*, Wall St. J. (Apr. 8, 2017); Wursthorn, *A Complete List of Brokers and Their Approach to "The Fiduciary Rule,"* Wall St. J. (Feb. 6, 2017).

10 Investment News, *The Economics of Change: How the DOL Fiduciary Rule Will Set Money in Motion and Alter Business Models Across the Advice Industry* at 11.

11 *Id*. at 13.

12 Milloy, *The Consequences of the Fiduciary Rule for Consumers*, American Action Forum at 11 (Apr. 10, 2017), *available at* https://www.americanactionforum.org/research/consequences-fiduciary-rule-consumers/.

13 82 Federal Register 16902 (April 7, 2017).

the reexamination of the Final Rule, which expires on April 17, 2017. The Department also acknowledged that it had not completed the thorough reexamination that the President had directed. In relying upon the analysis and determinations it made in initially promulgating the Final Rule to determine that the Final Rule will become effective June 9, the Department appears to discount entirely financial data that indicates the Final Rule will be directly detrimental to Retirement Investors.

For example, one report indicates that many Retirement Investors, especially those having a modest amount of assets to invest, could be left without access to professional advice.[14] Yet advisors help Retirement Investors save more, better customize their portfolios to individual risk tolerance, increase overall investor comfort with investment decisions, and improve financial literacy.[15] Studies indicate that households that have worked with a financial advisor over a 15-year period "have about 290% more financial assets than non-advised households,"[16] even though half of these households had less than $25,000 in savings when they initially began to work with an advisor.[17] "The discipline imposed by a financial advisor on households' financial behavior and increased savings of advised households are key to improving asset values

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[14] Milloy, *The Consequences of the Fiduciary Rule for Consumers,* American Action Forum at 11. To the extent advisers move to fee-based accounts, "based on a minimum balance requirement of $30,000, the fiduciary rule could force 28 million Americans out of managed retirement accounts completely."

[15] *See*, Bergstresser *et al*., *Assessing the Costs and Benefits of Brokers in the Mutual Fund Industry* (October 2009), 22 REV. FIN. STUD. (ISSUE 10) 4129 (2009), *available at* http://ssrn.com/abstract=1479110; Gennaioli *et al*., *Money Doctors* (Nat'l Bureau of Econ. Research, Working Paper No. w18174, 2012), *available at* http://ssrn.com/abstract=2089246.

[16] Montmarquette and Viennot-Briot, *The Gamma Factor and the Value of Financial Advice*, CIRANO at 24 (Aug. 2016), *available at* https://cirano.qc.ca/files/publications/2016s-35.pdf.

[17] Pollara, *Canadian Mutual Fund Investors' Perceptions of Mutual Funds and The Mutual Fund Industry* at 5 (2016).

of households relative to comparable households *without* an advisor."[18] Indeed, some studies find that "behavioral coaching can add 1% to 2% in net return."[19]

Thus, the harm to Retirement Investors resulting from the loss of advice far outweighs the speculative cost savings projected by the Department. The Regulatory Impact Analysis must be updated to address this and other issues we discuss in this letter.

The Department states that "there is fairly widespread . . . agreement about the basic Impartial Conduct Standards"[20] in support of its determination that the June 9, 2017 applicability date should not be extended further. Regardless of whether there is agreement that the Impartial Conduct Standards are appropriate for persons who provide fiduciary advice, we submit the Final Rule's definition of fiduciary advice is overbroad and is a significant reason for the adverse impacts described above. As part of its reexamination of the Final Rule, the Department may conclude, for example, that the definition of "recommendation" should be revised in material ways, including that a broader seller's exception is appropriate, that discussions with IRA participants regarding required minimum distribution options are not fiduciary advice, or that the investment education exception for IRAs should be broadened to permit reference to investment products. Accordingly, applying the Final Rule in advance of a complete and thorough reexamination of the Final Rule and the conditions of the Associated PTEs is inappropriate, and will cause uncertainty in the investment community that will likely

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[18] Montmarquette at 40. *See also*, Kinniry Jr., Jaconetti, DiJoseph, and Zilbering, *Putting a value on your value: Quantifying Vanguard Advisor's Alpha*, The Vanguard Group at 16 (2016), *available at* http://www.vanguard.com/pdf/ISGQVAA.pdf (finding that based on "actual client behavior, . . . investors who deviated from their initial retirement fund investment trailed the target-date fund benchmark by 150 [basis points]. This suggests that the discipline and guidance that an advisor might provide through behavioral coaching could be the largest potential value-add of the tools available to advisors.").

[19] Kinniry at 16.

[20] 82 Federal Register at 16905.

have adverse consequences for Retirement Investors and their access to appropriate financial advice and investment opportunities.

In light of the adverse impacts on Retirement Investors, it makes no sense to implement a rule that could be rescinded or at least materially revised in a mere matter of months. We urge the Department to reconsider this premature determination, and postpone the June 9, 2017 applicability date of the Final Rule until its consequences and effects can be, and are, thoroughly and fully examined afresh in accordance with the Presidential Memorandum's criteria. We further urge the Department to include the proposed exemptive relief for independent marketing organizations ("IMOs")[21] as part of a thorough reexamination of the Final Rule.

QUESTIONS POSITED FOR REEXAMINATION

The Presidential Memorandum directed the Department to reexamine the Final Rule to determine whether it "may adversely affect the ability of Americans to gain access to retirement information and financial advice."[22] As part of this reexamination, the President directed the Department to prepare an updated economic and legal analysis concerning the likely impact of the Final Rule. In reviewing the Final Rule, the Presidential Memorandum instructs the Department to consider the following questions:

- Whether the anticipated applicability of the Final Rule has harmed or is likely to harm investors due to a reduction of Americans' access to certain retirement savings offerings, retirement product structures, retirement savings information, or related financial advice;

[21] Proposed Best Interest Contract Exemption for Insurance Intermediaries, 82 Federal Register 7336 (Jan. 19, 2017).

[22] 82 Federal Register 9675 (Feb. 7, 2017) (Presidential Memorandum on Fiduciary Duty Rule).

- Whether the anticipated applicability of the Final Rule has resulted in dislocations or disruptions within the retirement services industry that may adversely affect investors or retirees; and
- Whether the Final Rule is likely to cause an increase in litigation and an increase in the prices that investors and retirees must pay to gain access to retirement services.[23]

The Presidential Memorandum further directed that, if an affirmative determination were made as to any of the above three considerations, or the Department concludes for any other reason that the Final Rule is inconsistent with the priority of the Administration "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," then the Department shall publish for notice and comment a proposed rule rescinding or revising the final rule, as appropriate and as consistent with law.[24]

It is apparent that in setting June 9, 2017 as the applicability date for the Final Rule, the Department did not give any meaningful consideration to the considerable data that has become available since the adoption of the Final Rule regarding the expected impact of the Final Rule on Retirement Investors' access to financial advice and investment products. The Department also did not consider the significant data that has become available since the adoption of the Final Rule related to the substantial cost increases that will arise from the Final Rule and that will be borne by those Retirement Investors who will continue to have access to advice. And there is nothing in the record that suggests that the Department gave any consideration to the

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[23] *Id.*

[24] *Id.*

proliferation of litigation that the Final Rule will cause. Indeed, in promulgating the Final Rule, the Department expressly indicated that it was relying the threat of litigation as the principal means of enforcement regarding advice provided to IRAs.

When the Department turns its attention to the questions that were set forth in the Presidential Memorandum and the new information that has become available since the promulgation of the Final Rule, as is described in greater detail below, it is unequivocally clear that each of the above questions must be answered in the affirmative and that the Department's reexamination should lead it to rescind or materially revise the Final Rule.

Question 1. Whether the anticipated applicability of the Final Rule has harmed or is likely to harm investors due to a reduction of Americans' access to certain retirement savings offerings, retirement product structures, retirement savings information, or related financial advice.

> *Yes, the Final Rule has caused harm to investors due to reductions in products, services, and advice available to them. The Regulatory Impact Analysis must be updated to account for the adverse effects we discuss below.*

Reduction in the Choices Available to Investors. Published reports indicate that several large providers of financial products and services to Retirement Investors are changing service models and products available to such investors as a result of the Final Rule, [25] although prior to the Department's premature determination that June 9 will be the Applicability Date of the Final Rule, several had been reconsidering their decisions in light of the possibility that the Final Rule will be rescinded or revised. Many other institutions, including several of the largest IRA service providers, are reducing the

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[25] *See*, Hazard, *DOL Rule Causing Ripple Effect In Retirement Industry,* Richmond Times Dispatch, Sept. 26, 2016.

investment products that they will offer to such investors, or are eliminating the availability of recommendations or advice to all or some types of Retirement Investors, or both.[26] This reduction in choice is directly caused by the need to rely on the so-called "Best Interest Contract Exemption" (the "BIC Exemption")[27] to comply with the prohibited transaction provisions applicable under Section 4975 of the Code and/or Section 406 of ERISA, to which financial institutions and advisers would become subject in providing investment assistance to Retirement Investors by reason of being deemed fiduciaries under the Final Rule.

Many financial institutions that must now rely on the BIC Exemption to provide advice and receive fees, commissions or other compensation related to such advice can only offer investments with respect to which they receive level fees and other compensation related to the investment advice given. The BIC Exemption's Impartial Conduct Standards include a "Best Interest Standard" that requires that any institution relying on any of the Associated PTEs must be able to prove that the recommendations that its advisers provide to Retirement Investors are made without regard to the financial or other interests of the adviser or the institution.

Where the institution receives differential compensation among the various recommendations that its advisers can make, the institution will have the burden of proving compliance with the Best Interest Standard. It is unclear what will be required to sustain this burden, and quite conceivable that different standards will be applied in different jurisdictions to institutions that attempt to meet this unchartered burden. Accordingly, an institution can be exposed to material liability if it cannot

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[26] Iacurci, "*Amid DOL Fiduciary Rule Doom and Gloom, Some Take Opportunistic Tack*," Investment News, Nov. 4, 2016 (noting some providers see sales opportunity due to broker-dealers' narrowing of product platforms).

[27] 81 Federal Register 21002 (April 8, 2016).

surmount this uncertain and potentially challenging hurdle despite its good faith attempt to comply with such standard and promote the interests of its Retirement Investor clients.

In light of the risks presented by this fact specific and amorphous burden, and given the BIC Exemption's complex requirements and potentially material new liabilities flowing from the contractual and warranty provisions, service providers are being forced to limit product choice, service model choice, and access to advice. The adverse impact of the Final Rule and the constraints of the BIC Exemption on the institution's ability to continue to provide common investment recommendations are illustrated below.

Mutual Funds. Assume that a financial institution and its advisers want to offer Retirement Investors a choice among several available mutual fund options. While the core investment mix in such funds might be comparable, there will be differences in the investment strategies that may make one fund a superior choice for a specific Retirement Investor, based on such investor's objectives and risk tolerances. Yet, if the adviser or institution were to receive a greater level of compensation in respect of one fund as compared to another, the BIC Exemption would be unavailable if the adviser received differential compensation for making that recommendation. The Best Interest Standard requires that the institution bear the burden of proof that the differential in compensation did not influence in any way the recommendation made. This is true even in circumstances where that differential in compensation between the investment choices relates to other services that the institution or its affiliates provides to such mutual fund.

As a result, the mutual fund industry is devoting considerable resources toward the development of new share classes and fee structures that would allow institutions to conform to the Fiduciary Rule's requirements when offering these common investment choices to Retirement Investors. However, pending availability of these new share classes, Retirement Investors at some firms will not have access to mutual funds in a commission-based account over concern that, regardless of the institution's good faith belief that making a particular investment is in the best interest of the Retirement

Investor, it will be exposed to significant liability—and almost certainly exposed to significant litigation expenses—if it receives a level of compensation that may suggest that that the recommendation was motivated, at least in part, by such compensation.

Fixed-Indexed Annuity Products. Similarly, insurance agents and IMOs market fixed-indexed annuity products to Retirement Investors for which they receive commissions in accordance with applicable state insurance laws. The applicable state insurance authority will have reviewed and approved the terms and conditions of the annuity contracts, and will monitor the marketing practices for such products. Yet, if the licensed agent that makes the recommendation associated with such insurance product receives differential compensation in recommending different insurance products. The BIC Exemption will likely not provide the promised exemptive relief because the agent may be unable to prove that the commissions received were not a factor in the decision to make the investment recommendation. Even if the compensation received by the agent making the recommendation is level, the IMO may be perceived as having unresolvable conflicts of interest that would breach the Best Interest Standard included in the specific exemption proposed to afford relief to IMOs (which would not be deemed financial institutions under the BIC Exemption) if they would receive a higher rate of commission for their agents marketing the product of one insurer versus that of another carrier.[28]

Rollover and Transfer Transactions. Institutions and their advisers that provide a recommendation to rollover assets from an existing IRA or an individual account plan that would be coupled with a recommendation to invest in proprietary products or products with respect to which the institution or adviser may receive third party payments must assure that any compensation received in connection with such recommendations

[28] Under the Associated PTE proposed by Department for the benefit of such institutions, the exemption will still not be available to an IMO that can meet the restrictive conditions associated with the Best Interest Standard if the IMO does not participate in sales of fixed annuity contracts in each year averaging at least $1.5 billion in premiums over each of the three prior fiscal years. See, 82 Federal Register at 7347.

does not offer them differential compensation, unless such compensation is based on neutral factors. Similarly, institutions or advisers that recommend fixed-income only portfolios must adhere to level compensation across all portfolios.

We note that the ability of an institution and one of its advisers to comply with the Impartial Conduct Standards in making investment recommendations to affect a rollover and transfer is conditioned upon the adviser making a thorough comparison and evaluation of the costs and investment alternatives available to the Retirement Investor prior to any such transaction. However, the information that would be needed to conduct such a comparison and evaluation is likely often unavailable or incomplete.

The foregoing examples illustrate conclusively that, under the BIC Exemption, it is practically impossible for an adviser or financial institution to offer Retirement Investors an investment option that may be best suited to the investor's needs if such product would provide the adviser or institution enhanced compensation as compared to alternative investments. Thus, such advisers are effectively forced to limit the choices made available to Retirement Investors to a finite universe of investment products that provide compensation within parameters that eliminate potential conflicts of interests for the adviser and institution.

Effects on Smaller Investors. Published reports note that the extensive web-based disclosure mandated by the BIC Exemption and the elaborate policies and procedures that financial institutions must implement to comply with the BIC Exemption will likely prove excessively burdensome for smaller institutions, particularly smaller broker-dealers who have traditionally serviced the accounts of investors with more modest-sized accounts.[29] Estimates of the true costs of these burdens conclude that the Department

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[29] Skinner, *Figuring Out Fiduciary: Now Comes the Hard Part,*" Investment News (May 9, 2016).

grossly miscalculated the impact of complying with the Final Rule.[30] These burdens are likely to result in the businesses that have serviced modest-sized accounts having to merge with larger institutions, or to abandon servicing such accounts. As a result, Retirement Investors with modest-sized accounts are likely to have access to fewer advisers, and perhaps just to robo-advisers. In a free market economy, fewer available options usually mean greater costs.

Moreover, even larger institutions that have a sufficiently large client base over which they can spread the material costs of such compliance have announced that they are restricting access to advice for smaller accounts. Some institutions will provide only fee-for-service accounts, and plan to establish minimum balances for such accounts that will leave a number of their existing clients without access to advice. Others are forced to limit materially the product choices made available to small accounts to be able to continue to provide services to such smaller accounts within the restrictive parameters of the BIC Exemption in a manner that balances the risks and exposures that fiduciary status under the Final Rule imposes with the revenues that the institution can appropriately charge for its services.

Expansion of Fee for Service Programs. Many institutions have planned to restructure large segments, if not all, of their business operations to rely on a level fee approach to provide services to Retirement Investors. This is because the "level fee" alternative releases the institution from a number of the onerous conditions applicable under the BIC Exemption to provide commission-based services, including:

> (1) the detailed web-based disclosure that relates to fees for offered services that must be regularly and continually updated;

[30] *See*, Batkins, *Fiduciary Rule Has Already Taken Its Toll: $100 Million in Costs, Fewer Options,* Insight (Feb. 22, 2017).

> (2) entering into a contract that requires the institution to adopt a series of incremental policies and undertake a series of warranties, the alleged breach of which can subject the institution to potential class action litigation; and
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> (3) additional disclosures and litigation risks associated with the offering of proprietary products or products with respect to which the institution receives third party payments, even if such payments are directly related to other services provided to such third party by such institution or its affiliates.

For more modest-sized accounts, the change to a level fee arrangement will likely increase significantly the fees payable by the Retirement Investor. One study notes that advisors earn .54 percent on commission-based accounts versus 1.18 percent on fee-based accounts.[31] Assuming that there are $7.3 trillion of assets in IRAs, that's a difference between consumers paying a total of $39.4 billion or $46 billion in fees each year, an average of $813 per IRA account holder. Moreover, Retirement Investors that already have paid a fee on their commissioned-based accounts potentially would be subject to an estimated "$1,500 in duplicative fees [if they] move the same investments into a fee-based account."[32] Thus, as to some accounts, the increase in fees required to make the continued provision of services economically viable would be so significant that such option could not be offered to such accounts in compliance with the requirements of the Final Rule and the BIC Exemption. And while the Department has allowed for a modest level of grandfathering protection, such grandfathering provision has only limited utility as the institution may generally not render any advice on grandfathered assets, leaving the Retirement Investor to find another adviser or make any on-going investment decisions without professional assistance.

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[31] Pricemetrix, Insights (August 2012), http://www.pricemetrix.com/cms/wp-content/uploads/PriceMetrix-Insights_Transitioning-To-Fee_English.pdf.

[32] Milloy, *The Consequences of the Fiduciary Rule for Consumers*, American Action Forum at 6, 11 (Apr. 10, 2017).

The Investment Company Institute found that 23 percent of the approximately 57 million individuals with IRAs had assets of less than $ 5,000, 42 percent had less than $20,000 in assets, and almost three quarters of the IRA accounts had assets of less than $100,000.[33] Such accounts likely cannot afford to pay the fees that will be required to make offering advice to them under fee for service arrangements economically viable for the institution providing such services. These accounts will be too small to make it cost effective for the institutions to provide services under the prescriptive requirements (including the Best Interest Standard) of BIC Exemption and the other Associated PTEs.

Accordingly, a direct effect of the Final Rule is that many modest-sized accounts will either lose access to services from their prior providers or be offered an extremely limited choice of investment products. This outcome differs significantly from what the Department anticipated in its original regulatory impact analysis:

> [T]he Department concludes that it is likely that some small service providers may find that the increased costs associated with ERISA fiduciary status outweigh the benefits of continuing to service the ERISA plan market or the IRA market. The Department does not believe that this outcome will be widespread or that it will result in a diminution of the amount or quality of advice available to small or other retirement savers, because other firms are likely to fill the void and provide services the ERISA plan and IRA market.[34]

Under the Presidential Memorandum, if the Department finds that the Final Rule has caused such an adverse effect on Retirement Investors, the Department is to publish for notice and comment a proposed rule rescinding or revising the Final Rule.

Costs and Effects of Litigation. As is discussed in greater detail below, these detailed disclosures and the additional conditions that the BIC Exemption mandates to

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[33] The Investment Company Institute, IRA Database (2014).

[34] 81 Federal Register at 20994.

receive relief from the prohibitions that are imposed because of the expansive definition of fiduciary investment advice in the Final Rule will present a material litigation risk to financial institutions which continue to service Retirement Investors on a commission basis. These added burdens will compel a prudent institution to expend even greater resources to assure exemplary compliance. Thus, the risks and burdens of such litigation will only further increase compliance costs, which in turn will increase the cost of advice to Retirement Investors. This increase in cost will occur despite the fact that the Final Rule and the BIC Exemption will also lead to such Retirement Investors suffering reductions in the investment products available to them.

As and when the anticipated litigation becomes a reality, it can be expected to diminish further investor access to assistance, products and services as institutions that initially opt to continue to service their Retirement Investor clients are forced by economic realities to re-evaluate the cost-benefit analysis of their initial decision to attempt to operate within the precarious parameters of the Final Rule and the BIC Exemption.

Morningstar has estimated that the long-term costs associated with class action lawsuits are between $70 and $150 million annually.[35] This number could be even higher in the near-term as institutions are first endeavoring to comply with the Best Interest Standard, which could lead to extremely costly settlements, not due to the institutions misconduct or negligence, but due to uncertainty as to the application of the Final Rule and the BIC Exemption. Such litigation is likely to have a material effect on the profits derived by institutions from providing services in the IRA marketplace, which can

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[35] Morningstar, *Cost of Fiduciary Rule Underestimated*, Feb. 9, 2017 at http://news.morningstar.com/articlenet/article.aspx?id=793268 ("Morningstar") (estimating potential liability based on historical restitution data of wealth management firms, claims on implied errors and omissions insurance policies, the Department's monetary estimates, and previous settlements in class action lawsuits).

reasonably be expected to further impair access by Retirement Investors to advice, products, and services.

Question 2: Whether the anticipated applicability of the Final Rule has resulted in dislocations or disruptions within the retirement services industry that may adversely affect investors or retirees.

> *Yes, the anticipated applicability of the Final Rule has resulted in dislocations or disruptions that may adversely affect Retirement Investors due to reductions in products, services, and advice available to them. The Regulatory Impact Analysis must be updated to account for the adverse effects we discuss below.*

Disruption Generally. As noted above, the Final Rule has already caused disruption, and is expected to cause even greater disruption, in the industry and regarding the availability of investment advice for Retirement Investors. The Final Rule "has affected 92,000 investment advisers, $190 billion in assets, and at least 2.3 million customers."[36] A number of financial institutions are changing products, service models, and advice available to Retirement Investors (although, before the Department prematurely determined that June 9 would be the Applicability Date of the Final Rule, several had suggested they were reconsidering these decisions in light of the re-examination and possible rescission or revision of the Final Rule that may follow). If the Final Rule becomes effective, other institutions will reduce the investment products that they offer to Retirement Investors, not because of the determination that such products are inappropriate for such Investors, but because they cannot be offered within the narrow constraints available under the Associated PTEs, especially the BIC Exemption.

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[36] Batkins, *Fiduciary Rule Has Already Taken Its Toll: $100 Million in Costs, Fewer Options,* Insight (Feb. 22, 2017).

Disruption for Smaller Investors. Additionally, the added costs burdens and litigation risks associated with the Final Rule will likely diminish substantially the number of advisers servicing modest-sized accounts,[37] who likely are in the greatest need of professional guidance. Thus, rather than helping such Retirement Investors, the Final Rule may leave them isolated and without needed support. As we noted above, investors with modest-sized accounts benefit from access to advice over a sustained period.[38] These investors also may face higher investment account minimums for commission-based IRAs, restrictions on investment products in commission-based IRAs, or other changes in product or service availability.

To anticipate the disruptive effect that the Final Rule will have on these small accounts, one only has to look to the experience of smaller investors in the United Kingdom, which bans commission-based accounts. A study conducted by the U.K.'s Financial Conduct Authority shortly following the implementation of the Retail Distribution Review initiative found that "the proportion of firms who ask for a minimum portfolio of more than £100,000 has more than doubled, from around 13 percent in 2013 to 32 percent in 2015" and that 45 percent of firms "rarely advise" customers on retirement income options if the investors has a modest amount of funds (i.e., less than £30,000).[39]

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[37] Investment News, *The Economics of Change: How the DOL Fiduciary Rule Will Set Money in Motion and Alter Business Models Across the Advice Industry* at 11, 13.

[38] *See,* Montmarquette and Viennot-Briot, *The Gamma Factor and the Value of Financial Advice*, CIRANO at 24 (Aug. 2016) (noting advised households over a 15-year period "have about 290% more financial assets than non-advised households"); Pollara, *Canadian Mutual Fund Investors' Perceptions of Mutual Funds and The Mutual Fund Industry* at 5 (2016) (noting that half of the households in the Montmarquette study had less than $25,000 in savings when they initially began to work with an adviser).

[39] Financial Conduct Authority, *Financial Market Report*, Final Review (March 2016), at 20. https://www.fca.org.uk/publication/corporate/famr-final-report.pdf.

Question 3. Whether the Final Rule is likely to cause an increase in litigation, and an increase in the prices that investors and retirees must pay to gain access to retirement services.

> *Yes, the Final Rule is likely to cause an increase in litigation and in the prices that Retirement Investors pay for retirement services. The Regulatory Impact Analysis must be updated to account for the adverse effects we discuss below.*

Increased Costs Generally. As outlined above, the Final Rule imposes fiduciary status on those financial institutions that wish to continue to provide services on a commission or transaction-based compensation system. The Final Rule and the BIC Exemption create an elaborate set of added conditions—including extensive disclosure, warranties and other undertakings—that dramatically increase the compliance costs for such institutions. For many accounts, institutions forced to contend with the Final Rule will default to a fee for service arrangement that will offer reduced investment options to avoid perceived conflicts. This approach may lead to increased out-of-pocket expenditures for many Retirement Investors, particularly those which generally follow a buy-and-hold method of investing.

Part of these added costs will derive from the Department's decision to subject IRA service providers to the full myriad of ERISA's fiduciary responsibility provisions. Although Congress purposefully chose not to impose such duties on such advisers, the Department incorporated ERISA's fiduciary responsibility provisions into the BIC Exemption. Since IRA participants have complete discretion over the choice of the persons advising their accounts, Congress selected a path whereby IRA participants could invest their assets largely on the same terms and conditions as would apply to their personal assets.

However, through the promulgation of the BIC Exemption and the conditions that will apply when such exemption is fully applicable, the Department has created an

incremental and potentially disruptive system of protections that will add substantially to the investors' costs. Moreover, the burden of the added litigation costs that will be an inevitable result of the Final Rule have yet to be realized and factored into the equation. Once these costs materialize, the added out-of-pocket expenditures for Retirement Investors due to the Final Rule will materially increase.

With $31.5 billion in total costs and $2 billion in annual burdens, the Final Rule was the most expensive regulation in 2016.[40] One report indicates that the Department's cost of compliance estimates was grossly underestimated. Compliance costs are reported to already exceed the Department's estimates.[41]

Some of these costs will prove to be primarily one-time costs related to converting from the generally accepted business model that had been in effect for many years to a new paradigm that comports with the vast changes required by the Final Rule and the provisions of the BIC Exemption. However, the BIC Exemption's burdensome requirements[42] will be on-going and carry significant costs that will of necessity be passed on to Retirement Investors. When the incremental litigation expenses are layered into the system, reaching perhaps as high as $150 million annually or more during the initial period following implementation of the Final Rule and the Associated PTEs,[43] the cost of advice—to the extent that it remains available, particularly to the vast majority of IRAs that do not have assets in excess of $100,000—can only be expected to increase substantially.

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[40] Batkins, *Fiduciary Rule Has Already Taken Its Toll: $100 Million in Costs, Fewer Options,* Insight (Feb. 22, 2017).

[41] *Id*.

[42] These requirements include web-based and other on-going disclosures, and monitoring compliance with policies and procedures.

[43] *See*, Morningstar, *Cost of Fiduciary Rule Underestimated* (Feb. 9, 2017).

Proliferation of Litigation. While the Department contends that the BIC Exemption is volitional, the BIC Exemption provides the only means for a financial institution and its advisers who become investment-advice fiduciaries under the Final Rule's expansive definition to

> (1) continue to receive commissions in connection with advice provided to retirement investors,
>
> (2) offer proprietary products created by the financial institutions to service the investment needs of their clients, or
>
> (3) receive fees from third parties in connection with the investment products offered to retirement investors, even if the fees received relate to other services afforded by the financial institutions to such third parties.

Practically, the Final Rule closed the door on methods of investing that have long been an accepted means of providing services to investors. The Associated PTEs (including the BIC Exemption) open a single path to continue such practices with terms and conditions that are fraught with numerous avenues to encourage litigants to challenge the conduct of financial institutions regarding the investment advice they provide.

The provision of such advice is not an exact science, but based on many variables and the exercise of informed judgments that can readily generate a divergence of opinions as to what is the best course of action on a going-forward basis. And yet, in the context of providing professional advice regarding investments where there is no certainty as to success of any investment, the Department compels those that seek to continue their previously accepted business practices to bear the burden that the judgment of all of those involved was not influenced by the very compensation and incentives that the Department purports to allow through the BIC Exemption and the other Associated PTEs. Increased and protracted litigation will arise. One only has to look to the suits

brought against Vanguard to see that, given the opportunity to assert claims founded on the perception of self-interest, plaintiffs' lawyers will hurry to the court house steps.[44]

Endorsement of the Threat of Litigation. Moreover, an expected increase in litigation was not only identified in the comments on the proposed rule, the prospect of litigation was actively encouraged by the Department. For example, commenters raised significant objections to the contract requirement included under the BIC Exemption with all its added disclosures, warranties and documentary requirements.

> Commenters pointed to certain conditions of the exemption that they found ambiguous or subjective and indicated that these conditions could form the basis of class action lawsuits by disappointed investors. *Some commenters said the contract requirement and associated litigation exposure would cause investment advice providers to stop serving Retirement Investors or provide only fee-based accounts that do not vary on the basis of the advice provided, resulting in the loss of services to Retirement Investors with smaller account balances.* These commenters stated that investment advice fiduciaries would not risk the anticipated legal liability for Retirement Investors, particularly with respect to small accounts (emphasis added).[45]

Nevertheless, the Department opted to retain the contract requirement, asserting that it provided an "administrable means of ensuring fiduciary conduct" and created a "powerful incentive to comply with the exemption's standards, thereby assuring compliance" that would align the interests of the financial institutions, advisers and retirement investors.[46] The Department made this determination despite the fact that Congress had chosen to rely entirely on the imposition of an excise tax under the Code to enforce a violation of the prohibited transactions in the context of IRAs or other plans not

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[44] *See*, Wille, *Chevron Hit With Lawsuit Over 401(k) Plan Fees*, Pension & Benefits Daily (Feb. 19, 2016); Iacurci, *New 401(k) suit targets Vanguard fund fees*, Investment News (Jan. 5, 2016).

[45] 81 Federal Register 21002, at 21021 (April 8, 2016).

[46] *Id*. at 21022.

subject to the provisions of ERISA. The Department concluded that the approved method of enforcement Congress provided was inadequate:

> Without a contract, the possible imposition of an excise tax provides an additional, but inadequate, incentive to ensure compliance with the exemption's standards-based approach. This is particularly true because imposition of the excise tax critically depends on fiduciaries' self-reporting of violations, rather than independent investigations and litigation by the IRS. In contrast, contract enforcement does not rely on conflicted fiduciaries' assessment of their own adherence to fiduciary norms or require the creation and expansion of a government enforcement apparatus. The contract provides an administrable way of ensuring adherence to fiduciary standards, broadly applicable to an enormous range of investments and advice relationships.
>
> The enforceability of the exemption's provisions enables the Department to grant exemptive relief based upon broad protective standards, applicable to a wide range of investments and compensation structures, rather than rely exclusively upon highly prescriptive conditions applicable only to tightly-specified investments and compensation structures. In the context of this exemption, *the risk of litigation and enforcement serves many of the same functions that it has for hundreds of years under the law of trust and agency. It gives fiduciaries a powerful incentive to adhere to broad, flexible, and protective standards applicable to an enormous range of transactions by imposing liability and providing a remedy when fiduciaries fail to comply with those standards.*[47]

Yet, as the commenters had warned, the litigation risk has forced some firms to limit product choice, service model choice, and access to advice as we describe in this letter.

Invitation to Litigation. Indeed, many of the conditions in the BIC Exemption invite or facilitate a class action litigant's challenge to the conduct of a financial institution or its advisers. In the adopting materials, the Department notes that the conditions of the BIC Exemption are no different from the enforcement provisions related

47 *Id.*

to traditional matters of jurisprudence involving fiduciary conflict, both under ERISA and at the common law. But the BIC Exemption creates a series of documentary requirements that would appear to benefit greatly the ability of a plaintiff's lawyer to mount challenges against financial institutions for failing to comply with the conditions of the BIC Exemption, as built into the contract with the Retirement Investor. Institutions that use proprietary products or receive third party payments are compelled to conduct a review of the potential conflicts of interests related to such products:

> The Financial Institution documents in writing its limitations on the universe of recommended investments; documents in writing the Material Conflicts of Interest associated with any contract, agreement, or arrangement providing for its receipt of Third Party Payments or associated with the sale or promotion of Proprietary Products; documents in writing any services it will provide to Retirement Investors in exchange for Third Party Payments, as well as any services or consideration it will furnish to any other party, including the payor, in exchange for the Third Party Payments; reasonably concludes that the limitations on the universe of recommended investments and Material Conflicts of Interest will not cause the Financial Institution or its Advisers to receive compensation in excess of reasonable compensation for Retirement Investors as set forth in Section II(c)(2); reasonably determines, after consideration of the policies and procedures established pursuant to Section II(d), that these limitations and Material Conflicts of Interest will not cause the Financial Institution or its Advisers to recommend imprudent investments; and documents in writing the bases for its conclusions.[48]

Unless the institution can identify in advance and document every possible conflict, or fails to provide adequate rationales for why these conflicts do not interfere with the institution's advice to the Retirement Investor, the omission of any such conflict will afford a plaintiff's firm the ability to present a *prima facie* claim that the institution failed to act in the Retirement Investor's best interests. This *prima facie* claim may be

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[48] 81 Federal Register at 21081.

sufficient to withstand challenges at the early phases of litigation and cause a compliant institution nevertheless to incur sizable costs responding to discovery or otherwise preparing for trial. Moreover, no matter how thorough and carefully considered, this document will provide a plaintiff's counsel an invaluable advantage in crafting claims against even the most well-intended and properly-motivated institution.

Through the BIC Exemption, the Department has created a system where ordinary business judgments made each day by well-intended, but not legally trained investment professionals, need to be documented in a manner that will make such documents the primary exhibits presented by a plaintiff's lawyer in a class action that is likely to allege multi-million dollar claims. This will potentially lead to institutions having lawyers experienced in dealing with class action litigation review and approve the records, and indirectly the decisions, made by these investment professionals. Such reviews will significantly increase the costs associated with the advice that is given, will limit the investment choices that are allowed, and ultimately diminish the efficacy of the services that can be afforded to assist Retirement Investors in enhancing the value of their retirement savings.

Similarly, the Department mandates the information that a person deemed to be a fiduciary about advice regarding rollovers must consider in evaluating its recommendation, and again requires that the conclusion supporting such recommendation be fully documented. Such documentation will be available for a person seeking to challenge the exercise of such fiduciary judgment, if the investor decides that he or she is unhappy with the ultimate results. These factors are likely to be very personal to the investor, and may be principally motivated by non-economic factors, such as desiring not to have to deal with representatives of a former employer, having immediate and direct control over the person's retirement assets, or the investors' desire to continue a relationship with a trusted and effective adviser who has changed his or her business affiliation. Such personal and wholly appropriate motivations may be difficult to

document, and may on paper appear less substantial and important than they were at the time of the original decision in the context of subsequent litigation.[49]

Introduction of Conflicts of Interest in Enforcement. And, if one were to assume that the Department's analysis was that the mere threat of litigation, and not actual litigation, were adequate to promote its objectives, there was a fatal flaw in its analysis. To police a rule that the Department has promoted for the avowed purpose of curbing the effect of self-interest and personal economic motivation, the Department assigned the enforcement of the Final Rule to persons who have a significant and material economic interest in pursuing a claim that the Impartial Conduct Standards were breached. Advisers and institutions that choose to rely on the BIC Exemption or one of the other Associated PTEs by definition are confronted with some degree of a conflict of interests in rendering their advice. Were this not the case, no exemption would be required.

The BIC Exemption's enforcement scheme generally will not afford advisers and institutions a review of their actions and judgments by an impartial government employee who has no pecuniary interest in the conclusions that he or she may reach in evaluating the investment advice given and its compliance with the amorphous and subjective standards set forth in the Impartial Conduct Standards. Instead, the BIC Exemption will facilitate enforcement by individuals who have a pecuniary interest in finding that the institutions failed to comply with these amorphous and subjective standards. The sole reason for having the BIC Exemption is that the Final Rule deems the institution and its advisers to be fiduciaries in circumstances where the existence of a potential conflict of interest is always going to be present. Therefore, an experienced litigator will always have some basis on which to attempt to challenge, in hindsight, the judgment of the

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[49] *See also*, Michaels, *SEC's Piwowar: Obama-Era Retirement-Savings Rule Boon for Trial Lawyers*, Wall St. J. (Mar. 2, 2017) ("saying the rule was written to 'increase profits' for trial lawyers").

adviser, about decisions that require the exercise of judgment about matters that are subject to future events.

Thus, the Final Rule's enforcement mechanism will cause financial institutions to incur significant expense even if they are ultimately exonerated from any wrong doing. Such a system could potentially lead to good compliance and enforcement, as the Department posited would occur. But such an enforcement mechanism is more likely to lead to opportunistic actions that drive good advisers and qualified institutions from the marketplace, to increased costs for investors, and to benefits primarily to those who assert the claims and not necessarily provide relief for those who may have been adversely affected by improper motivation.

If the ERISA standard were truly to apply, IRA advice providers would at least have comfort that they would be under federal jurisdiction like other ERISA plan fiduciaries. ERISA has very well-established pre-emption. Instead, the Department overreaches and creates new remedies that have never been authorized by Congress, and in fact, are contrary to the standards that are applicable to the securities and insurance industries.

Thus, were the Department to evaluate the risk that the Final Rule will lead to a proliferation of litigation and increased costs for Retirement Investors, taking into account the developments in the marketplace that have followed the promulgation of the Final Rule and the litigation that will occur, it would undoubtedly answer this question from the Presidential Memorandum affirmatively. And as noted above, if any of the questions raised by the Presidential Memorandum are answered in the affirmative the Department has been directed by the President to propose the rescission or the revision of the Final Rule.

Since the developments in the marketplace, and the studies that have been conducted regarding the litigation that will occur, require the Department to reach the undeniable conclusion that the Final Rule will result in increased costs for Retirement

Investors and protracted litigation surrounding the Final Rule and the BIC Exemption, the Department should have followed the direction in the Presidential Memorandum and proposed the rescission or revision of the Final Rule, rather than fixing the date on which the Final Rule will be applicable without paying heed to the issues raised by this question.

CONCLUSION

Each of the items discussed above lead to an affirmative answer to each question set forth in the Presidential Memorandum. The marketplace developments since the adoption of the Final Rule and the Associated PTEs (especially the BIC Exemption) have created a new factual record that the Department needs to address in a new Regulatory Impact Analysis.

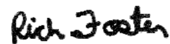
It makes no sense to implement a rule that could, and in keeping with the Presidential Memorandum should, be rescinded or revised in a few months' time. Re-evaluating the Final Rule now can at least avert the potentially sizable costs and disruption to investor access and the additional adverse effects that will almost assuredly follow protracted litigation for well-meaning institutions that, despite their best efforts, may not have been completely successful in navigating the complex and narrow path that the Final Rule and the Associated PTEs have carved out for those institutions that try to advance the best interests of their clients.

* * * *

For the reasons noted in our letter, we believe a thorough reexamination of the Final Rule and the Department's updated Regulatory Impact Analysis should and will lead to the rescission or material revision of this overly burdensome and disruptive regulation. We also urge the Department to postpone the June 9, 2017 applicability date of the Final Rule until its consequences and effects can be, and are, thoroughly and fully examined in accordance with the Presidential Memorandum.

FSR welcomes the opportunity to work with the Department on how to address the concerns raised by the Final Rule and Associated PTEs going-forward. If it would be helpful to discuss FSR's specific comments or general views on this issue, please contact Richard Foster at Richard.Foster@FSRoundtable.org; or Felicia Smith at Felicia.Smith@FSRoundtable.org.

Sincerely yours,



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