Consumer Federation of America

April 17, 2017

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

Re: RIN 1210-AB79, Fiduciary Rule Examination

Ladies and Gentlemen:

We are writing on behalf of the Consumer Federation of America (CFA)[1] in response to the Department of Labor's request for comment regarding its reconsideration of the conflict of interest (or "fiduciary) rule. This unjustified exercise has unnecessarily disrupted the remarkable progress financial firms have made to comply with the rule just weeks before implementation was set to begin. At best, the new legal and economic assessment will simply reinforce what we already know: that conflicts of interest are pervasive; that they exert a harmful influence on the recommendations financial advisers make to their retirement advice clients; that the retirement savings of workers and retirees are seriously eroded as a result; and that the Department acted well within its legal authority to craft a strong and workable rule to address those harms. If the Department conducts a fair review, it will inevitably conclude that the rule is working even more quickly and more dramatically than anyone could have reasonably expected to rein in the toxic conflicts that have for too long been allowed to bias retirement investment advice. Meanwhile, retirement investors will have suffered billions of dollars in harm because of this needless delay.

Indeed, the evidence from the retirement plan market suggests that, if the Department erred, it did so by casting too narrow a net. If the Administration is serious about improving the ability of Americans to save for retirement, it should be looking, not to roll back this essential reform, but to expand the rule's fiduciary protections to a broader swath of the retirement plan market. As we discuss further below, that one step would ensure that tens of billions of dollars each year remain in the nest eggs of working Americans and retirees instead of being syphoned off to line the pockets of well-heeled financial firms.

[1] The Consumer Federation of America is a non-profit association of nearly 300 consumer groups that was established in 1968 to advance the consumer interest through research, advocacy, and education.

Unfortunately, little about this process leads us to conclude that the Department will conduct the fair and even-handed review that would support implementation of the rule without further delay. The decision to reconsider the rule was based exclusively on input from the powerful special interest groups opposed to the rule, without any consultation with senior, worker, and consumer advocates supportive of the rule. Administration spokespeople have routinely parroted rule opponents' criticisms of the rule before any reevaluation has been conducted. The decision to delay the rule was made even though the Department's own analysis showed that the harm to retirement investors from even a relatively short delay would far outweigh any benefits to industry. And the comment process on the reconsideration itself is being conducted in haste, without adequate time for interested parties to participate fully and thoughtfully. The one positive development we can point to is the commitment in the delay rule to move forward with core provisions of the fiduciary rule in June, without additional delay, pending the Department's reconsideration.

Despite that development, and although we still hope to be proven wrong, the weight of the evidence leads us to conclude that the Department has already predetermined the outcome of this reconsideration and expects to revise or repeal the rule, regardless of what the reconsideration indicates about the effectiveness and workability of the rule. If true, that would be a gross abuse of process and would subject the Department to claims that it had acted in an arbitrary and capricious manner. It would also be a great disservice to American workers and retirees, who have already had to wait far too long for the simple assurance that the financial professionals they rely on for retirement investment advice will act in their best interests and not simply recommend what is most profitable for the adviser and the firm.

Table of Contents

I. The Premise behind the Reconsideration is Fundamentally Flawed

The Presidential Memorandum directing the Department to reconsider the fiduciary rule relies on pure industry propaganda: that a rule requiring financial professionals to act in their customers' best interests when providing retirement investment advice is somehow inconsistent with Administration priorities to empower Americans to make their own financial decisions and to facilitate their ability to save for retirement and build wealth.[2] Based on this faulty premise, the Department is directed to conduct a new legal and economic analysis in order to determine whether the fiduciary rule "may adversely affect the ability of Americans to gain access to retirement information and financial advice." The Department has, in turn, posed a number of complex questions designed to measure the rule's impact. But making that determination with any certainty before the rule has been implemented is an impossible task. Worse, it is a task that encourages the kind of baseless speculation and distortions from the powerful special interest groups opposed to this rule that have already informed the Administration's approach to the issue. Comment letters on the delay proposal from rule opponents were full of just such distortions, along with cherry-picked or misrepresented findings from studies and warmed over economic arguments that have already been debunked by both the Department itself and by independent experts.

It is important to acknowledge at the outset of this exercise that the fiduciary rule is the result of one of the most open and inclusive rulemaking processes ever conducted. The Department received thousands of comment letters, heard days of public testimony, and held hundreds of individual meetings with industry rule opponents as well as supporters. Throughout that multi-year process, the Department carefully weighed the input it received in order to ensure that the final rule was not excessively burdensome for financial firms while providing strong protections to retirement savers. The Department sought and received input not only on the rule itself, but also on the economic analysis that led the Department to conclude that rulemaking was needed and that its proposed approach was both feasible and appropriate. That economic assessment is incorporated in a 395-page Regulatory Impact Analysis (RIA), which was issued for public comment along with the proposed rule before the rule was finalized.[3] And the preamble to the final rule and accompanying prohibited transaction exemptions (PTEs) includes a detailed explanation of the comments the Department received, how it evaluated those comments, how it changed the rule to reflect that input and why it rejected other proposed changes. The Administration has pointed to no shortcoming in either that process or that analysis to justify the reconsideration.[4]

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[2] Memorandum for the Secretary of Labor, Fiduciary Duty Rule, February 3, 2017, 82 Fed. Reg. 9675, http://bit.ly/2okrJM2.

[3] Department of Labor, "Regulating Advice Markets, Definition of the Term "Fiduciary," Conflicts of Interest, Retirement Investment Advice," Regulatory Impact Analysis for Final Rule and Exemptions, April 2016, http://bit.ly/2mT9Gfq. ("RIA")

[4] One commenter (*See* Letter from Kent A. Mason, Davis & Harmon, on behalf of a group of unnamed clients, to the Department of Labor, March 16, 2017, http://bit.ly/2nLi44l.) has suggested that the rulemaking process was a rush job that didn't begin in earnest until the reproposal was issued in 2015. This patently absurd allegation is based on the claim that industry didn't have an opportunity until the rule was re-proposed to meaningfully engage with the Department. But this is a clear distortion of the record. The fact that industry chose to stonewall the Department after the initial rule proposal was withdrawn in 2011 -- presumably out of confidence that they could kill the rule in Congress if necessary -- doesn't mean they didn't have the opportunity to engage constructively with the Department had they chosen to do so. DOL publicly and repeatedly requested additional input, including

The new request for comment simply re-plows old ground. Every question posed in this new request has already been exhaustively analyzed by the Department, based on the best available information, before the rule was finalized. So far, at least, industry rule opponents have failed to provide concrete information on which to update the Department's evaluation. Instead, with few exceptions, their letters in support of the delay largely rely on outdated and discredited studies and analysis,[5] vague statements about actions "some firms" may be taking rather than concrete evidence about steps they or their member firms have taken in response to the rule, and cherry-picked evidence from the public record that ignores positive developments in the retirement investment advice market. The simple fact is that it is premature to reopen the rulemaking process now, while financial firms are in the midst of preparing for implementation. At this stage, we do not yet have sufficient concrete new information on which to assess how the rule will change the retirement advice market, and rule opponents seem reluctant to offer *verifiable* information to support their claims. Moreover, the evidence we have seen, while preliminary, suggests that the rule is both workable and working as intended to reduce the harmful impact of conflicts while preserving affordable access to retirement investment advice, as discussed further below.

A. Questions regarding the Department's legal authority have already been laid to rest.

The Department invites comments with regard to its legal analysis. Rule opponents have sought to use this reconsideration to re-litigate issues about the Department's authority to act, the regulatory approach it adopted, and the process it undertook to develop the rule.[6] Contrary to these arguments, as well as Administration statements justifying the reconsideration, three separate federal courts have reaffirmed: that the Department had clear legal authority to adopt the rule, that it had followed an appropriate procedure, and that its regulatory approach met the test of being administratively feasible, in the interest of plan participants and IRA investors, and protective of their rights. In the most comprehensive of the rulings, for example, Chief Judge Barbara M.G. Lynn of the Northern District of Texas refuted plaintiffs' arguments point by point:[7]

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data industry groups refused to provide, and maintained an open door policy toward anyone with a constructive message regarding how to improve the rule. Moreover, two of the key developments during that time -- preparation of an economic analysis and drafting of prohibited transaction exemptions to accompany the definition change -- were in direct response to concerns raised by industry during the earlier comment process. Had they chosen to provide input on how best to craft those exemptions, they clearly could have done so.

[5] *See*, for example, the comment letter from the Investment Company Institute which simply restates its criticisms of the RIA, which have already been completely debunked by Advanced Analytical Consulting Group (AACG) in its March 2016 *Review of Selected Studies and Comments in Response to the Department of Labor's Conflict of Interest 2015 Proposed Rule and Exemptions*, http://bit.ly/2ofTF4N. Similarly, both the Financial Services Roundtable and the Insured Retirement Institute reference the study from NERA Economic Consulting, which was thoroughly discredited by AACG. In addition, CFA debunked several of the industry opponents' arguments in our September 2015 comments. We hereby incorporate by reference, as if fully set forth herein, those comments. Letter from Barbara Roper and Micah Hauptman, Consumer Federation of America, to the Department of Labor, September 24, 2015, http://bit.ly/2nK64ge.

[6] *See*, for example, letters from the National Association of Fixed Annuities, the American Council of Life Insurers, and the Insured Retirement Institute.

[7] Chamber of Commerce of the United States, et al., v. Hugler, No. 3:16-cv-1476-M (N.D. Tex. Feb. 8, 2017).

- In response to plaintiffs' argument that DOL had adopted a definition of fiduciary investment advice that was inconsistent with the statute, Judge Lynn ruled that "the plain language of ERISA does not foreclose the DOL's interpretation."[8] The ruling goes on to explain, "Plaintiffs argue the Fiduciary Rule exceeds the coverage of ERISA because it imposes fiduciary status on those who earn a commission merely for selling a product, regardless of whether advice is given. Actually, the Fiduciary Rule plainly does not make one a fiduciary for selling a product without a recommendation. Because Plaintiffs' contention is directly contradicted by the plain language of the Fiduciary Rule, the Court rejects it."[9]
- The decision is similarly blunt in rejecting plaintiffs' argument that DOL had exceeded its authority in conditioning its exemptive relief for advice to IRA investors on the adviser's compliance with a fiduciary standard. "Nothing in ERISA or the Code unambiguously prevents the DOL from conditioning exemptive relief under Title II on the fiduciary's adherence to the duties of loyalty and prudence. … Congressional silence does not overcome the DOL's express statutory authority to grant exemptive relief….Title II does not contain such a limitation. No rule of statutory interpretation supports the conclusion that Congress clearly intended to bar the DOL from imposing a Title I duty as a condition for granting exemptive relief under Title II."[10]
- The court also rejected plaintiffs' argument that the best interest contract exemption (BICE) is unworkable and imposes unreasonable conditions on those who are paid through commissions, stating: "The Court also finds that the conditions to qualify for BICE are reasonable. … Although the industry will likely respond in different ways to BICE, BICE does not appear to be a 'Hobson's choice,' and the exemption's conditions have been deemed workable by many in the industry."[11]
- With regard to plaintiffs' objections to the rule's liability provisions, the court ruled that the exemptions did not "create" a private right of action. Moreover, the court found that, "The DOL weighed the pros and cons of the class action provision, and reasonably found it was in the best interest of retirement investors, helped prevent systemic fiduciary misconduct, and provided an incentive for the industry to comply with BICE. For these reasons, the Court finds that the conditions to qualify for BICE and the consequences Plaintiffs cite are reasonable."[12]
- The court found that neither the rule nor the rulemaking process violated the Administrative Procedure Act. "The DOL considered the relevant factors for BICE's workability, addressed commenter concerns, and reasonably justified its conclusions, thereby satisfying the APA's requirements."[13]
- The court also found that the Department's cost benefit analysis was reasonable. "The DOL collected and studied a wide range of evidence to assess harm to IRA investors, including public comments, academic research, government and industry statistics, public comments, and consultations with various agencies and industry organizations. The DOL relied on a compilation of nine studies to generate a quantitative estimate of the cost of conflicted advice in the mutual fund segment of the IRA market. It also

[8] *Id*. at 16.
[9] *Id*. at 19-20.
[10] *Id*. at 27-29.
[11] *Id*. at 35.
[12] *Id*. at 36.
[13] *Id*. at 60.

relied on the Christofferson, Evans, and Musto ("CEM") study to quantify an estimate for investor gains if they received non-conflicted advice. This was appropriate, because the DOL found the CEM study provided the most accurate quantitative data for this purpose.

The studies upon which the DOL relied were also largely consistent with the other evidence it considered, including NPRM comments and statements made at the public hearing. Considering the studies and substantial empirical and quantitative evidence, the Court concludes the DOL could reasonably extrapolate its qualitative conclusions from mutual funds to annuities.

The DOL's assessment of mutual fund performance was reasonable. It did not, as COC [Chamber of Commerce] argues, select an unrepresentative time frame. It conducted its own review of mutual fund performance analysis at points from 1980 through 2015, considered a study referenced by a commenter which used data from 2008 to 2014, and updated the record to include another study which used data from 2003 through 2012. DOL acted reasonably when it 'consider[ed] evidence from multiple studies, which, in aggregate, span a long time horizon.'"[14]

- The court ruled that the Department gave adequate consideration to both the costs of litigation and the costs to retirement investors of lost access to retirement investment advice. In doing so, the court noted the industry's failure to provide requested data regarding litigation costs. "The DOL did not specifically quantify potential class action litigation costs, but it is not required to do so. It considered the relevant issues and satisfied the APA's requirements. The DOL requested the industry provide supplemental litigation cost data, but again, the industry did not do so because "of the extreme uncertainties surrounding litigation risk."[15]
- Having considered both the liability costs and the risks that investors could lose access to retirement investment advice, "DOL reasonably found the benefits outweighed the costs."[16]

In the legal challenge filed by the National Association for Fixed Annuities (NAFA), the D.C. District Court rendered a similarly sweeping decision rejecting NAFA's claims.[17] Among other things:

- The judge found that the revised definition of investment advice adopted by the Department is not only consistent with the statute, but is more consistent with the statute than the 5-part test it replaced: "Indeed, if anything, it is the five-part test—and not the current rule—that is difficult to reconcile with the statutory text. Nothing in the phrase 'renders investment advice' suggests that the statute applies only to advice provided 'on a regular basis.'"[18]
- The court also emphatically rejected both NAFA's argument that the Department had overstepped its authority by imposing a fiduciary duty as a condition of the prohibited transaction exemption and that it had overstepped by "creating" a private right of action.

[14] *Id*. at 61-62.
[15] *Id*. at 63.
[16] *Id*. at 64.
[17] Nat'l Ass'n for Fixed Annuities v. Perez, No. 16-1035 (D. D.C. Nov. 4, 2016).
[18] *Id*. at 32.

On the first point, the decision states, "Importantly, there is … a clear nexus between the risk that commission-based compensation will skew investment advice and the condition that advisers paid on a commission basis must provide advice that satisfies the duties of loyalty and prudence."[19] On the second point, it states, "The Department did not create a 'cause of action' or a 'private litigation right.' Rather, any action brought to enforce the terms of the written contract would be brought under state law, and, as both parties acknowledged at oral argument, state law would ultimately control the enforceability of any of the required contractual terms."[20]

- In assessing NAFA's claim that the requirement to charge only reasonable fees was impermissibly vague, the court again demurred: "This guidance is, admittedly, imprecise. But that is as much a product of the endeavor as the standard; assessing whether a fiduciary is charging more than the relevant services demand is an inherently imprecise undertaking. A more precise standard would, in all likelihood, either preclude legitimate payments or invite evasion. 'A regulation,' however, 'is not impermissibly vague because it is 'marked by flexibility and reasonable breadth, rather than meticulous specificity.' U.S. Telecom Ass'n, 825 F.3d at 737 (citation omitted).'"[21]
- The court also upheld the rule on procedural grounds. "As an initial matter, the administrative record provides a detailed explanation for the Department's conclusion that fixed indexed annuities should be subject to the more rigorous conditions contained in the BIC Exemption."[22]

Having seen its legal analysis upheld in three separate courts, the Department cannot reasonably reopen issues that have already been laid to rest. The only reason to reopen the process at this point is to relitigate questions that were thoroughly reviewed both prior to the rule's adoption by the Department and since then in court. Worse, there is strong reason to believe that the real motivation is to grant concessions to powerful special interest groups – either an outright repeal of the rule or a fatal weakening of provisions that the Department previously determined were essential to its effectiveness – concessions that they failed to win in court, in Congress, or from the previous Administration.

B. The Administration appears to have prejudged the outcome of the reconsideration.

Comments from Administration spokespeople support the view that they are ignoring the extensive evidence already compiled by the Department, ignoring the findings of the courts, and embracing without question industry rule opponents' baseless criticisms and discredited studies. Even before President Trump took office, transition team member Anthony Scaramucci had pledged to "repeal" the fiduciary rule, which he famously compared to the Supreme Court's 1857 Dred Scott ruling, on the grounds that the rule "discriminates" against broker-dealers.[23] At a press briefing to announce the signing of the Presidential Memorandum, White House spokesman Sean Spicer called the rule "a solution in search of a problem" and parroted industry's favorite talking point, that "its effect has been to limit the financial services that are

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[19] *Id*. at 53.
[20] *Id*. at 55-56.
[21] *Id*. at 66.
[22] *Id*. at 77.
[23] Mark Schoeff Jr., *Trump adviser Anthony Scaramucci promises to 'repeal' DOL fiduciary rule*, INVESTMENT NEWS, Oct. 18, 2016, http://bit.ly/2el36ec.

available to" retirement savers.[24] With this statement, Spicer not only categorically dismissed overwhelming evidence regarding the pervasiveness of conflicts of interest in the retirement advice market and the extent of their harmful impact, he also prejudged the very question the reconsideration is supposed to explore. Spicer also restated as if it were fact industry's contention that the Department had overstepped its authority in promulgating the rule, an argument that, as previously noted, has been soundly debunked in four court decisions.

Other Administration officials voiced similar views. In discussing the Presidential Memorandum, for example, National Economic Council Director Gary Cohn used a tortured analogy suggesting that the rule was harming retirement investors by depriving them of access to "unhealthy" retirement investments.[25] An unnamed senior White House official demonstrated either a serious misunderstanding of the rule, or a willingness to bend the facts, when he or she told *Time Magazine* that the rule had "taken away a huge variety of investment options for individual investors."[26] "We actually think we're giving consumers back what they want," this individual reportedly stated, "which is the ability to invest in a variety of asset classes," adding, "I don't think you protect investors by limiting choices."[27] In fact, however, the rule does not limit either the types of investments that financial professionals can recommend or the types of investments that individuals can choose to invest in.[28] The memorandum was signed in a ceremony that featured strong opponents of the rule. All these factors strongly suggest that the reconsideration is a mere formality and that the outcome – a decision to engage in new rulemaking to rescind or revise the rule – has already been determined.

If news reports are accurate, industry rule opponents were directly involved in the drafting of the Presidential Memorandum on which the reconsideration proposal is based. A lobbyist for the Financial Services Roundtable acknowledged, for example, having taken part in reviewing and making recommendations on the memorandum.[29] This is an opportunity that, to our knowledge, was not afforded to any rule supporters. It also explains why the statements by Administration officials sound like they were drafted by industry lobbyists.

Statements suggesting that the reconsideration is a mere formality have been matched by a willingness to flout procedural requirements in order to rush through the reconsideration. As we discussed in our previous comment letter opposing the delay proposal, that action to delay implementation has been taken in violation of the Congressional Review Act, the Administrative Procedure Act, and several Executive Orders. Now, a scant 45 days has been

[24] The White House, Office of the Press Secretary, Press Briefing by Press Secretary Sean Spicer, Feb. 3, 2017, http://bit.ly/2lbwoyS.
[25] Lisa Beilfuss and Michael Wursthorn, *Trump Moves to Kill Off Obama's Landmark Retirement Rule*, THE WALL STREET JOURNAL, Feb. 3, 2017 http://on.wsj.com/2jFvgqZ.
[26] Zeke J Miller and Haley Sweetland Edwards, *White House Stalls Obama Administration Rule on Retirement Advisers*, TIME, Feb. 2, 2017 http://ti.me/2l2sWr5.
[27] *Id*.
[28] While the initial 2015 rule proposal sought to limit the types of investment financial professionals could recommend when receiving conflicted compensation, the final rule includes no such limits. And no version of the rule limited either what investors themselves could choose to invest in or what financial professionals could recommend when not receiving conflicted compensation.
[29] Charles Lane, *Trump Thwarts Action On Dodd-Frank Investor Protection*, WSHU PUBLIC RADIO, Feb. 5, 2017, http://bit.ly/2kLoCyK.

provided in which to answer a host of complex questions about the likely impact of the rule. That is simply not sufficient time for stakeholders to respond fully and thoughtfully. It is, for example, far shorter than the 75-day comment period that was originally provided on the 2015 rule proposal, which set off howls of protest among industry rule opponents that more time was needed.[30] In response, the Department extended the comment period to 90 days and then reopened it to provide for public hearings.

Neither the fact that the Department receives a high volume of comments, nor the fact that our own comment is a lengthy one, can be taken as proof that an adequate opportunity to weigh in was provided. On the contrary, while we've done the best we can in the available time, we have not been able to cover all the points or offer all the evidence we'd like or to discuss these issues with the care and attention to detail that a matter of this gravity deserves. Doubtless others have suffered similar time constraints that prevented them from commenting or from doing so at the level of detail they would have done under a more reasonable time frame. Moreover, some of the questions asked are so hypothetical as to be unanswerable except by sheer speculation. As just one example, the Department asks whether any gains to investors from reducing conflicts might "be offset by a reduction in consumer investment, if consumers have reduced access to retirement savings advice as a result of the final rule." There is no way the Department can fairly evaluate that question without knowing how the availability of advice has, or has not, been affected by the rule. By asking the question, the Department invites a specious argument from rule opponents undercutting the value of the rule in reducing investor harm.

The Presidential Memorandum also sets an entirely inappropriate standard for determining that new rulemaking to repeal or revise the rule must be undertaken. It requires the Department to examine: whether the rule is likely to reduce Americans' access to certain retirement savings offerings, retirement product structures, retirement savings information, or related financial advice; whether it has resulted in dislocations or disruptions within the retirement services industry that may adversely affect investors or retirees; and whether it 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. If the Department makes an "affirmative determination" with regard to *any* of these considerations, or if it concludes *"for any other reason"* that the rule is inconsistent with Administration priorities, it is directed to engage in rulemaking to repeal or revise the rule. In other words, even if the record provides overwhelming evidence that the rule is benefiting retirement investors, the Department could still conclude that rulemaking is warranted based on one of these factors (though doing so would expose it to legal challenge on the grounds it had acted in an arbitrary and capricious manner).

At his confirmation hearing, Labor Secretary nominee Alexander Acosta affirmed that he expects to take just such a rigid approach to implementing the memorandum. He stated that "the executive action directs the secretary of Labor and Department of Labor to repeal or revise the fiduciary rule if any of the criteria laid out in that executive order is found. That criteria

[30] Letter from Joint Trades, ABA, ACLI, ARA, et. al., to the Department of Labor, April 22, 2015, http://bit.ly/2p4JOm6.

really regulates and determines the DOL's approach to fiduciary rule."[31] Moreover, his statements at that hearing -- that the rule goes "far beyond" addressing the standard of conduct for investment advice -- further suggests that he has prejudged the outcome of the reconsideration.[32]

In short, everything about this reconsideration process sends the message that its only purpose is to give the powerful special interest groups that oppose this rule a chance to make their case once again to a more sympathetic audience. The only way for the Department to counter that impression would be to conduct a balanced review that fairly evaluates objective evidence, doesn't give undue weight to unsupported and unverifiable industry claims about the harmful impact of the rule, and considers the full range of factors that led the Department to conclude that rulemaking was necessary to better protect retirement savers.

C. The rule is based on sound logic that must continue to shape reconsideration.

The Department invites comment regarding its economic analysis, which has been a favorite target of rule opponents. But the fiduciary rule is based on a simple and persuasive logic that is well articulated in both the RIA and the preamble to the rule. Conflicts of interest between financial professionals and their clients pervade the market for retirement investment advice. Incentives to act in ways that do not promote the best interests of clients influence the recommendations that brokers, insurance agents, and other conflicted advisers make, and they do so in ways that have a significant harmful impact on the financial well-being of retirees and workers saving for retirement.[33] Retirement investors cannot adequately protect themselves from the harmful impact of conflicted retirement advice by making an informed choice among investment options or investment advice providers. This harmful impact can be significantly reduced by holding all those who provide retirement investment advice for compensation to a legally enforceable fiduciary standard that requires them to act in their clients' best interests, charge reasonable fees, and reduce or eliminate incentives that encourage and reward advice that is not in clients' best interests. Such an approach allows firms operating under a variety of business models to meet their fiduciary obligations, preserving investor access to affordable advice and choice regarding how best to receive that advice while simultaneously improving the quality of that advice. While financial firms and their advisers will in many cases be required to make extensive and sometimes costly changes to comply with the rule, those costs are more than justified by the benefits workers and retirees will enjoy as a result of receiving best interest advice about their retirement savings.

In order to justify reopening the rulemaking process, the Department bears the burden of proving that its previous conclusions are invalid. It can't simply reverse course without a compelling justification for its actions. It must show the basis on which it determined that its

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[31] Maggie McGrath, *Labor Secretary Nominee Alexander Acosta Spars With Elizabeth Warren Over Fiduciary Rule*, FORBES, March 22, 2017, http://bit.ly/2o42LBw.

[32] Jessica Karmasek, *Acosta, Trump's pick to head DOL, says he will follow order to review fiduciary rule,* LEGALNEWSLINE, March 27, 2017, http://bit.ly/2nLut8G.

[33] CFA presented extensive evidence of the harmful impacts of conflicted advice in our original comment letter on the rule proposal. We hereby incorporate by reference, as if fully set forth herein, those comments. Letter from Barbara Roper and Micah Hauptman, Consumer Federation of America, to the Department of Labor, July 21, 2015, http://bit.ly/2mtNqgg.

previous conclusions about the need for regulation and Department's chosen regulatory approach were unfounded. Comment letters from industry rule opponents supporting the delay give a taste of how they plan to make their case for reopening the rule. Few seek to challenge the rule's most basic premise, that conflicts of interest are pervasive. That fact has been established beyond a shadow of a doubt. And the rule appropriately targets the conflicts that pose the greatest potential harm (e.g., differential compensation and the toxic web of incentives it creates) while explicitly permitting commissions and other transaction-based payments. Instead, most rule opponents tend to make two key arguments: 1) that the Department exaggerated the harm that results from conflicted advice and 2) that the Department didn't adequately consider the harm that would result from depriving investors of access to conflicted advice or forcing them into "costlier" fee accounts.

Neither of these arguments holds water. In making the first argument, rule opponents studiously avoid acknowledging that the quantified estimate of harm in the RIA represents only a tiny fraction of the total harm retirement investors suffer as a result of conflicted advice. Instead, they raise specious arguments over the accuracy of the Department's estimate of harm associated with load-sharing in the sale of front-end load mutual funds, arguments that have already been thoroughly addressed and soundly refuted by both the Department and independent experts. The second argument, which essentially maintains that the rule does more harm than good, fails because it rests on a series of unsupported claims: that the rule is unworkable or overly burdensome, that it is forcing a shift to fee accounts, that these accounts are necessarily more costly for investors, that as a result it will not be affordable for firms to serve small accounts, and that investors will therefore be denied access to advice. While the rule has certainly caused changes in the delivery of advice -- that was after all the goal -- the evidence suggests that affordable advice will remain available to accounts of all sizes. Finally, some have suggested that the rule is not needed because investors are capable of protecting their own interests, an argument for which there is no basis in fact. Our letter provides additional information to rebut each of these arguments, as well as the equally specious claim that the same beneficial results could be achieved through a less "burdensome" regulatory approach.

II. Investors Cannot Protect Themselves

The Department invites comments on what changes could be adopted to make the rule less "burdensome." Rule opponents are likely to suggest a number of changes that would either scale back coverage of the fiduciary protection, by reopening loopholes in the definition of investment advice, or weakening requirements under the BIC to mitigate conflicts. A favorite suggestion among some rule opponents is to create a new seller's carve-out for sophisticated investors, modeled on the securities law "accredited investor" definition. But these suggestions pre-suppose that investors can adequately protect their interests without the protections afforded by the rule. The evidence simply does not support any such assumption.

Few who are familiar with the complexities of investment decisions and Americans' low level of financial literacy would suggest that investors are capable of protecting themselves from the harmful consequences of conflicted advice. But that is exactly what one unnamed

White House official reportedly did in an interview around the release of the Presidential Memorandum. Asked about the concern that "consumers aren't sophisticated enough to discern between the vast multitudes of investment options," the official reportedly responded, "I think the average consumer has the ability to make those choices."[34] There is simply no basis for that confidence, and it is a confidence that ignores clear evidence to the contrary in both the RIA and subsequent research.

Based on its thorough analysis of available research, the Department reached the conclusion, shared by virtually all experts in the field, that "many IRA investors lack financial sophistication and, absent adequate protections, are vulnerable to abuse … Many cannot effectively assess the quality of the investment advice they receive or even the investment results they achieve."[35] The RIA cites research showing that "most individuals cannot distinguish between the different types of advisers or the different standards of conduct to which different advisers must adhere, and this confusion is exacerbated by industry marketing and other practices …"[36]

The Department concluded that these problems are particularly acute for IRA investors for several reasons.

- IRA investors tend to be older and generally have higher account balances at stake than younger investors. "Because most IRAs are retirement income vehicles fed by job-based pension plans, balances tend to be highest at advanced ages, close to before and after retirement."[37]
- The decisions they make at or near retirement can have a particularly acute effect on their financial well-being in retirement: "Vulnerability is often particularly acute at the moment of retirement, as investors roll over large balances from more protected, job-based DC (or even DB) plans to less-protected IRAs … If such advice is tainted by conflicts, the participant may suffer serious negative consequences."[38]
- Evidence suggests that, "as investors age, they become more vulnerable to and targeted for abuse. By several measures, according to academic research, financial capability begins to decline around age 53. Individuals over the age of 55 often 'lack even a rudimentary understanding of stock and bond prices, risk diversification, portfolio choice, and investment fees.' While financial literacy falls at advanced ages, confidence in financial capability may actually increase, leading to poor investment decisions and vulnerability to fraud (citations omitted)."[39]
- The Department noted, moreover, that "IRA annuity purchasers may be particularly vulnerable insofar as they tend to be at or near retirement age, when individuals are older and have the most assets at stake."[40]

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[34] Zeke J Miller and Haley Sweetland Edwards, *White House Stalls Obama Administration Rule on Retirement Advisers*, TIME, Feb. 2, 2017, http://ti.me/2l2sWr5.
[35] RIA at 108.
[36] *Id*.
[37] *Id*.
[38] *Id*.
[39] *Id*. at 108-109.
[40] *Id*. at 109.

Based on its careful review of the evidence, the Department appropriately concluded that "IRAs not only merit but also need special protections."[41]

A. Recent research supports the Department's conclusions.

More recent research validates the Department's conclusion that retirement investors often "lack financial sophistication and, absent adequate protections, are vulnerable to abuse." This is a sentiment that many investors share. In a survey supplemented by focus groups of retirement investors, Merrill Lynch found that finances are the number one worry of many Americans.[42] One focus group participant summed it up this way: "The implications of a bad financial decision could be devastating to me and my family. Yet making smart financial decisions is incredibly confusing and complex. How am I supposed to know the answer?"[43] One reason for this anxiety, according to the Merrill white paper, is that, "They don't know the full cost of retirement or how much they need to save."[44] Fully 81 percent of those surveyed by Merrill said they don't know how much money they'll need to fund their retirement.[45]

These findings are hardly unique. On the contrary, every study we are aware of that has tested financial knowledge has concluded that Americans are ill-prepared to make even basic financial decisions, let alone the complex decisions that go into investing for retirement. The most comprehensive recent study, *Investors in the United States 2016*, was conducted by the FINRA Investor Education Foundation (FINRA Foundation).[46] The survey of 2,000 individuals included a 10-question investor knowledge quiz.[47] Although the survey is of individuals who hold investments in non-retirement accounts, it offers insights that are directly relevant in the retirement context as well. Indeed, because non-retirement investors are wealthier on average than the population at large, and more likely to be male, college educated, and white, this population is likely to be more financially sophisticated than the average retirement investor. Previous research has shown that non-retirement investors generally have higher levels of financial knowledge on average than retirement investors.[48]

Despite the relative sophistication of the survey group, only 10 percent of respondents were able to answer eight questions correctly, while 56 percent answered fewer than half of the questions correctly.[49] Correct response rates on individual questions ranged from a low of 12 percent on a question about the difference between nominal and real returns to a high of 76 percent on a question about the relationship of risk to return.[50] Adding to the concern, nearly two-thirds (65 percent) of survey respondents rate their investment knowledge as high, suggesting that investors are both uninformed and over-confident.

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[41] *Id*. at 110.
[42] Finances in Retirement: New Challenges, New Solutions, A Merrill Lynch Retirement Study, conducted in partnership with Age Wave 2017, http://bit.ly/2kvmjMY ("Merrill Study").
[43] *Id*. at 12.
[44] *Id*. at 6.
[45] *Id*. at 7.
[46] FINRA Investor Education Foundation, *Investors in the United States 2016*, Dec. 2016, http://bit.ly/2hMrppX ("FINRA Survey").
[47] *Id*. at 2.
[48] Barbara Roper and Stephen Brobeck, Mutual Fund Purchase Practices, June 12, 2006 http://bit.ly/2nBKTjO
[49] FINRA Survey at 18.
[50] *Id*. at 17.

While some have suggested that wealthier investors do not need the protections of a fiduciary standard, the FINRA survey does not support that conclusion. At our request, FINRA Foundation used a proxy for the accredited investor definition to determine whether wealth was a reliable indicator of financial sophistication. Because the highest income bracket in the survey was $150,000, FINRA used that in place of the $200,000 per individual and $300,000 per household threshold in the accredited investor definition itself. This higher income group scored 5.6 questions correct on average, compared with 4.2 for the less wealthy population of survey respondents. In short, they were found to be more knowledgeable, but not highly knowledgeable. Interestingly, the survey did ask individuals to self-report as to whether they are accredited investors. The group that self-identified as accredited investors scored slightly *below* those who identified as non-accredited (4.2 vs. 4.4 questions correct), leading us to conclude that there is likely a large number of "false positives" among those self-reporting as accredited.[51]

While the FINRA survey tested investor knowledge at a higher level than is typical of such surveys, others have reached similar conclusions based on more basic tests of investor knowledge. A recent survey of employees at smaller companies (those with between five and 200 employees) found that nearly four in five flunk a test of basic retirement plan knowledge.[52] Among the findings: 57 percent don't know the percentage of salary to invest to achieve their retirement goal and 76 percent cannot define a mutual fund.[53] Nearly half (49 percent) of 401(k) plan participants lack confidence in their ability to make appropriate investment selections.[54] As the survey concluded, "People tend to get the overall big picture (like their 401(k) match), but when it comes to investment specifics … they quickly struggle."[55] It should come as no surprise then that, on a recent National Institute on Retirement Security survey, more than half of respondents (52 percent) cite the fact that workers must fund and manage their own retirement funds as a major factor in making retirement more difficult, and 87 percent say retirees don't know enough about managing investments to make savings last.[56]

The latest annual Financial Freedom survey by Capital One finds that lack of knowledge and experience (at 51 percent) is the leading factor impacting Americans' confidence in investing, with investing complexity (42 percent) also making the list.[57] In its retirement white paper, Merrill Lynch describes the problem this way: "People find the language of finance confusing: Sixty-five percent of Americans say that most of the language used by the finance industry is not user-friendly. The world of financial instruments and strategies can be complicated, and many people's 'financial IQ' isn't high. Only six in ten of

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[51] FINRA Survey Supplemental Findings, on file with authors.
[52] Warren S. Hersch, *Why 401(k) plan participants need more help*, LIFEHEALTHPRO, Feb. 9, 2017 http://bit.ly/2mE1Vi2.
[53] *Id*.
[54] *Id*.
[55] *Id*.
[56] Diane Oakley and Kelly Kenneally, National Institute on Retirement Security, Retirement Security 2017: A Roadmap for Policy Makers Americans' Views of the Retirement Crisis and Solutions, February 2017, http://bit.ly/2mAmVT1.
[57] Capitol One Financial Corporation, Retirement Confidence Dips in 2017, PRNEWSWIRE, Mar 13, 2017, http://prn.to/2o6pb5o.

Americans age 50+ say they clearly understand the two terms most associated with saving for retirement—IRA and 401(k). Far fewer understand the process of asset decumulation or the problem of 401(k) leakage. Only 17% give themselves high grades for understanding how Social Security works."[58]

This profound lack of knowledge extends to other issues important to 401(k) investors. For example, the National Association of Retirement Plan Participants (NARPP) conducted a comprehensive retirement plan participant survey in April 2015 and found that 58 percent of working Americans don't know they are paying fees on their workplace retirement savings accounts.[59] NARPP estimated the amount of fees generated off of this group of investors is around $35 billion dollars a year, or roughly $835 per investor.[60] For those people who did know they were paying fees, only 26 percent could accurately answer how the fees are calculated.[61]

B. Investors' lack of knowledge makes them vulnerable to conflicted advice.

When a majority of investors do not know how much they need to save, do not know the basics of either their retirement plans or the various investment options available to them, and are confused by the language of finance, it is only natural that many will choose to turn to financial professionals for advice. For this reason, relying on financial professionals for advice will continue to be an important means by which Americans choose to save for retirement. And no efforts, no matter how laudable, to empower Americans to make their own financial decisions are likely to change that. But just as most Americans are ill-equipped to make investment decisions, many lack a clear understanding of basic concepts essential to an informed choice among financial professionals.

Many investors do not understand something as basic as how their adviser gets paid. On the FINRA survey, for example, just 56 percent of those who work with a professional adviser said they have a clear understanding of how their adviser gets paid.[62] An A.T. Kearney survey of "mass affluent" investors (defined as those with $50,000 or more in investable assets) found that nearly 30 percent of those who receive advice believe they do not pay for that advice, and another 12 percent said they do not know how they pay.[63] Among the 60 percent who say they do know how they pay for advice, many do not know how much they pay.[64] The authors of the Kearney study found that low level of awareness regarding the cost of investment advice "astounding."[65] It is simply not conceivable that those who aren't sure how or how much their adviser gets paid fully comprehend the complex web of financial incentives that can affect that pay. As a result, the Department cannot reasonably conclude that they are capable of protecting themselves from the harmful impact of those conflicts.

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[58] Merrill Study at 13.
[59] Press Release, The National Association of Retirement Plan Participants, "42 Million People Do Not Know They Are Paying Any Fees On Their Workplace Retirement Plans" (June 2, 2015), http://bit.ly/2pAXZf5.
[60] *Id*.
[61] *Id*.
[62] FINRA Survey at 7.
[63] A.T. Kearney, 2016 Future of Advice Study, *Why Investing Will Never Be the Same*, June 2016, http://bit.ly/2nwbAEz.
[64] *Id*. at 10.
[65] *Id*. at 11.

Moreover, previous research has shown that investors are generally unable to tell salespeople, who are free to act in their own self-interest, from true advisers, who must act in their clients' best interests.[66] And most mistakenly believe that all financial advisers are held to a best interest standard.[67] This is of paramount importance, since their lack of financial sophistication leaves most investors unable to properly gauge the nature and extent of advisory conflicts, protect themselves from those conflicts, or determine whether the recommendations they receive from financial professionals are in fact in their best interests.

That investors struggle to distinguish between salespeople and advisers is the inevitable result of widespread industry practices that deliberately blur the lines between these two functions. Earlier this year, CFA and Americans for Financial Reform (AFR) released a report evaluating the websites of 25 major broker-dealer and insurance firms.[68] The report draws a contrast between the practices these firms adopt to market themselves to customers and the legal argument their trade associations have made in court. According to those legal arguments, the DOL erred in applying a fiduciary standard to "salespeople"who were "merely selling a product" and where "both parties understand that they are acting at arms' length." When examining their websites, however, we found that, when describing their services to the investing public, all of the firms analyzed present their employees as trusted financial advisers who put client interests first.

Our review of firms' websites did not find any prominent reference that labeled firms' representatives and agents as salespeople. Instead, the title most commonly adopted by financial firms for their financial professionals appears to be "Financial Advisor." Other firms have adopted variations that create a similar impression, such as "Financial Consultant," "Retirement Consultant," "Wealth Manager," and "Retirement Counselor." Moreover, they typically describe their services as providing investment "advice" and retirement "planning," not simply product sales. The CFA/AFR review of company websites did not identify any prominent description of their services as arm's length investment sales recommendations. We found, moreover, that firms market those services with messages the clear intent of which is to convince retirement savers that they should trust that their adviser will be looking out for their

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[66] Angela A. Hung, et al., Investor and Industry Perspectives on Investment Advisers and Broker-Dealers. Santa Monica, CA: RAND Corporation, 2008, http://bit.ly/1OrrZ3v.

[67] *Id*; *See also* Infogroup/ORC, U.S. Investors & The Fiduciary Standard: A National Opinion Survey (September 15, 2010) http://bit.ly/1Npodra (finding that three out of five U.S. investors (including 65 percent of 18-34 year olds and 57 percent of households $100,000 or more) mistakenly think that "insurance agents" have a fiduciary duty to their clients; Two out of three U.S. investors (including 70 percent of 45-54 year olds and 62 percent of college graduates) are incorrect in thinking that stockbrokers are held to a fiduciary duty; 76 percent of investors are wrong in believing that "financial advisors" – a term commonly used by brokerage firms to describe their salespeople -- are held to a fiduciary duty; by contrast, 75 percent of investors think the fiduciary standard is in place for "financial planners" and 77 percent say the same about "investment advisers."); S. Kathi Brown, Fiduciary Duty and Investment Advice: Attitudes of 401(k) and 403(b) Participants, AARP (Sept. 2013), http://bit.ly/2phP3vs; Siegel & Gale, LLC and Gelb Consulting Group, Inc., Results of Investor Focus Group Interviews About Proposed Brokerage Account Disclosures, Report to the Securities and Exchange Commission (March 10, 2005) http://bit.ly/1MkdujW.

[68] Micah Hauptman and Barbara Roper, *Financial Advisor or Investment Salesperson? Brokers and Insurers Want to Have it Both Ways*, Jan. 18, 2017 http://bit.ly/2jKUbFD.

best interests. In so doing, firms encourage reliance on their expertise and recommendations. (The full report is included in Appendix A.)

C. Plan sponsors often lack financial knowledge needed to fulfill their fiduciary obligations.

There is similar support for the Department's conclusion that plan sponsors often lack a sophisticated understanding of their role as plan fiduciaries. The Government Accountability Office (GAO) released a study in 2008 that examined plan sponsors' knowledge and ability to comply with their fiduciary obligations and found serious shortcomings.[69] Based on a survey of industry professionals, GAO reported that, "Several pension practitioners observed that most sponsors, especially sponsors of small plans, have very little fiduciary knowledge."[70] One effect of this lack of knowledge of their fiduciary obligations is that many plan sponsors may look to non-fiduciary service providers to provide those fiduciary services. For example, one attorney with an employee benefits firm told GAO researchers that, "while sponsors may know they are fiduciaries, without understanding the concept and extra duties of being responsible for plan assets, they primarily see their function as hiring service providers who they may view as the 'real' fiduciaries."[71]

A number of practitioners interviewed for the report indicated that "some service providers understand fiduciary roles better than plan sponsors do but may wish to avoid the liability associated with certain fiduciary duties, even though their actions may define them as fiduciaries under the law. This can lead some sponsors to assume that they have delegated certain fiduciary duties to a service provider, although the provider may not acknowledge any fiduciary role. When the service provider is not a fiduciary, it is not bound by the fiduciary duties to act prudently and solely in the plan's best interest."[72]

Although the GAO report was issued in 2008, plan sponsors' lack of knowledge about either their own fiduciary obligations or the fiduciary obligations of their retirement plan adviser remains a significant problem today. In its 2017 Micro Plan Survey, PLANADVISER found that, of the micro plans that use retirement plan advisers, 40 percent said they were unaware of whether their adviser is a fiduciary to the plan or not.[73] Similarly, according to a survey by MassMutual: one-third of plan sponsors mistakenly say they are not a fiduciary to their plan; 15 percent don't know whether they are a fiduciary to their plan; and about 2 out of 10 sponsors who work with an adviser are not sure whether they or their adviser is a fiduciary to their plan.[74]

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[69] GAO, Fulfilling Fiduciary Obligations Can Present Challenges for 401(k) Plan Sponsors, http://bit.ly/2prHMcS.
[70] *Id*. at 23.
[71] *Id*.
[72] *Id*.
[73] Alison Cooke Mintzer, 2017 PLANADVISER Micro Plan Survey, PLANADVISER, February 2017, http://bit.ly/2mbAvy5.
[74] MassMutual, DOL Fiduciary Rule, Winning Combination Study 2015, http://bit.ly/2pB4b6u.

The Administration's goal of empowering Americans to make their own financial decisions cannot take priority over real evidence that Americans are often ill-equipped to make those decisions, particularly with regard to retirement investing. In light of this evidence, the Department cannot reasonably conclude that the rule is not needed based on an entirely unfounded belief that most retirement investors are capable of: 1) making their own investment decisions, 2) making an informed choice among different types of financial professionals with differing legal obligations to the client; or 3) protecting themselves from the harmful consequences of conflicted advice. Nor can the Department reasonably conclude that most plan sponsors are capable of protecting themselves and their employees without the rule's protections. That reality, and not the Administration's aspirational goal of empowering Americans to make their own financial decisions, must guide policy in this area. Failure to take this reality into account in evaluating the need for the rule would deal a fatal blow to the Administration's goal of facilitating Americans' ability to save for retirement and would be arbitrary and capricious.

III. The Harm from Conflicted Advice Far Exceeds the RIA's Estimate

The RIA meticulously chronicles the nature and scope of conflicts that can influence advice to retirement savers, including plan participants and IRA investors. And it relies on a wide body of economic evidence to support its conclusion that "the impact of these conflicts of interest on investment outcomes is large and negative."[75] Included among the supporting evidence are: "statistical analyses of conflicted investment channels, experimental studies, government reports documenting abuse, and economic theory on the dangers posed by conflicts of interest and by the asymmetries of information and expertise that characterize interactions between ordinary retirement investors and conflicted advisers."[76] That data "consistently point to a substantial failure of the market for retirement advice."[77] While much of this evidence can't be quantified, the Department did use the best available, peer reviewed academic research to arrive at an estimate that "underperformance associated with conflicts of interest – in the mutual fund segment alone – could cost IRA investors between $95 billion and $189 billion over the next 10 years and between $202 billion and $404 billion over the next 20 years."[78] It cautioned, however, that these expected losses "represent only a portion of what retirement investors stand to lose as a result of adviser conflicts."[79]

The Department invites comment on its economic analysis, which it has been directed to update as part of this reconsideration. Rule opponents hope to seize this opportunity to re-fight a battle they have already appropriately lost over the accuracy of the RIA's cost estimate, while ignoring the overwhelming evidence of a much broader problem. Recent research presented here reinforces the RIA's conclusion that conflicts of interest are pervasive in the retirement advice market, are poorly understood by investors, and result in serious harm to plans, plan participants, and IRA investors. These include independent studies documenting the

[75] RIA at 9, 96, 158, 326.
[76] *Id*.
[77] *Id*.
[78] *Id*.
[79] *Id*.

impact of conflicts on advisers' product recommendations and the lack of effective cost competition in the mutual fund market. Further evidence on the high costs and abusive features of fixed indexed annuities is also available. Of particular interest is new evidence that helps to illuminate the enormous harm that results from conflicted advice to retirement plans.

The additional evidence presented here further reinforces the Department's previously arrived at conclusion that the quantified estimate of harm in the RIA represents only a tiny portion of the total harm that retirement investors suffer as a result of conflicted advice. Even in the unlikely event that rule opponents were to offer convincing evidence that the quantified estimate of harm is somehow overstated -- something they have so far entirely failed to do -- that by itself would not be enough to justify rulemaking to rescind or revise the rule. The Department must consider the full range of quantitative and qualitative evidence, which provides conclusive proof of a market that is rigged to maximize profits to financial firms at the expense of working families and retirees. The Department certainly can't reasonably reverse course based on specious attacks on that estimate that the Department has already examined at length, submitted for independent evaluation, and rejected as unsound. To do so would be arbitrary and capricious and expose the Department to legal challenge.

The Department invites comment on whether there have been new insights from or into academic research with implications for the economic analysis. The following is a summary of additional research and evidence, further supporting the Department's previous conclusions with regard to the harmful impact of conflicts, that should be incorporated into a revised economic analysis of the rule.

A. New evidence suggests brokers fail to recommend superior mutual funds.

By every conceivable measure, the mutual fund market would appear to be highly competitive, but new research from Professors Michael Cooper, University of Utah, Michael Halling, Stockholm School of Economics and the Swedish House of Finance, and Wenhao Yang, University of South Carolina, documents the limits of that competition in disciplining mutual fund costs.[80] Building on earlier research that focused on S&P 500 index funds, the authors expand the analysis to include passive and active domestic equity funds using yearly data from 1963 to 2014 in order to determine whether similar funds have similar prices and, if not, what factors might explain that fee dispersion. The report finds economically large, robust, persistent and pervasive fee dispersion in the mutual fund industry, including among the largest funds (top TNA quintile) as well as among institutional funds. They find, moreover, that fee dispersion has noticeably increased over the last twenty years, even as the industry has experienced enormous growth in capital invested and the number of funds.

In a market where similar funds have economically significant differences in fees, advisers who serve their clients' best interests ought to help them choose those that have lower costs, when other factors relevant to fund quality are held equal. But when the authors examine the universe of retail funds, they find that not only are costs higher among these funds than they are for institutional share classes -- much of which is explainable by the inclusion of

[80] Michael Cooper, Michael Halling and Wenhao Yang, The Mutual Fund Fee Puzzle, October 2016, http://bit.ly/2nEq7MK

distribution costs[81] -- but that fee dispersion (spreads in reported and residual expenses) are also larger in retail funds than they are in institutional share classes. This suggests that many investors who pay for a brokers' help in selecting mutual funds are not being directed into the best available option and instead are paying higher than necessary costs for their investments.

While the report leaves unanswered many questions about the causes of fee dispersion, it nonetheless suggests that an enforceable best interest standard that requires brokers to consider the costs of the investments they recommend could be beneficial in helping to bring down those costs. In light of the breadth and impact of the fee dispersion reported by the authors -- they show that a low-expense fund investor would have earned approximately 71 to 145 percent more in cumulative abnormal returns than a high-expense fund investor over their sample period -- the potential to improve investor results through better advice is significant.

B. Mystery shopper survey confirms inferior quality of non-fiduciary advice.

Recent research from Professors Antoinette Schoar of MIT, Sendhil Mullainathan of Harvard University and Markus Noeth of Hamburg University provides new evidence that fiduciary advice is in fact superior to non-fiduciary advice. The study, which has not yet been published, follows up on earlier research by the same authors, who sent trained auditors to financial advisers in the Boston area and observed whether the advisers acted in their own interest or in the interest of the client.[82] The earlier study, which was discussed in the RIA, found that advisers routinely moved clients with low-fee, diversified funds into higher-fee funds with the same risk-return profile that were in the advisers' economic interest. For the new study, the authors conducted a follow up audit to analyze the quality of financial advice commonly given to clients based on whether or not the adviser was a fiduciary.[83] To conduct the study, they sent "mystery shoppers" to financial advisers in the greater Boston area impersonating customers seeking advice on how to invest their retirement savings. The mystery shoppers represented different levels of bias or misinformation about financial markets.

By and large, the non-fiduciary advice the shoppers received did not correct any of their misconceptions, according to Schoar, who wrote about the study in the *Wall Street Journal*. Instead, the non-fiduciary advisers seemed to exaggerate existing misconceptions of clients if it made it easier to sell more expensive and higher fee products. In addition, the non-fiduciary advisers strongly favored actively managed funds over index funds. In only 7.5 percent of sessions did advisers encourage investing in index funds. If these advisers did happen to mention fees, they usually downplayed their importance, according to Schoar. Schoar said their results suggested non-fiduciary advisers were "willing to make their clients worse off in order to secure financial gain for themselves." Schoar, Mullainathan, and Noeth found, on the other hand, that fiduciary advisers provided better and less biased advice than non-fiduciary advisers. Fiduciary advisers were less likely to move people away from index funds and to reinforce erroneous beliefs about the market.

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[81] It is not necessarily the case that all of the higher costs are attributable to distribution costs. When we examined S&P 500 index funds, we found that broker-sold funds had higher administrative costs even after the distribution costs had been entirely removed.
[82] RIA at 145-146.
[83] Antoinette Schoar, *We Put Financial Advisers to the Test–and They Failed*, WALL STREET JOURNAL, Oct. 27, 2016, http://on.wsj.com/2k9LMMT.

The findings of this research directly contradict rule opponents' arguments that treat non-fiduciary and fiduciary advice as equivalent in order to suggest that investors would be harmed if they lost access to this conflicted advice. Instead, the study strongly reinforces the conclusion reached in the RIA that conflicts of interest have a harmful impact on advisers' recommendations and that a fiduciary standard, particularly one that reins in conflicts, can provide an effective antidote.

C. Conflicted advice imposes harms on the broader economy.

A soon-to-be-published law review article by Barry University School of Law Professor Benjamin P. Edwards examines how the regulatory structure for financial advice "tolerates incentives motivating financial advisors to manipulate and deceive retail investors," with harmful consequences for investors and the economy as a whole.[84] Drawing on literature about manipulation and deception in principal-agent relationships, the article shows how "conflicts of interest cause the market for financial advisor services to generate excessive intermediation, driving harms to the real economy." As such, the study documents not just the harmful impact of conflicted advice, but the inadequacy of existing securities regulations in preventing the harm.

Edwards starts from the widely accepted premise: 1) that the markets' ability to allocate capital appropriately depends on financial assets' being priced to reflect their underlying merits and risks and 2) that there is a link between capital allocation and the health of the macro-economy. Using case studies of non-traded REITs and closed-end funds, he documents how "conflicted investment advice drives capital misallocation, causing significant macroeconomic and other harms."[85] With regard to REITs, for example, he concludes that, "non-traded REITs use conflicted financial advice to gather an outsized amount of capital," and that this causes "excessive capital to flow to the real estate market—driving up the prices of real assets. If the equilibrium were different—rewarding more competition on the merits and the risks instead of efforts to bias financial advisors, these products would likely attract less capital, freeing it for more productive uses," he concludes.[86]

Similarly, Edwards identifies buying shares in a closed-end fund (CEF) in an IPO as a particularly unattractive investment option, especially when similar CEFs already exist. "Because the IPO shares are sold at a premium and will soon trade at a significant discount, economists cannot discern any good reason why a rational investor would purchase CEF shares in an IPO instead of purchasing the shares of a CEF already on the market," he writes.[87] Yet, brokers continue to sell CEF shares to retail investors, "despite a long record of underperformance."[88] Edwards attributes this to the lack of sophistication among retail investors and the high commissions paid to brokers. Edwards then describes a variety of broader economic harms, beyond the poor returns to the investors, that result from these

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[84] Benjamin P. Edwards, "Conflicts & Capital Allocation," Ohio State Law Journal, Vol. 77, 2017, Forthcoming, http://bit.ly/2nlbP8v.
[85] *Id*. at 7.
[86] *Id*. at 13.
[87] *Id*.
[88] *Id*. at 14.

misplaced incentives, including misdirected financial innovation, amplified systemic risks, and increased cost of capital that inhibits economic growth.

While Edwards favors eliminating commission compensation for investment advice entirely, he identifies requiring financial advisers "to act in the best interests of their clients without regard to their personal financial interests" as a promising mechanism to address the problem. "From a capital-allocation perspective, imposing a fiduciary duty on advisers may offer significant benefits for the economy by reducing the likelihood that advisors will misallocate client assets in exchange for commissions," he writes. He notes that the "vociferous opposition raised by certain issuers of high-commission products provides evidence that the DOL's fiduciary rule may significantly affect the allocation of retirement account capital. Put simply, certain issuers will likely see their capital inflows reduced in a fiduciary environment—forcing them to develop some other strategy to attract capital—perhaps by improving their returns."[89]

IV. New Evidence Supports RIA Conclusions Regarding Harmful Practices in the Annuity Market

Some rule opponents have suggested that the Department did not adequately consider the annuities market, including existing regulation of this market, before concluding that the best interest contract exemption should apply to recommendations of both variable and fixed-indexed annuities.[90] While it is certainly true that the quantitative analysis in the RIA is based primarily on mutual funds, where more and better data is available, the RIA also provided an extensive analysis of the annuity market. This included a review of the various products and their features, the distribution of various annuity products, the conflicts of interest that exist in the annuity market, and the harms to retirement savers that can result from those conflicts. While data limitations impeded quantification of the losses that affect retirement savers who invest in annuities, the DOL found nonetheless that there is "ample qualitative and in some cases empirical evidence that they occur and are large both in instance and on aggregate."[91]

Analogizing to the substantial harms that occur in the mutual fund context as a result of conflicted investment advice, the DOL found that "various annuity products…involve similar or larger adviser conflicts [as compared to mutual funds], and these conflicts are often equally or more opaque. Many of these same products exhibit similar or greater degrees of complexity, magnifying both investors' need for good advice and their vulnerability to biased advice. As with mutual funds, advisers may steer investors to products that are inferior to, or costlier than, similar available products, or to excessively complex or costly product types when simpler, more affordable product types would be appropriate."[92] The DOL also examined the current

[89] *Id*. at 48.
[90] *See, for example,* comment letters on the delay proposal from American Council of Life Insurers, Insured Retirement Institute, and National Association for Fixed Annuities.
[91] RIA at 9.
[92] RIA at 9; In "Insurance Agents in the 21st Century: The Problem of Biased Advice," a chapter in *Research Handbook in the Law and Economics of Insurance*, Schwarcz and Siegelman also consider it appropriate to analogize conflicts in the mutual fund space to conflicts in the insurance space, stating, "While not exactly on point, this literature is comparatively well developed and involves many of the same basic considerations as are at

fragmented regulatory landscape affecting the annuity market and appropriately concluded that it does not provide sufficient protections for retirement savers who purchase annuities.

Contrary to the claims made by industry rule opponents, the DOL compellingly justified the need for regulatory action and its chosen regulatory approach. New evidence since the rule was finalized strongly supports the conclusions the Department reached regarding the complexity of these products, the abusive practices associated with their sale, and the inadequacy of existing regulatory protections. Moreover, instead of impeding the sale of annuities, evidence suggests the rule has spurred industry to respond by developing more investor-friendly versions. This evidence must be incorporated into the updated economic analysis being undertake as part of this reconsideration.

A. Annuity Products are Highly Complex.

As the DOL documented in the RIA, both variable and fixed-indexed annuities are highly complex products that pose risks to investors that investors may fail to understand. Returns on both products can vary widely.[93] And though fixed-indexed annuities are often sold as devoid of market risk, in reality insurers are able to transfer investment risks to fixed-indexed annuity investors in ways that resemble the transfer of risk to variable annuity investors.[94] For example, fixed-indexed annuities credit investors' accounts based on changes in a market index, but indexed-linked gains are generally not fully credited to investors' accounts. Instead, a fixed-indexed annuity's rate of return is reduced by participation rates, interest rate caps, and spread/margin asset fees.[95] Finally, fixed-indexed annuities don't receive dividends from the index,[96] a significant disadvantage since reinvested dividends have historically made up about 42 percent of the market's historical returns.[97] Financially unsophisticated retirement investors are unlikely to understand these complex product features.

Adding to the complexity is the huge array of fixed-indexed annuities available in the market. According to one industry survey report, there are 317 indexed annuities as segmented by product and 1,648 index annuity strategies as segmented by index-crediting method.[98] Because these annuities combine complicated crediting factors in an opaque manner, the vast majority of investors will find it impossible to understand the basis on which insurance companies are crediting their accounts. Even prominent industry analysts and executives acknowledge that the emergence of exotic indices has rendered indexed annuities too convoluted.[99] "They are complex, unnecessarily so, if you ask me," said Sheryl Moore,

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play in insurance markets." Daniel Schwarcz and Peter Seigelman, Research Handbook on the Economics of Insurance Law: Insurance Agents in the Twenty-First Century: The Problem of Biased Advice, Edward Elgar Publishing, http://bit.ly/2ocEKb2.

[93] RIA at 123.

[94] *Id*.

[95] *Id*.

[96] Investor Alert, Equity-Indexed Annuities—A Complex Choice, FINRA, http://bit.ly/2oI4ejK.

[97] Sam Ro, *Dividends Were Responsible For 42% Of Stock Market Returns Since 1930*, BUSINESS INSIDER, January 10, 2013, http://read.bi/2ovfLRg.

[98] RIA at 119.

[99] Greg Iacurci, *Have indexed annuities become too complicated?*, INVESTMENTNEWS, Dec. 16, 2016, http://bit.ly/2pBAaU3.

president and CEO of Moore Market Intelligence, who tracks indexed annuity products and is a well-known proponent of indexed annuities.[100]

When they were originally introduced, indexed annuities were typically tied to well-known indices, such as the S&P 500 or Russell 2000. However, insurance companies have recently launched proprietary indices as a way to distinguish their products. In reality these new versions don't offer much benefit beyond traditional indices and only serve to confuse advisers and investors, analysts and executives say.[101] For example, companies have launched "hybrids," with volatility management or multi-asset characteristics, such as the UBS Market Pioneers index, JPMorgan ETF Efficiente 5 index and the Barclays All Caps Trailblazer 5 index.[102] These exotic hybrids often carry additional costs, without adding much value beyond a traditional index, according to Moore.[103] Judson Forner, vice president of investment marketing at ValMark Securities Inc., added, "I think it can add to the complexity, because you may not know what that index is," Mr. Forner said. "You can't turn on Bloomberg and look at the different indices."[104]

In a follow up blog post explaining her comments to *InvestmentNews*, Moore documented the huge increase in market complexity that has occurred over the past 20 years.[105] "When I started my work in the insurance industry nearly 20 years ago, the typical indexed annuity measured its S&P 500 indexed gains over a seven-year period, likely offered two choices for allocating premiums and may have limited the indexed interest by using a spread rate," she explained.[106] Consumers definitely had some choices when it came to their indexed annuity purchase, according to Moore, but these likely consisted of five choices of indices, four choices of indexed crediting methods, and three choices of methods to limit indexed interest.[107] Even then, it was likely the rare investor who could knowledgeably choose among the various options. Today, investors face 65 choices of indices, 12 choices of indexed crediting methods, and five choices of methods to limit indexed interest, according to Moore.[108] That makes the choice of the best option all the more confusing for investors (and advisers).

The past decade has also witnessed a proliferation of hybrid indices, from one in 2007 to six in 2013, to 47 in 2016, according to Moore.[109] Many of these hybrid indices do not have online resources to obtain index values, much less identify what the index consists of, according to Moore. "In fact, there are numerous indices where you can Google the name of the index, and not even receive a single hit!" she wrote in a comment on the *InvestmentNews*

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[100] *Id*.
[101] *Id*.
[102] *Id*.
[103] *Id*.
[104] *Id*.
[105] Sheryl J. Moore, *Have Indexed Annuities Become Too Complicated?!?*, December 27, 2016, http://bit.ly/2ocGbWY.
[106] Id.
[107] Id.
[108] Id.
[109] Id.

article.[110] While hybrid indices aren't necessarily bad, they facilitate the deceptive marketing of indexed annuity products tied to them, Moore warned. "Stories of 'unlimited potential for gains' abound. Consumers are being led to believe that they will receive market-like returns when they won't."[111]

In addition to complex crediting factors, fixed-indexed annuities have other problematic features. Insurance companies generally reserve the power to unilaterally change terms and conditions to lower an investor's effective return, for example, leaving the investor with little or no recourse.[112] Moreover, while fixed-indexed annuities are advertised as providing minimum rates of returns, typically between 1 and 3 percent, those advertisements often fail to make clear that the guarantee is not applied to the full amount of premiums invested. Rather, the rate is applied to only a portion of premiums invested, typically 87.5 percent.[113] So, for example, if an investor invests $100,000, she would be guaranteed the minimum rate of return per year on $87,500, not the full $100,000. If at the end of the surrender period, the value of the annuity is less than the amount credited by gains in the index (discounted by whatever terms and conditions are imposed), then the investor would receive the minimum rate of return on $87,500. The chart below illustrates the dramatic impact this can have on investor gains. Assuming a 1 percent return on 87.5 percent of premiums, it would take 14 years for the investor to receive the original amount invested.

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[110] Greg Iacurci, H*ave indexed annuities become too complicated?*, INVESTMENTNEWS, Dec. 16, 2016, http://bit.ly/2pBAaU3.
[111] Sheryl J. Moore, *Have Indexed Annuities Become Too Complicated?!?*, December 27, 2016, http://bit.ly/2ocGbWY.
[112] Investor Alert, Equity-Indexed Annuities—A Complex Choice, Caution!, FINRA, http://bit.ly/2oI4ejK; Fidelity Investments, Viewpoints on Indexed annuities: Look before you leap, July 13, 2016, http://bit.ly/1KFnq3L. ("One challenge here is that insurance companies typically have the flexibility to lower the participation rate, increase the spread, or lower the cap, which lowers your potential returns," says Tom Ewanich, a vice president and actuary at Fidelity Investments Life Insurance Company. "If this happens during the surrender charge period after you've invested in the annuity, you have very little recourse.")
[113] *Id*.

MNL Capstone 14	1% on 100% of premiums	1% on 87.5% of premiums
0	$100,000	$87,500
1	$101,000	$88,375
2	$102,010	$89,259
3	$103,030	$90,151
4	$104,060	$91,053
5	$105,101	$91,963
6	$106,152	$92,883
7	$107,214	$93,812
8	$108,286	$94,750
9	$109,369	$95,697
10	$110,462	$96,654
11	$111,567	$97,621
12	$112,683	$98,597
13	$113,809	$99,583
14	$114,947	$100,579
15	$116,097	$101,585

B. Variable and Fixed-indexed annuities are converging.

The Department's decision to require commission sale of fixed-indexed annuities to comply with the BIC is justified in light of the complexity and opacity of these investments. The wisdom of that decision is further reinforced by evidence that variable and fixed-indexed annuities are converging.

A comment letter submitted by Allianz Life Insurance Co. (AZL Group) made precisely that point. [114] In it, Allianz describes how fixed-indexed annuities can resemble variable annuities. AZL Group offers fixed-indexed annuities that blend features of variable annuities and vice versa, according to the letter. "This registered AZL Group product [referring to a fixed-indexed annuity] blends annuity types in other ways. The annuity offers mutual fund investment options in addition to index investment options, and so it is referred to as 'a variable annuity with index investment options."[115] The AZL Group has also offered variable annuities with a fixed (unregistered) investment options. The fixed (unregistered) investment options

[114] Letter from Gretchen Cepek, Allianz Life Insurance Company, to the Department of Labor, July 21, 2015, http://bit.ly/2ozwm8r.
[115] *Id.* at 22.

provide benefits which comply with standard minimum nonforfeiture laws required by state insurance regulations.[116]

Other companies are also blending multiple different types of annuity product. One issuer offers a variable annuity with a fixed index (unregistered) investment option. Other companies offer other combinations of registered/unregistered and fixed/index/variable products."[117] In its comment letter on the rule, Jackson National Life Insurance Co. echoed the view that these product types have converged, stating, "Recent changes to the structures of fixed-indexed annuities (FIAs) and variable annuities…have resulted in these products becoming remarkably similar."[118]

C. *Annuities' complexity makes investors heavily reliant on highly conflicted financial professionals.*

While these products' shared characteristics and their exceeding complexity do not necessarily result in harm to retirement savers, they do create an environment in which it is more likely that harm will occur and that the harm will be masked. It also makes retirement savers acutely dependent on the recommendations they receive from their financial professional to select an appropriate product. This is because investments in general, and annuities in particular, are classic "credence goods" -- goods and services where the expert providing the goods and services knows more about them than the consumer, and the consumer relies on the expert's opinion and advice to make a decision.[119] In a credence goods market, "an expert has an incentive to exploit the asymmetric information in the market, which sometimes results in fraud, overcharges, undertreatment and overtreatment."[120] Based on these considerations, the DOL determined that, while prudent and impartial advice is important to all investors, it is even more crucial in guarding the best interests of investors in variable and fixed-indexed annuities.[121]

As the DOL described in the RIA, however, the commission and incentive structures in the annuity market align the interests of the insurance agent or broker with the insurance company, not the customer. Moreover, reliance on commissions creates an incentive to aggressively maximize sales generally, sales of the annuities that pay the highest compensation specifically, and sales of annuities over other available alternatives, such as mutual funds, that pay lower commissions.[122] As the RIA points out, this has particularly serious consequences in

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[116] *Id*.
[117] *Id*.
[118] Letter from James R. Sopha, Jackson National Life Insurance Company, to the Department of Labor, September 24, 2015, http://bit.ly/2ocFX29.
[119] RIA at 155 (citing Uwe Dulleck and Rudolf Kerschbamer, 2006, "On Doctors, Mechanics, and Computer Specialists: The Economics of Credence Goods" Journal of Economic Literature Vol . XLIV pp.5-42.)
[120] *Id*.
[121] RIA at 123, 140.
[122] RIA at 131. (Commissions on indexed annuities averaged 6.3 percent of the principal payment in 2012, according to Sheryl Moore, founder of AnnuitySpecs, a market-research firm. Wink's Sales and Market Report 4th Quarter, 2014 reported that commissions of fixed-indexed annuities were on average 6.1 percent of total premium paid in the 4th quarter in 2014. U.S. life insurers' aggregate commission payments accounted for 7 percent of aggregate total expenses and amounted to 9 percent of total premiums in 2013, according to "American Council of Life Insurers: Life Insurers Fact Book 2014." Jim Poolman, the executive director of the Indexed Annuity Leadership Council, also testified at the DOL hearing that commissions on fixed-indexed annuities are "6 to 8

the annuity market, because purchasers of annuities are often older individuals who lack sophistication in financial matters.[123]

Some of the most egregious practices used by annuities companies to promote sales were detailed in an October 2015 report from Senator Elizabeth Warren (D-MA), "Castles, Villas, and Vacations: How Perks and Giveaways Create Conflicts of Interest in the Annuity Industry."[124] Sen. Warren found, for example, that thirteen of the largest fifteen insurance firms were offering sales agents a vast range of perks, including luxurious, all-expenses-paid vacations to destinations like Aruba, the Bahamas, Ireland, and South Africa, as well as golf outings, iPads and other electronics, expensive dinners, theatre or professional sports tickets, and sports memorabilia, diamond encrusted 'NFL Super Bowl Style' rings, cash, and stock options to entice sales of their products. These rewards were given regardless of whether the products sold were in the best interests of retirees.

In February 2017, Sen. Warren issued a follow-up to her original report. It finds that, just months before the fiduciary rule had been scheduled to take effect, firms continued to provide kickbacks to their agents that would clearly violate the rule's prohibition on practices that encourage sales based on considerations other than customers' best interests.[125] Among the examples highlighted in the report:

- Sentinel Security Life's "Top 15 Annuity Agents" can qualify for a May 2017 week-long trip to Playa Del Carmen, Mexico, known for its "palm-lined beaches, coral reefs, and scuba-diving." Agents will stay at a resort featuring "high-class hospitality and the finest experience of pristine coastlines and natural surroundings."
- AIG Partners Group, in order to "renew and strengthen bonds with our most valued distribution partners," offers its top-selling annuity agents a May 2017 four-day stay—with a guest—at the Ritz-Carlton in San Francisco. Agents with even higher sales volumes are also invited to the three-day "Elite Leaders" event at the Ritz-Carlton Half Moon Bay resort.
- The American National Insurance Company offers its "top 80 qualifiers and their guest" a five-day stay at "The One & Only Palmilla" resort in Los Cabos, Mexico in May 2017.
- Assurity Life Insurance Company is offering a June 2017 trip – for agents and a guest -- to the Westbury Hotel in Dublin, Ireland for its "Leaders' Conference." The company was explicit about its desire to keep the incentives hidden from consumers, advertising it to agents with a flyer that warns, "NOT TO BE FORWARDED TO CONSUMERS."

percent, give or take." http://bit.ly/2pfYKgN. Also at the hearing, University of Mississippi Law Professor Mercer Bullard provided examples of how an adviser could increase his compensation substantially by recommending a variable or fixed-indexed annuity over a mutual fund. http://bit.ly/2p3QtwX.

[123] *Id*.

[124] Office of Senator Elizabeth Warren, "Villas, Castles, and Vacations: How Perks and Giveaways Create Conflicts of Interest in the Annuity Industry," October 2015, http://bit.ly/2nNgb8t.

[125] Office of Senator Elizabeth Warren, "Villas, Castles, and Vacations Americans' New Protections from Financial Adviser Kickbacks, High Fees, & Commissions are at Risk, 2017 Edition," February 2017, http://bit.ly/2l3OUbI. (Included in Appendix B).

Many other companies and third-party agent representatives offer similar travel and other incentives to agents. Sen. Warren's staff identified at least 25 companies that continued to offer these incentives in the months before the conflict of interests rule was set to go into effect.[126]

One insurance industry Independent Marketing Organization (IMO), Market Synergy Group (MSG), which challenged the rule in court, appears to provide the exact types of perverse incentives for selling fixed-indexed annuities that the rule is designed to address. We reviewed its members' advertising and found:

- MSG member IAM Services advertises providing agents the "highest commission levels in the industry."[127] It further advertises on its "Incentives" webpage trips to the Fairmont Empress in Victoria, British Columbia and the Four Seasons at Mandalay Bay for top producers. An agent qualifies for the Four Seasons trip, for example, by selling $1,250,000 of Athene Premium between November 1, 2015 and December 31, 2016.[128]
- MSG member InsurMark, advertises on its "Agent Rewards" website "COLD CASH, GREAT TRIPS, JUICY PERKS."[129]
- MSG member Magellan Financial has advertised trips for top producers to the Hard Rock Resort and Casino, Punta Cana in the Dominican Republic and free iPads for meeting certain production requirements.[130]

MSG's members offer incentives that are typical in the IMO industry.[131] These incentive programs that IMOs administer exacerbate conflicts of interest, encouraging and rewarding agents for recommending annuity products that are in the agents', IMOs', and insurance companies' financial interest, not the best interests of retirement savers. Certainly, there is no indication that, through their activities or structure, IMOs adequately ensure retirement investors receive advice that is genuinely in their best interest or that conflicts are mitigated. Given these factors, it was entirely reasonable for the DOL to conclude that FIAs should be subject to the more protective exemptive conditions under the BIC and that IMOs should not be allowed to be treated as financial institutions, without first demonstrating they have an adequate supervisory mechanism to ensure compliance with the rule. The Department cannot reasonably conclude that conflicts would be appropriately addressed absent the rule's requirements.

D. *High-pressure sales tactics are used to promote fixed-indexed annuities sales.*

Media reports add to our understanding of high-pressure sales tactics used to sell fixed-indexed annuities. In 2008, Dateline NBC ran an undercover special documenting the predatory

[126] *See* Appendix B for list of "Companies Offering Incentives for Annuity and/or Insurance Sales in 2016 or 2017."
[127] IAMServices, Annuity, http://bit.ly/2pg3ROb (included in Appendix B).
[128] IAMServices, Incentives, http://bit.ly/2oIo7Yf (included in Appendix B).
[129] InsurMark, Rewards, http://bit.ly/2ocFGMJ (included in Appendix B).
[130] Office of Senator Elizabeth Warren, "Examples of Incentives for Annuity Brokers," http://bit.ly/2ozzK2Q (Included in Appendix B).
[131] *See, e.g.,* LifePro, Elite Hawaii Trip, http://bit.ly/2nNr9Lw (Advertises an all-expense paid week-long trip to Maui, Hawaii in October, 2017 for Elite advisers); Capmar Ins. Servs., Reward Yourself with Our Capmar Incentive Program!, http://bit.ly/2pBFTJT (Advertises Apple watches, golf clubs, Tiffany & Co. jewelry, spa packages, flat screen TVs, Dyson vacuums, and more).

and abusive tactics fixed-indexed annuities salespeople use to sell to unsophisticated and vulnerable investors, particularly to elderly senior citizens. Dateline NBC highlighted advisers' scare tactics, such as making prospective clients think their money is not safe in FDIC insured accounts, downplaying huge surrender charges, and claiming annuities never lose money.[132] More recently, an article in the *Philadelphia Inquirer* documented the extent to which similar scare tactics and misleading practices continue to this day.[133]

The *Inquirer* article focuses on one Philadelphia area salesman, Phillip J. Cannella 3rd, and the tactics he uses to push fixed-indexed annuities as the "crash-proof" answer for a world on the brink of economic collapse. "It's going to be a world collapse, economically speaking," Cannella reportedly warns attendees at his sales events. "You need to plan for this storm coming. You need to be in a vehicle that's not going to sink when Wall Street sinks." Rather than calling the investment "annuities," according to the article, Cannella prefers to describe them "as 'crash-proof' investments, 'like a magical mutual fund.'" Cannella's brother-in-law, who worked for him for about a year, described the company's sales tactics this way: "We want to make sure that we leave the least amount of money on the table and we get — garner back the highest commissions to us."[134]

The article goes on to explain several of the deceptive claims made by Cannella in his presentation to potential investors. For example, according to the article, Cannella misrepresents his fiduciary status, claiming in an interview that, "Licensed professionals in our insurance industry must operate under a fiduciary duty. There is no fiduciary duty with Wall Street."[135] Of course, the fiduciary duty insurance agents owe is to their employers, not their customers, and no group has fought harder to avoid a fiduciary duty toward clients than the trade associations for fixed-indexed annuities.

Cannella's presentations to clients also feature claims that annuities "out-performed the stock market 'every year.'"[136] In making this claim, Cannella reportedly refers to a chart, by industry giant American Equity Investment Life Insurance Co., which shows one of its fixed-indexed annuities outperforming the S&P 500 index from 1998 to 2015. "What Cannella and other agents don't mention," according to the *Inquirer* article, "is the S&P 500 returns on the chart do not include reinvested dividends. With dividends included, the stock market's aggregate return handily outperformed Cannella's favorite annuity product over the same period."[137] Another analysis by William Reichenstein, published by the CFA Institute, examined the historical returns of four designs of equity-indexed annuities and 13 specific contracts for the period from the beginning of the S&P 500 Index (1957) to 2008.[138]

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[132] Dateline NBC, Tricks of the Trade (Apr. 23, 2008), viewable at http://nbcnews.to/2pjtTxj; *see also* Brokers' Choice of Am., Inc. v. NBC Universal, Inc., 138 F. Supp. 3d 1191, 1199–1215 (D. Colo. 2015) (finding Dateline broadcast to be substantially true in granting motion to dismiss defamation action).
[133] Mark Fazlollah and Erin Arvedlund, *Fixed Indexed Annuities: 'Magical' or 'Unsuitable,'* PHILADELPHIA INQUIRER, March 5, 2017, http://bit.ly/2nNto1h.
[134] *Id.*
[135] *Id.*
[136] *Id.*
[137] *Id.*
[138] William Reichenstein, CFA, Financial Analysis of Equity-Indexed Annuities (Digest Summary), Financial Services Review, Vol. 18, No. 4 (Winter 2009): 291-311, http://cfa.is/2p3TMnH.

Reichenstein found that equity-indexed annuities underperformed the market on a risk-adjusted basis by at least 1.73 percent per year, with an average underperformance of about 2.9 percent per year. Reichenstein concluded that the designs of these contracts make it inevitable that equity-indexed annuities will fail to match returns available on competitive market-based assets of comparable risk.

In addition to these media accounts, several state regulators have expressed particular concern after observing an increase in aggressive and misleading advertising by producers and IMOs. For example, Iowa's Insurance Division has observed some IMOs "aggressively promoting indexed annuities in potentially deceptive manners."[139] These include: advertising promotional high-interest lifetime withdrawal benefits without informing clients of the restrictions on those payouts; promising uncapped rates of return without informing clients of the limitations that reduce rates of return; and using "back-casted" indexes that did not exist previously and that are based on cherry-picked periods of tremendous market growth to create a false impression that investors will receive similar returns the future.[140] Similarly, Kansas' Insurance Department has observed IMOs and Field Marketing Organizations (FMOs) engaging in potentially "unfair and deceptive methods to advertise and market that insurer's products," including: failing to identify the insurer when promoting a specific product or product feature; using misleading, deceptive, and/or incomplete information intended for the general public in what appear to be bait-and-switch sales tactics; making exaggerated and unsubstantiated claims regarding the benefits of a product; and recruiting, training, and educating producers using misleading, deceptive, and/or incomplete material which is designed to be used for advertising to the general public.[141]

E. Long surrender periods and high surrender fees can harm annuity investors.

Instead of charging commissions directly to investors, fixed-indexed annuities impose often lengthy surrender periods and hefty surrender charges to ensure that they recoup the costs of compensating the seller. Fixed-indexed annuity surrender charges and surrender periods can be devastating to investors in these products. Investors who are forced to withdraw their money before the lengthy surrender period runs can suffer a loss of principal. Other investors may make other economically suboptimal decisions, albeit less harmful than paying the surrender charge, to cover a financial need. While the cost of this choice and resulting harm is not readily quantifiable, the harm is real. An investor also pays other opportunity costs by investing in a fixed-indexed annuity with a hefty surrender charge and lengthy surrender period, including the lost opportunity to choose a more liquid investment alternative that does not carry those detrimental features.

Our review of fixed-indexed annuities available on the market shows products with surrender periods as long as 16 years and surrender charges as high as 20 percent of premiums.[142] The mere fact that a product with such disadvantageous features exists and is sold proves that the insurance company creating these products and the agents selling them are not

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[139] Nick Gerhart, Iowa Ins. Comm'r, Bulletin No. 14-02 (Sept. 15, 2014), http://bit.ly/2pjCrnD.
[140] *Id*.
[141] Sandy Praeger, Kan. Comm'r of Ins., Bulletin No. 2014-1 at 1 (May 22, 2014), http://bit.ly/2oIlEgd.
[142] American Equity Bonus Gold Index 1-07 (In Delaware, the surrender period is 17 years), http://bit.ly/2pBEzGG.

reliably acting in customers' best interests. And while this particular annuity may be an extreme example, it is not an isolated example. Nor is it uncommon for fixed-indexed annuities to have surrender periods between 10 and 14 years and surrender charges between 10 and 15 percent of premiums. For example:

- Athene performance elite -- 15-year surrender period, with a surrender charge as high as 15 percent;[143]
- Fidelity and Guaranty AccumulatorPlus14 -- 14-year surrender period, with a surrender charge as high as 13.75 percent;[144]
- Midland National Life MNL IncomeVantage 14 -- 14-year surrender period, with a 10 percent surrender charge that lasts for the first five years before declining;[145]
- NorthAmerican RetireChoice 14 -- 14-year surrender period, with a 10 percent surrender charge that lasts for the first five years before declining;[146]
- Phoenix Personal Retirement Choice -- 12-year surrender period, with a 15 percent surrender charge for the first three years before declining;[147]
- Allianz 222 (Allianz's best-selling FIA, according to press reports) -- 10-year surrender period, with a 10 percent surrender charge for the first three years before declining.[148]

Indeed, market research shows that, as of 2015, surrender fees for the 10 top-selling indexed annuities averaged 11.25 percent in the first year.[149]

Several commentators have connected fixed-indexed annuities' hefty surrender charges to the lofty commissions that these products pay to encourage and reward financial professionals for selling them. For example, Kimberly Lankford of *Kiplinger's Personal Finance Magazine* wrote in 2007, "[T]he longer the surrender period, the higher the commission, so agents have a big incentive for selling deferred annuities…When a $500,000 IRA rollover can earn an agent an immediate commission of $60,000, it's easy to understand what motivates a hard sell."[150] More recently, financial planner and blogger Michael Kitces wrote: "In fact, the whole purpose of surrender charges on annuities is simply to ensure that when an insurance agent is paid a commission upfront, the annuity funds will remain invested long enough with the ongoing interest rate spread extracted from the investor return to allow the insurance company to recover that commission cost from the investor (or else he/she pays a surrender charge to make up the difference!). In the end, this means that not only do fixed and indexed annuities have a cost to the client for compensation paid to the insurance agent that

143 Athene Performance Elite® 15 Product Details, http://bit.ly/2ovD0eh.

144 Fidelity and Guaranty AccumulatorPlus14, http://bit.ly/2og6WJn.

145 Midland National Life MNL IncomeVantage 14, http://bit.ly/2nNB8jN.

146 NorthAmerican RetireChoice 14, http://bit.ly/2ocznZP.

147 Phoenix Indexed Annuity Disclosure 8, http://bit.ly/2nNwItg.

148 Allianz, How Allianz 222® Annuity works, http://bit.ly/2ofRJrR.

149 Fidelity Investments, Viewpoints on Indexed annuities: Look before you leap, July 13, 2016 http://bit.ly/1KFnq3L (citing AnnuitySpecs, Beacon Research and Fidelity Life Insurance Company, as of Q3 2015).

150 Kimberly Lankford, *The Great Annuity Rip-Off*, KIPLINGER, January 2007, http://bit.ly/2pBUOUg.

impacts long-term retirement wealth… but it's actually remarkably similar to what investors typically pay brokers and investment advisers as well!"[151]

Annuity expert Stan Haithcock explained how insurance companies compete to attract sellers, rather than investors, and how that can lead to less favorable product features for investors. "The longer the surrender charge period, the higher the commission paid to the agent, and carriers know that agents are going to gravitate to high commissions ... so that's the products they give them. The carriers pretty much move the pieces around till they find the right 'product recipe' to attract the agent and entice them to sell it to the client."[152] Haithcock says that these financial incentives have led these products to be over-promoted, which has translated into record sales. "This annuity nonsense has created a toxic formula of over hyped sales madness that is sweeping the country," he said. "The fact that Internet, TV, radio, and print promotions go largely unregulated and without repercussion has spawned a new breed of annuity elixir carnival barkers."[153]

Lengthy surrender periods are far from the only conflict in the fixed-indexed annuity market that harms retirement investors. The payment of opaque, indirect costs also reduce investors' effective returns. As mentioned above, insurance companies control how much is credited to the fixed-indexed annuity investor's account by imposing caps, participation rates, and spreads. These terms are both opaque and harmful. Based on his extensive research on fixed-indexed annuity products and spreads in particular, Dr. Craig McCann of the Securities Litigation and Consulting Group has found that spreads on fixed-indexed annuities are the functional equivalent of the annual expense ratio for investment management in the securities market, but often impose much higher costs.[154] For example, Dr. McCann examined SEC filings for American Equity, one of the top fixed-indexed annuity providers, and found: "Just like the annual expense ratios in a mutual fund levied by fund companies, the investment spread is a charge levied by American Equity to pay for commissions, overhead and profit….This process is not meaningfully different from what mutual fund companies do with the proceeds from the sale of mutual fund units except that American Equity and the other equity-indexed annuities issuers deduct ten times as much from the gross returns of the investment portfolio before passing the returns on to retail investors."[155] Since Dr. McCann issued his research in 2008, American Equity's investment spreads have barely budged from their average 2.81 percent for the years 2002-2007. As of 2015, American Equity's investment spreads have averaged 2.76 percent for the years 2013-2015.[156]

Kitces has produced a similar analysis finding that, while fixed-indexed annuities' method of charging customers may be different and less transparent, it still has the same effect

[151] Michael Kitces, *The Myth Of "Free" No-Expense Fixed Or Equity Indexed Annuities*, KITCES.COM, March 18, 2015, http://bit.ly/2oIvKhc.
[152] Stan Haithcock, *Confessions of an Indexed Annuity Insider*, MARKETWATCH, April 29, 2014, http://on.mktw.net/2pk14R2/.
[153] *Id*.
[154] Craig J. McCann, An Economic Analysis of Equity-Indexed Annuities (Sept. 10, 2008), http://bit.ly/2p3TBsv.
[155] *Id*.
[156] American Equity Life 2015 Annual Report, http://bit.ly/2oIMViK (showing the company's investment spread was 2.72 percent in 2013, 2.80 percent in 2014, and 2.77 percent in 2015).

as charges for other investments.[157] "The bottom line, though, is simply this: while paying an ongoing annuity expense through interest rate spread is less visible and harder to compare than a line-item expense ratio or AUM [assets under management] fee subtracted from the balance of a variable annuity or an investment account, in the end the cost structure that fixed and indexed annuities use to compensate insurance agents is remarkably similar to almost every other type of financial services investment product," he wrote.[158] "While the agent's compensation may be 'paid by the insurance company', it is still generated directly from and netted against the investment return produced by the client's assets, as evidenced by the existence of surrender charges to ensure that the interest rate spread against the client's assets remains in place for enough years to allow the insurance company to recover the commissions paid upfront."[159] In short, Kitces concludes, the interest rate spread is "still a cost to the client for compensating the advisor."[160]

Despite this fact, the fixed annuity industry often misleadingly claims independent insurance agents provide advice "at no expense," and that "[t]he only significant difference between fixed indexed annuities and fixed declared rate annuities is the method for computing interest earnings credited to the policies."[161] Investors have little if any capacity to challenge these claims or recognize the true costs they face when investing in these products. This is yet another reason why the Department was right to conclude that sale of fixed-indexed annuities should be subject to the more protective conditions imposed by the BIC.

F. True costs of fixed-indexed annuities include inferior returns relative to similar alternatives.

Research suggests that fixed-indexed annuities are grossly over-priced, given their risks and returns. Dr. McCann's research led him to conclude that equity-indexed annuities produce lower returns than U.S. Treasury securities, despite being illiquid and exposing investors to stock and bond market risk. "This is a recurring theme in equity-indexed annuities," he wrote. "There is an enormous amount of complexity designed into the product but ultimately the complexity is a smoke screen designed and managed to provide investors with substantially the same miniscule returns regardless of which index option is chosen. The resulting investor returns equal the returns on a bond portfolio less a 2.5% - 3.0% annual expense ratio."[162] More recently, Professors Andy Terry and Erick Elder, both at the University of Arkansas at Little Rock College of Business, examined the distribution of returns that could have been created on a rolling monthly basis since 1928 for 11 through 15-year investment horizons. They concluded that, for long time horizons, the opportunity costs of investing in EIAs is high.[163]

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[157] Michael Kitces, *The Myth Of "Free" No-Expense Fixed Or Equity Indexed Annuities*, KITCES.COM, March 18, 2015, http://bit.ly/2oIvKhc.

[158] *Id.*

[159] *Id.*

[160] *Id.*

[161] Market Synergy Group Memorandum in Support of Motion for Preliminary Injunction at 6, 41, Civil Action No. 5:16-cv-04083-DDC-KGS.

[162] Craig J. McCann, An Economic Analysis of Equity-Indexed Annuities (Sept. 10, 2008), http://bit.ly/2p3TBsv.

[163] Andy Terry and Erick Elder, A Further Examination of Equity Indexed Annuities, Financial Services Review, Vol 24, No. 4, Winter 2015.

One way of understanding the true cost of fixed-indexed annuities is to compare the amount those products credit to an investor's account with the returns that an investor could have received elsewhere without taking on additional risks. Several analyses have done just that. For example, an illustration by Fidelity Investments shows how an investor would be considerably worse off purchasing a fixed-indexed annuity as compared with a portfolio that is 90 percent invested in 10-year zero-coupon Treasuries and 10 percent invested in the S&P 500 index.[164] Assuming an initial investment of $100,000 in both the indexed annuity and the Treasury/S&P 500 portfolio, Fidelity concluded that the average ending balance of the Treasury/S&P 500 portfolio would be about $10,000 higher ($140,090 for the Treasury/S&P 500 portfolio vs. $130,031 for the annuity) over 56 simulated rolling 10-year periods beginning with 1951–1960 and ending with 2006-2015.[165]

Moreover, this analysis does not consider other ways in which an investor would be better off purchasing the U.S. Treasuries/S&P 500 portfolio. For example, in sharp contrast to fixed-indexed annuities, these securities are among the most liquid securities that exist, meaning that they can be sold immediately and with negligible transaction costs. If an investor needs to access her money, she could do so without having to pay a hefty surrender charge, which would further reduce her return on a fixed-indexed annuity relative to the U.S. Treasury/S&P 500 portfolio. In addition, because U.S. Treasuries are backed by the full faith and credit of the U.S. government, rather than the financial strength (or weakness) of an insurance company, the investor would be exposed to significantly less credit risk by purchasing the U.S. Treasury/S&P 500 portfolio.

In a recent blog post, Certified Financial Planner and industry commentator Anthony Isola provided another example of how an investor could create an extremely low-cost equivalent to a fixed-indexed annuity.[166] Under this approach, the investor would first allocate the majority of the initial investment to a CD that, based on its interest rate, guarantees the investor's return of principal. For example, assuming a $100,000 investment, the investor would need to invest $78,886 in a 10-year CD that pays a 2.40 percent interest rate, in order to receive $100,000 in 10 years. The investor would then use the remaining $21,114 to buy a low-cost total market index fund, (with an expense ratio of as low as 0.05 percent, or less). At the end of the 10 years, the money invested in the total market index fund, including any returns, would be gravy. In other words, the value of the index portfolio could go to zero, an unlikely scenario, and the investor would still preserve her principal.

Isola sees several advantages to this approach. First, it's simple. Second, it's dirt cheap. (If you consider that CDs do not carry any embedded costs so long as they are held to term, low-cost ETFs can be purchased commission-free, and ETF expenses are about 0.05 percent, the total cost of this strategy on a $100,000 investment is about $11, or roughly 1 basis point.) Third, the CD is backed by the federal government through FDIC insurance, which is much safer than being backed by a private insurance company, particularly in the event of an economic meltdown of the sort used by Cannella and others to sell fixed-indexed annuities.

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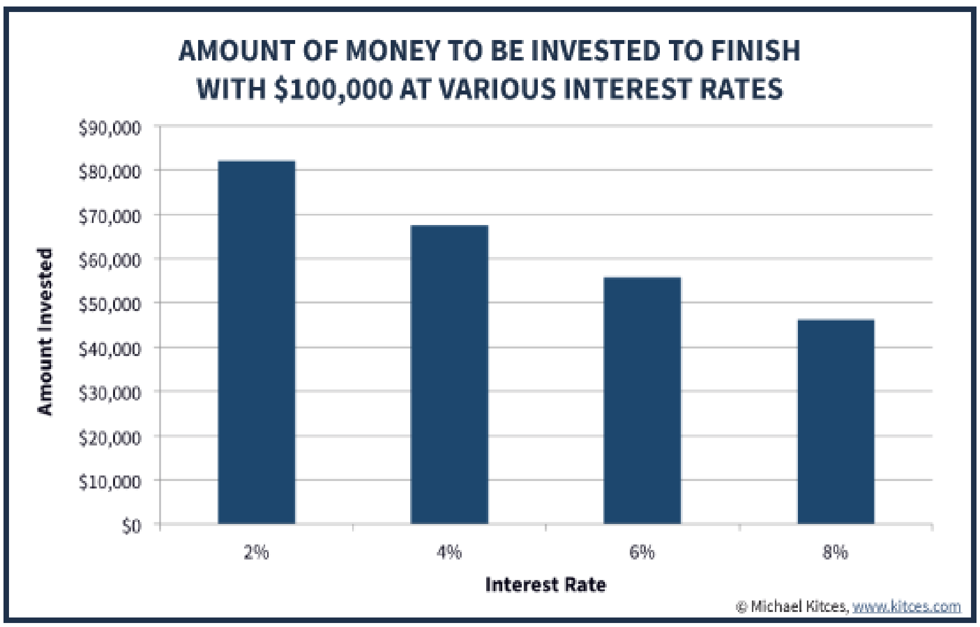
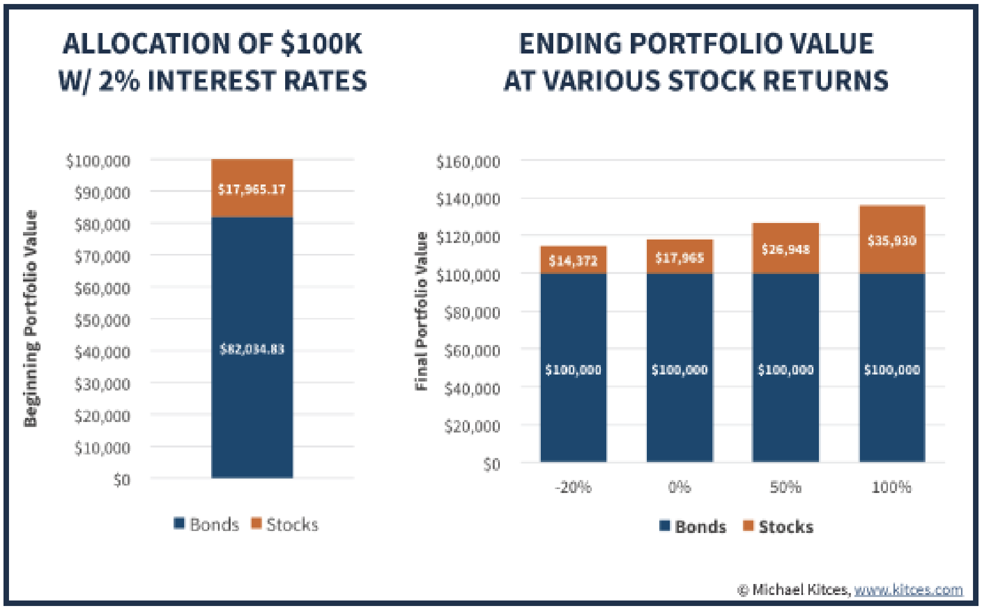
[164] Fidelity Investments, Viewpoints on Indexed annuities: Look before you leap, July 13, 2016, http://bit.ly/1KFnq3L.
[165] *Id*.
[166] Anthony Isola, CFP, *How to Create Your Own Equity-Indexed Annuity*, A TEACHABLE MOMENT, March 31, 2017, http://bit.ly/2pkgdSy.

Fourth, there is much more liquidity in this approach, because the equity portion can be sold at any time without penalty. Fifth, any returns on the equity portion are neither capped nor reduced by participation rates, spreads, or commissions. And, the investor receives the dividends from the index.

Kitces offers several other approaches to achieve largely the same goals at lower cost.[167] The strategy starts with buying enough 10-year Treasuries to ensure that just holding them until maturity will replenish the entire principal. The amount of money invested to ensure return of principal is dependent on interest rates, as shown below. Then, similar to the approaches of Fidelity and Isola, the investor would put the remaining amount of the initial investment in a portfolio of equities. As depicted below, even if the equities lost 20 percent over the ten-year period, the investor will still end up with more than $114,000 under this approach. That is significantly more than the roughly $96,700 the investor would receive based on a fixed-indexed annuity's one percent guaranteed minimum return applied to 87.5 percent of the investor's premiums.



[167] Michael Kitces, *Building Your Own Equity-Indexed Annuity or Structured Note*, KITCES.COM, June 10, 2015, http://bit.ly/1WLQdrL.



Alternatively, Kitces proposes a more complicated approach that an adviser could implement, pairing Treasury bonds with equity index options, for a more efficient downside guarantee.[168] Under this approach, the investor would buy a series of 10-year Treasury bonds, and use the annual bond interest to buy a series of one-year at-the-money call options for an equity index, for example the S&P 500. At worst, if the market doesn't go up for 10 years, the options will expire worthless every year, and all the investor will have lost is the premiums. Here again, however, the bonds remain to mature at par at the end of the decade, returning the investor's principal. And any year the options expire in the money, the investor participates in at least some of the upside. On the other hand, under this options approach, the investor would not receive the dividends from her equity participation. Kitces proceeds to offer variations on this approach that could enhance the investor's return.

We are not offering these alternative approaches to suggest any one particular approach is superior to another. In fact, these examples show that the potential variations to achieve the same result are virtually limitless, depending on how simple or complex the investor and her adviser want to make things. The point is that an investor can use any of these alternative approaches to achieve significantly better outcomes at much lower costs than purchasing a fixed-indexed annuity from an annuity salesperson whose promised benefits are illusory.

In summary, while the costs and conflicts of interest in the fixed-indexed annuity market may not be as transparent as the mutual fund and variable annuity markets, they are significant and likely are even more detrimental to retirement savers. Indeed, the lack of transparency increases the likelihood that investors will suffer harm as a result of these conflicts. The DOL compellingly showed this and therefore justified the need for regulatory action. If, as industry rule opponents have suggested, the Department reevaluates the rule's impact on the sale of fixed-indexed annuities, it must include in that evaluation the enormous excess costs investors currently pay for these products, the additional harms they suffer, such as

[168] *Id.*

loss of liquidity, and the potential of the rule to reduce both those costs and those harms. Before concluding that a different regulatory approach is appropriate for fixed-indexed annuities, the Department must first demonstrate on what basis it finds that any such approach is sufficient to protect investors from conflicted advice regarding a product that is complex, opaque, costly, and sold based on toxic financial incentives through often predatory practices.

G. *The Department should consider regulating all conflicted annuity sales under the BIC.*

In the RIA, the Department carefully evaluates the existing regulatory oversight governing annuities and concludes that it is not sufficient to protect retirement savers from the harmful impact of conflicted advice. Indeed, if the DOL erred in its approach, it was by exempting fixed-rate annuity sales from regulation under the BIC, allowing sale of these traditionally more plain vanilla annuities under PTE 84-24. Our concern is that insurance companies are likely to exploit that disparate treatment to create increasingly complex versions of fixed-rate annuities that would appropriately be regulated under the more protective conditions of the BIC.

A recent *Insurancenews.net* article suggests this may already be occurring. That article noted that, "A flood of new income riders attached to fixed annuities has helped fuel a boom and powered the product segment to record sales of $117.4 billion last year."[169] Already in 2017, several annuity companies have launched income riders on a traditional fixed annuity, according to Wink, an annuity industry tracker.[170] The companies are American Equity Investment Life Holding, Life Insurance Company of the Southwest, Midland National Life Insurance Company, and North American Company for Life and Health.[171] New riders are "designed for independent insurance agents looking to sell under prohibited transaction 84-24 of the DOL fiduciary rule," said Ron Grensteiner, president of American Equity Investment Life Insurance.[172] "Due to the competitive guaranteed income, we think they will be accepted by a broader group of agents," Grensteiner said.[173]

Experts quoted in the *Insurancenews.net* article attribute the development of the new products to the desire to craft a product that can be sold under PTE 84-24 but that "looks like indexed annuities as much as possible."[174] Jeremy Alexander, CEO of Beacon Research, a consulting firm that tracks annuity sales, was quoted as saying, "What they (insurers) want to do is to help all those agents in the independent channel who were selling FIAs to help them sell fixed annuities."[175] Sheryl J. Moore, president and CEO of Moore Market Intelligence and Wink, said income riders will help "the transition for those salespeople that will no longer be doing any indexed annuity business because of the BIC exemption."[176]

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[169] Cyril Tuohy, *Income Riders Invade Fixed Annuities*, INSURANCENEWSNET.COM, April 3, 2017, http://bit.ly/2nOFyDW.
[170] *Id.*
[171] *Id.*
[172] *Id.*
[173] *Id.*
[174] *Id.*
[175] *Id.*
[176] *Id.*

Just as the Department appropriately concluded that fixed-indexed annuities and variable annuities are susceptible to abuse and thus appropriately sold under the more protective conditions of the BIC, the Department should reconsider whether all annuity sales should be subject to BIC requirements.

V. The Fiduciary Rule and the Growing Significance of Alternative Investments

Fueled by promises of diversification benefits and the greater range of options for structuring investments that are permitted into retirement portfolios, "alternative investments" are playing a growing role in retirement savings.[177] While comprehensive information is lacking, a recent survey of advisers and brokers by Blackstone and *InvestmentNews* finds that 83 percent of clients are interested in alternative investments and that advisers expect average allocation of alternative investments to rise from 10 to 14 percent of portfolios within just three years.[178] A recent study of defined benefit plans finds a mean allocation of over 12 percent to alternative investments and real estate.[179] Another recent analysis by Hewitt Enniskupp calls alternative investments the "next frontier" for defined contribution plans, and predicts accelerating growth in the inclusion of such investments in DB plans.[180] And, Josh Charlson, director of manager research for alternative strategies at investment researcher Morningstar Inc., recently stated in a *Wall Street Journal* article that advisers typically recommend that their clients allocate around 6 percent to 20 percent of a portfolio to alternatives.[181]

The impact of such growth on retirement investors is open to question. The usual justification given for increased use of alternative investments is portfolio diversification, or a supposed lack of correlation between the returns of alternative investments and more standard instruments traded on broad markets. But research from the Boston University Center for Retirement Research shows that alternative investments held by defined benefit plans actually underperformed conventional investments during the financial crisis, indicating that diversification benefits failed to appear during precisely the tail risk conditions for which they are supposed to be most beneficial.[182] This is not surprising given that correlations between asset classes typically increase during periods of high volatility, and it is a sign of future risk in diversification strategies given that correlations have continued to increase in recent years.[183]

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[177] While there's no commonly accepted definition of what constitutes an "alternative investment," the term typically connotes non-traditional investment strategies and non-traditional asset classes.
[178] InvestmentNews Research and Blackstone, Alternatives in the Mainstream: A Potential Growth Opportunity for Advisers, 2017, http://bit.ly/2pqVrRe. (citing Cerulli Edge adviser Edition projecting a $150B increase in allocation to alternatives across the entire independent advisory channel)
[179] *See* Constantijn W.A. Panis, PhD, Advanced Analytical Consulting Group Inc. and Michael J. Brien, PhD, Deloitte Transaction and Business Analytics LLP, Asset Allocation of Defined Benefit Pension Plans, November 19, 2015, Table 2. Schedule R and Schedule H Asset Mix Summary Statistics (2013), http://bit.ly/2pqW1hS.
[180] Eric Friedman, CFA, FSA and Lou Kahl, CFA, Alternative Assets: The Next Frontier for Defined Contribution Plans, An Idea Development Forum Paper, Hewitt EnnisKnupp, An Aon Company, September 2013, http://bit.ly/2oguSgO.
[181] Charlie Wells, *An Alternative Investment by Any Other Name Is Still…,* Wall Street Journal, August 10, 2015, http://on.wsj.com/2oDRcDs.
[182] Divya Anantharaman, Corporate Pension Plan Investments in Alternative Assets: Determinants and Consequences, Center for Retirement Research at Boston College, 2011, http://bit.ly/2pr4kKP.
[183] International Monetary Fund. Monetary and Capital Markets Department, Global Financial Stability Report, Navigating Monetary Policy Challenges and Managing Risks, April 15, 2015, http://bit.ly/2pqT2pD.

"Liquid-alt" mutual funds – the regulated mechanism by which many alternative investments may become available for ordinary retirement investors – have also recently recorded poor performance despite supposed diversification benefits.[184]

A. *Alternative investments have qualities that make investors vulnerable to exploitation by conflicted advisers.*

But if the benefits of alternative investments are questionable, there can be no question about the importance and relevance of a strong conflict of interest rule in a world where alternative investments are becoming more common. While there is a broad range of types of alternative investments, the asset class shares a number of qualities that render investors more vulnerable to exploitation by advisers who do not place their clients' interests first.

Many alternative investments are not traded on regulated exchanges and have limited secondary markets. A few examples include non-traded REITs, non-traded BDCs, and non-exchange traded structured notes. Some fund investments may also involve significant lock-up periods. Infrequent trading means investors may not have reliable data on the true market risk or price volatility of their investments. It also means that investors must have significant tolerance for illiquidity.

The complexity of the instruments involved in alternative investments means that the valuation is difficult for outsiders to understand, and additional costs or fees can easily be concealed. One example is the use of derivatives to conceal additional fees in both liquid-alt mutual funds and managed futures funds.[185] To take another example, structured notes are custom-designed and complex, and issuer disclosures have been found to conceal systematic overpricing and costs far in excess of reported fees.[186]

B. *Alternative investments have the potential for numerous conflicts of interest.*

On their own, the complexity and opacity of alternative investments create potential conflicts of interest concerning disclosure. But other conflicts arise due to management fee structures and opportunities for side payments to managers. For example, hedge funds can steer investors into services that offer side payments to the fund managers, can manipulate valuations to maximize fees, and the potential for these conflicts are massively increased in the case of funds of funds.[187] The payout for many structured notes is directly linked to proprietary indexes

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[184] Reshma Kapadia, *Liquid-Alt Mutual Funds Disappoint*, BARRONS, December 24, 2016, http://bit.ly/2pGf0Eq.

[185] Jason Zweig, *The Hidden Fees Inside Managed-Future Funds*, WALL STREET JOURNAL, January 27, 2017, http://on.wsj.com/2oBw9Qx; John Waggoner, *Morningstar slams some liquid alternative funds for masking actual expense ratios*, InvestmentNews, September 1, 2016, http://bit.ly/2pGel5W.

[186] Peter Løchte Jørgensen, Henrik Nørholm, David Skovmand, Overpricing and Hidden Costs of Structured Products for Retail Investors: Evidence from the Danish Market for Principal Protected Notes, June 13, 2011, http://bit.ly/2ogCpfx; Jennifer Bethel & Allen Ferrell, Policy Issues Raised by Structured Products, Brookings-Nomura Papers on Financial Services, October 2006, http://bit.ly/2pn9Cto.

[187] *See* Julie M. Riewe, Conflicts, Conflicts Everywhere – Remarks to the IA Watch 17th Annual IA Compliance Conference: The Full 360 View, February 26, 2015,http://bit.ly/2ogIJ6y; Gene Gohlke, Remarks before the Fund of Funds Forum, November 14, 2005, http://bit.ly/2oEktht; Gjergji Cici, Alexander Kempf, and Alexander Puetz Caught in the Act: How Hedge Funds Manipulate their Equity Positions, August 2011, http://bit.ly/2okhibh.

maintained and calculated by the issuer, who has a clear incentive to manipulate or misrepresent the index to minimize payouts while maximized sales.[188]

These are only a few of the most prominent examples of the unique risks presented to investors by alternative investment products. Of course, none of these risks mean that alternative investments may not in the right circumstances be a beneficial choice for investors. For example, for investors who understand the risks and have the capacity to tolerate illiquidity, illiquid investments offer a liquidity premium that permits additional profits to be earned. But these risks do mean that in the alternative investment space investors are extraordinarily dependent on good advice from advisers, and particularly vulnerable to advisers who do not place their interests first. The complexity and opacity of alternative investments can permit supra-normal returns for sellers if buyers are poorly informed, and these returns can be shared with brokers or advisers as an incentive for selling such products. For example, retail structured products have been found to systematically underperform at levels which imply that many such products should never be sold to retail investors, but they are in fact sold in high volumes.[189] In the face of additional competition, sellers of such products are found to maintain market share by increasing complexity, making it easier to deceive investors as to their value.[190] This is just one example of how the complexity and opacity of alternative investments require strong incentives at the retail advisory level to prevent the steering of investors into harmful products.

As we've stated previously, disclosure alone is totally inadequate in the face of the complexity and conflict of interests in the retirement market, and this is particularly the case with alternative products. The discussion above offers numerous examples of the failure of disclosure-based strategies to properly reflect the true costs of complex alternative investments. Nor can a suitability standard alone protect customers from the powerful anti-investor incentives brokers can face in this space. That is why we need the protections of the rule, especially when particularly complex, opaque, costly, and conflict-ridden investments are recommended to retirement savers.

Some rule opponents have advocated extending the seller's carve-out to "sophisticated" retail investors. In advocating this approach, they typically point to the securities law "accredited investor" definition as the appropriate vehicle for achieving their policy goal. But the accredited investor definition, as currently drafted, cannot reasonably be relied on to identify a population of financially sophisticated individuals capable of independently assessing the recommendations they receive from financial professionals. To our knowledge, no other widely accepted measure of financial sophistication exists that could be used in its place. In the absence of a reliable measure of financial sophistication, such an approach is simply not workable, as we detailed in our September 24th comment.[191]

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[188] Louie Woodall, *Proprietary indexes: private products face public scrutiny,* Risk.Net, December 17, 2015, http://bit.ly/2oBk91b.

[189] Oliver Entrop, Michael D. McKenzie, Marco Wilkens, and Christoph Winkler, The Performance of Individual Investors in Structured Financial Products, December 16, 2012, http://bit.ly/2pGkX4m.

[190] Claire Celerier and Boris Vallee, Catering to Investors through Product Complexity, July 12, 2016, http://bit.ly/2nSscJO (While this evidence comes from Europe, similar dynamics are thought to occur in U.S. markets, particularly as many issuers are active in both markets.)

[191] Letter from Barbara Roper and Micah Hauptman, Consumer Federation of America, to the Department of Labor, September 24, 2016, at 7-9, http://bit.ly/2nK64ge.

Moreover, recent research supports the Department's decision not to expand the seller's carve-out to include individual retail investors through an accredited or sophisticated investor test that uses wealth as a proxy for investor sophistication. As FINRA's survey research, discussed above, shows, wealth is a poor and unreliable indicator for financial sophistication. Using a proxy for the accredited investor definition to determine whether wealth was a reliable indicator of financial sophistication, FINRA found that this income group scored 5.6 questions correct on average out of 10 question, which strongly suggests that this population is insufficiently capable of fending for themselves in this highly complex, opaque, and conflicted marketplace.[192]

VI. The Rule Would Help to Address Harms That Are Prevalent in the 401k Market

The justification for the fiduciary rule is based largely on an analysis of the harm that occurs when individual investors receive conflicted advice either with regard to their IRA investments or with regard to recommendations to rollover assets out of a workplace retirement plan and into an IRA. The RIA does also discuss, however, the harm that can occur when plan sponsors rely on conflicted advice from service providers, often in the mistaken belief that their adviser is acting as a fiduciary.[193] The RIA cites a GAO report that found that "there is a considerable amount of confusion among plan sponsors about whether or not they are receiving investment advice subject to ERISA fiduciary standards."[194] GAO also found that "plan sponsors are often not aware when a service provider is not an ERISA fiduciary and often assume that the advice they receive from the service provider is subject to ERISA standards and safe from harmful conflicts."[195] As a result, "plan sponsors may not be aware that service providers can have a financial incentive to recommend certain funds that would be prohibited if they were ERISA fiduciaries."[196] The problem is particularly acute for smaller plan investors, the RIA concluded, because smaller plans are less likely than larger plans to receive investment assistance from a service provider that is acting as a fiduciary.[197] The RIA further concluded that plan sponsors and plan officials that rely on biased advice "may make poor investment decisions," which can in turn compromise participants' retirement security.[198]

We share the Department's concern over the harmful impact of conflicted advice to plan sponsors. Indeed, our own exploration of the evidence (discussed below) suggests that this harm at least matches, and likely greatly exceeds, the RIA's estimate of harm to IRA investors. As it conducts its reconsideration of the rule, including its reevaluation of the rule's economic impact, the Department should deepen its analysis of the harm that plan participants suffer when their employers receive conflicted non-fiduciary advice regarding plan menu options and the potential benefits of the rule in reducing that harm. Based on that analysis, we believe the

[192] FINRA Survey Supplemental Findings, on file with authors.
[193] RIA at 189, quoting GAO Publication No. GAO-11-119, 401(K) PLANS Improved Regulation Could Better Protect Participants from Conflicts of Interest, http://bit.ly/2p3UIZk.
[194] *Id*.
[195] *Id*.
[196] *Id*.
[197] *Id*.
[198] RIA at 200.

Department should consider strengthening protections for larger retirement plans to match those provided under the rule to small plans. Specifically, we believe the Department should at the very least restore the $100 million threshold for the seller's carve-out included in the rule proposal and reduced to $50 million in the final rule. It should consider raising the threshold to $1 billion, since evidence suggests that it is only these very largest of plans that are consistently getting the benefits of fiduciary protections.

A. *Recent research documents the inadequacy of existing protections to discipline costs of 401(k) plan investment options.*

Our previous letter opposing further delay of the rule cited recent research showing that conflicts in the 401(k) context can harm 401(k) participants, in the form of both excessive costs and inferior returns. We cited, in particular, a recent study published in the *Yale Law Journal* which found that a significant portion of 401(k) plans establish investment menus that predictably lead investors to hold high-cost portfolios.[199] The study by Professors Ian Ayres, Yale Law School, and Quinn Curtis, University of Virginia School of Law, uses data from more than 3,500 401(k) plans with more than $120 billion in assets to analyze the effectiveness of the ERISA fiduciary requirements in protecting plan participants from high costs.[200] Based on their analysis, the authors conclude that fees and menu restrictions in an average plan lead to a cost of 78 basis points in excess of the cost of index funds.

The authors also document the existence of a wide array of "dominated" menu options, which they define as "funds that make no substantial contribution to menu diversity but charge fees significantly higher than those of comparable funds in the marketplace."[201] As the authors explain, "Since investors in retirement plans are limited to choosing from the menu offered by their employers, high-cost funds in the menu can greatly affect the performance of a retirement account. The stakes are high: reforms that reduce fees incurred by investors by only ten basis points on average would save more than $4.4 billion annually, and these savings compound over the course of investors' careers."[202]

Drawing on a proprietary dataset of 401(k) plan menus from 2010 as well as mutual fund data from 2003 through 2013, the authors show that the primary problem for investors in 401(k) plans is not loss due to lack of diversification, but loss due to excessive fees. They find that investors in many plans bear costs well in excess of retail index funds that "are unlikely to be fully mitigated by returns."[203] In 16 percent of analyzed plans, they estimate that fees are so high "that they consume the tax benefits of investing in a 401(k) for a young employee."[204] Importantly, the authors found that "observed costs do not appear to be due to economies of scale; we find substantial variation in total costs over plans of similar size."[205] The authors also found that more than half of the plans studied offer at least one dominated fund. Because "some

[199] Ian Ayres & Quinn Curtis, Beyond Diversification: The Pervasive Problem of Excessive Fees and "Dominated Funds" in 401(k) Plans, Yale Law Journal, March 2015, http://bit.ly/2nwVtFF.
[200] *Id*.
[201] *Id*.
[202] *Id*.
[203] *Id*.
[204] *Id*.
[205] *Id*.

investors naïvely diversify by spreading their plan investments across all fund offerings," these unsophisticated investors "often invest in dominated funds when they are offered."[206]

Based on that research, and making conservative estimates regarding the amount of the market that, because of conflicts of interest, is invested in mutual funds that underperform available alternatives, we estimated harm to retirement investors of between $750 million and $7.5 billion a year, depending on assumptions. For example, assuming that just five percent of assets are affected and suffer just 50 bps in underperformance, the annual harm from this one conflict would total approximately $750 million a year. Alternatively, if 25 percent of assets are affected and suffer underperformance of one percent, harm to retirement savers would total roughly $7.5 billion a year. (See chart below)

Estimated % of Assets Affected	**Assets Affected**	**50 bps underperformance**	**1% underperformance**
5%	$150 billion	$750 million/year	$1.5 billion/year
10%	$300 billion	$1.5 billion/year	$3 billion/year
25%	$750 billion	$3.75 billion/year	$7.5 billion/year

These back of the envelope estimates based on the Ayres-Quinn study help to demonstrate the magnitude of the harm that 401(k) participants suffer when their employers receive conflicted investment advice regarding plan investment menus. Ayres and Quinn themselves concluded that, under existing regulatory requirements, courts have failed to provide an adequate remedy to ensure reasonable fees. "[B]y focusing on process over the substantive reasonableness of the plan's fees or of individual high-cost funds, courts have unwittingly allowed self-interested service providers to construct plan menus with dominated, high-fee options. These options predictably lead to investor decisions that benefit fund managers at investors' expense."[207] The authors express skepticism regarding "the capacity of fiduciary duties alone to resolve the problems in 401(k) plans," but their focus is on the fiduciary duties of employers. By requiring service providers to set aside their own financial interests and provide advice in the best interest of the plan and plan participants, the DOL fiduciary rule could play an important role in bringing down costs for 401(k) plan investment options, with dramatic potential benefits from retirement investors.

[206] *Id.*
[207] *Id.*

B. Brightscope data provides additional insights into plan costs, though most small plans are excluded from that data, and data likely understates costs.

In developing the rule, the Department provided stronger protections to sponsors of small plans than to large plans. The Department chose this path having concluded that small plan sponsors share common features with retail investors that make them particularly vulnerable to conflicted advice, including a lack of investment expertise and a resulting tendency to rely heavily on the recommendations they receive from professional advisers. To address this concern the rule requires financial professionals that provide investment advice to small plans -- those with less than $50 million in assets -- to either eliminate conflicts or comply with the BIC. (Above that $50 million asset level, the rule provides a seller's carve-out.) As a result, the rule's guarantee of fiduciary protections covers the vast majority of plans, but fewer than half of plan participants and just over a quarter of plan assets. According to the most recent ICI/Brightscope DC plan profile study, there were 526,547 plans with under $50 million in assets in 2014, comprising 98.7 percent of the total number of plans.[208] These plans covered more than 26 million participants, amounting to 41.6 percent of the total number of participants, and held roughly $1.16 trillion in assets, which equals 26.4 percent of the market by assets.

Even with sizeable data limitations that result in significant underestimates of small plan costs (explained below), Brightscope finds that participants in smaller 401(k) plans pay significantly and consistently higher costs for their investments than participants in large plans. For example:

- Asset-weighted average expense ratios in 401(k) plans in the database for domestic equity funds ranged from a low of 0.39 percent for funds with over $1 billion in assets to a high of 0.82 percent in plans with between $1 million and $10 million in assets. The asset-weighted average for plans with between $10 and $50 million in assets was 0.69 percent.
- Asset-weighted average expense ratios for international equity mutual funds ranged from 0.55 percent for funds with more than $1 billion in assets to 1.03 percent for plans with between $1 and $10 million in assets. Participants in plans with between $10 and $50 million in assets pay an average weighted expense ratio of 0.87 percent.
- Participants in plans with between $1 and $10 million in assets pay *well over twice as much* (an asset-weighted average of 0.72 percent) for domestic bond funds as participants in plans with more than $1 billion in assets (0.30 percent). The exorbitant costs for bond funds are particularly harmful, especially in this low interest rate environment, as they drastically cut into the funds' already modest expected returns.
- Small plan participants also pay *more than three times as much* for index funds (an asset-weighted average of 0.26 percent) as participants in the largest plans (0.08 percent). Participants in plans with between $10 and $50 million paid an asset-weighted average of 0.19 percent, still a hefty *two times higher* than the expenses paid by large plan participants.

[208] The BrightScope/ICI Defined Contribution Plan Profile: A Close Look at 401(k) Plans, 2014, December 2016, http://bit.ly/2pkzuDA (Exhibit 1.2: Universe of 401k plans).

There is simply no rational justification for such wide price differentials between small and large plans. Furthermore, as explained below, most small plans are excluded from the database. Among those that are excluded are those with under $1 million in assets, which likely have even higher costs than those reported here.

These wide price differentials help to illustrate just what a distorted view one gets of the market as a result of ICI's practice of presenting plan fund costs in terms of asset-weighted averages. Asset-weighted average expense ratios don't begin to tell the full story of the costs 401(k) investors could be paying, particularly in small plans. There is, after all, considerable variation in mutual fund expenses within asset classes. For example, the asset-weighted average expense ratio for all equity mutual funds held among all plans with audited 401(k) filings in the BrightScope database was 0.52 percent in 2014. However, 10 percent of assets were invested in funds with expense ratios of 0.98 percent or more.[209] When one adds plan size as a variable, the variation becomes even more striking. For example, the 90th percentile asset-weighted mutual fund expense ratio for domestic equity funds for plans with $1 million to $10 million in assets was 1.29 percent.[210] For international equity funds, it was 1.41 percent. For domestic bond funds, it was 1.07 percent, and for target date funds it was 1.20 percent. Perhaps most shocking, the 90th percentile asset-weighted expense ratio for index funds in small plans was 0.59 percent. Clearly not all index funds are created equal. Just because a small plan offers index fund options, that doesn't mean they are good, low-cost options. The 90th percentile asset-weighted average mutual fund expense ratio for plans with between $10 and $50 million in assets is not much better.[211] For example, the 90th percentile asset-weighted mutual fund expense ratio for domestic equity funds among such plans is 1.20 percent; for international equity mutual funds it is 1.31 percent; for target date funds it is 1.03 percent; for domestic bond funds it is 0.92 percent; and for index funds it is 0.45 percent.

This phenomenon of very high costs in a portion of small plans can likely be explained in part by the fact that insurance companies have tended to dominate this market. According to Brightscope data, insurance companies are recordkeeper for 52.8 percent of plans with between $1 and $10 million in assets.[212] Often, recordkeepers steer plans toward proprietary funds, which may, particularly in the insurance context, have costs that are considerably higher than other available options. According to Brightscope, 65.4 percent of 401(k) plans included proprietary funds in their investment lineups, and proprietary fund assets accounted for 26.1 percent of plan assets. A 401(k) investor who picks such a fund could be lulled into a false sense of security that it is a good deal. The fact that any of these excessively priced products exist at all, let alone the fact that they occupy a considerable part of the small plan 401(k) market, provides compelling evidence that imposing fiduciary duties on plan sponsors, without also making those they turn to for investment advice fiduciaries, is not providing sufficient protection to plan participants.

[209] *Id*. at 55.
[210] *Id*. at 64.
[211] *Id* at 64.
[212] *Id*. at 43-44.

C. *Brightscope data excludes most small plans and likely significantly understates small plan costs.*

Brightscope finds these higher costs for small plans despite serious data limitations that are likely to result in significant underestimates of small plan investment costs. Cost data on small plans is limited, since 401(k) plans with fewer than 100 participants are generally not required to file the audited reports that are required of larger plans. Audited reports provide valuable information on the investments offered by the plan and assets in these investments, but the vast majority of 401(k) plans have fewer than 100 participants. There were 479,307 plans with fewer than 100 participants in 2014, comprising 89.8 percent of the total number of plans, according to the ICI/Brightscope data. These plans covered more than 8.6 million participants, amounting to 13.7 percent of total plan participants. They held roughly $680 billion in assets, equaling 15.5 percent of the market by assets. But because of the lack of audited reports, few small plans are included in the Brightscope database. The Brightscope analysis also excludes micro plans, those with less than $1 million in plan assets. There were 303,753 such plans in 2014, comprising 56.9 percent of the total number of plans. These plans covered more than 4.6 million participants, amounting to 7.4 percent of the total number participants, and held roughly $105 billion in assets. As a result of these data limitations, the Brightscope database excludes the majority of plans, covering a significant minority of plan participants.

Because smaller plans have been found to have higher costs on average than larger plans, both with regard to investment-related expenses and administrative expenses,[213] the Brightscope data also likely significantly understates typical plan costs. First, as noted above, the majority of plans, affecting millions of plan participants, are not included in the database and likely have significantly higher costs than those plans that are included in the Brightscope database. Second, data imperfections[214] result in presentation of rough estimates only, using a formula that Brightscope itself has suggested likely understates costs.[215] (See footnotes for

[213] *Id*. at 48; *See also* Deloitte Consulting LLP and Investment Company Institute, Inside the Structure of Defined Contribution/401(k) Plan Fees, 2013: A study assessing the mechanics of the 'all-in' fee, Conducted by Deloitte Consulting LLP for the Investment Company Institute August 2014, http://bit.ly/2ow56pG (finding that larger plans tend to have lower fees as a percentage of assets, and the majority of plan costs are related to investment expenses).

[214] As the study explains, "Unfortunately, mutual fund company recordkeeping systems cannot see through to the underlying 401(k) plans, and thus it is not possible to analyze how mutual fund fees vary by plan size using the ICI mutual fund share class and Lipper fee data. The resulting asset-weighted measure of fees paid on 401(k) plan mutual fund investments reflects where the assets are invested and what 401(k) investors as a group paid on average for their 401(k) plan mutual fund investments. BrightScope's database of audited 401(k) Form 5500 filings contains reporting of mutual fund holdings by share class in DC plans for about 60 percent of the funds in the database. In the remaining cases where the mutual fund is known, but not the specific share class, BrightScope assigns a share class to the mutual fund holdings in a given DC plan based on the size of the plan's investment in the mutual fund. If the DC plan has less than $1 million invested in the mutual fund, a retail-type share class is assigned to the holding. If the DC plan has $1 million or more invested in the mutual fund, then an institutional-type share class is assigned. BrightScope matches Lipper fee information by mutual fund share class to estimate the fees paid by DC plan participants on their mutual fund holdings in their DC plans. Because BrightScope has DC plan–level information, it is possible to report how mutual fund fees vary across plan size and in aggregate."

[215] Letter from Ryan Aflred, Brightscope, to the Department of Labor, December 2, 2016, http://bit.ly/2pC7Cdf. ("BrightScope observes that about 50% of the investment information in the Department's audit reports currently do not have share class information. Therefore any person or firm evaluating a plan based on the current disclosures would have to make share class assumptions, which limits the accuracy of any performance or fee analysis of the plan. It is not uncommon for a single fund to have 10+ share classes and the range of expense ratios

details) However, understanding the data is imperfect and the costs are likely understated, the Brightscope database nonetheless provides a useful benchmark to gauge the respective costs 401(k) investors are paying.

D. New Analysis from RiXtrema finds potential costs savings in the plan market of $17 billion.

A recently released report from researchers at RiXtrema examined the fund holdings of more than 52,000 plans and found retirement plan participants could save $17 billion a year just by switching to lower cost investment options.[216] The authors of the study, Daniel Satchkov and Yon Perullo, compared the fund holdings of plan investments with other funds that have similar holdings but lower costs and higher returns (both raw and risk-adjusted) over the preceding 10 years. Where there was a better alternative available based on these factors, they replaced the inferior fund with a superior version. Using this method, Satchkov and Perullo estimated that participants could save 0.25 percent a year on a weighted average basis by switching into lower cost investments that are quantitatively very similar to those they already hold, resulting in savings to 401(k) investors of roughly $17 billion a year. According to the authors, that estimate is likely on the low end because, when information on share class was not available, they assumed the lowest cost share class of the fund. (Brightscope uses the same policy in developing its estimates, which is one reason its cost figures likely understate actual costs.)

Importantly, when Satchkov and Perullo ran the analysis excluding index funds and ETFs, their results did not vary. This shows the waste problem is not simply a function of active vs. passive, it is independently a problem in the active space. Furthermore, the differentials in returns between the actual plans and optimized plans were even larger, which indicates that the superior performance is not being driven purely by cost savings. The lower fee menus actually are made up of higher quality investments.

Unsurprisingly, the differentials in performance were the widest in the smallest of plans. For example, there was a 0.75 percent yearly reduction in performance between actual plans and optimized plans with under $1 million in assets. They nonetheless found significant and persistent differentials for plans of all sizes:

- 0.70 percent annual reduction in performance between actual plans and optimized plans with between $1million to $10 million of assets;
- 0.63 percent annual reduction in performance between actual plans and optimized plans with between $10 million to $50 million;
- 0.50 percent annual reduction in performance between actual plans and optimized plans with between $50 million to $100 million; and

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across those share classes to exceed 1%. BrightScope uses human assumptions and computer algorithms to determine fee levels when share class information is not present. **BrightScope's current policy of giving the plan sponsor the benefit of the doubt when it makes share class assumptions means we may be systematically underestimating plan fees, to the detriment of the participants in those plans**.) (bold added for emphasis)

[216] Daniel Satchkov, CFA and Yon Perullo, CFA, Significant Fee Waste in Retirement Plans – New Study Using Quantitative Methods Working Paper, RiXtrema, http://bit.ly/2ogbjV2.

- 0.58 percent annual reduction in performance between actual plans and optimized plans with over $100 million.[217]

These performance differentials between actual and optimized plans suggest the harm to 401(k) investors is much larger than the $17 billion in estimated losses based on fee waste alone. And, the harm affects a much larger percentage of the market than we originally estimated in our back-of-the-envelope estimates using Ayres and Quinn's data. The RiXtrema report concludes that, "as is evident from our study – most defined contribution plans in the US are very inefficient and retirees would be much better served by adoption of fiduciary best practices in design of the plan menu."[218]

Based on all of the research discussed above, we believe our previous estimates of the costs 401(k) investors are paying as a result of conflicted advice to plan sponsors are, if anything, conservative. Based on this evidence, the Department cannot reasonably conclude that plan sponsors do not need the protections afforded by the fiduciary rule. On the contrary, the Department should consider expanding the rule to cover a broader swath of the retirement plan market. At a minimum, it should raise the threshold for the seller's carve-out to $100 million, and it should consider whether a higher threshold is appropriate.

E. Small plans often pay excessive all-in costs.

In addition to asset-based investment management fees, plans may also pay asset-based administrative and advice fees, as well as other non-asset-based fees. These total plan costs, like investment expenses, are largely driven by plan size. And just like investment expenses, small plans often pay extremely high all-in costs. As illustrated by Brightscope data released in 2015, the average all-in fees for small plans are between 1.5 and 2 percent, and it is in fact quite common for small plans to pay between 2.5 and 3 percent in total costs.[219] While less common, there are even small plans that are paying between 3 and 4.5 percent. However, it is not just the smallest of plans that pay arguably excessive costs. Plans of all sizes, including many plans with $100 million in assets, are paying well over one percent annually. It is not until you get to the largest plans, those with over $1 billion in assets, that total costs consistently drop to under 0.50 percent. Again, as discussed above, these cost calculations are likely understated, given the fact that ICI and Brightscope can't accurately assess which share classes plans are actually using and give plan sponsors the benefit of the doubt when making share class assumptions.[220]

The following chart, according to Brightscope, summarizes the retirement plan fee issue succinctly.

[217] *Id*.
[218] *Id*.
[219] Ryan Alfred, The One Chart That Explains 401(k) Plans, Brightscope, 2015, http://bit.ly/2pksy99.
[220] *See supra* notes 214-215.

Again, it is important to note that plans with under $1million in assets are not represented on this chart. But extrapolating from the sloping trend line, it is likely that plans with under $1 million are routinely paying well above two percent and in many cases paying even more. The likelihood of higher costs for these plans is increased since market opacity has the tendency to provide the opportunity and incentive for financial services providers to take advantage beyond what they would otherwise do in a more transparent environment. Furthermore, this chart helps to illustrate that even large plans and their participants are not universally receiving best interest protections and are, in many cases of, being taken advantage of by high-cost service providers.

Other recent research further confirms that the smallest of plans are paying often exorbitant fees, even acknowledging that economies of scale explain a portion of those higher costs. Employee Fiduciary, a low cost retirement plan service provider that provides recordkeeping and TPA services to small businesses, launched a no-cost 401(k) fee comparison service about two years ago.[221] As part of this fee comparison service, the company provides a report that totals all of the compensation a 401(k) plan pays service providers and fund companies into a single "all-in" fee. Importantly, this report is not based on the data provided in Form 5500. Rather, it is based on plans' 408(b)(2) fee disclosures, the plan's current fund line-up with total balances for each fund, and the participant count.[222] This provides more accurate cost information than the Form 5500 disclosures.

In the two years it has provided this service, Employee Fiduciary has analyzed 121 401(k) plans, all with less than $2 million in assets. It found average all-in-fees of 2.22 percent, which is generally consistent with the Brightscope study. The study found that, in general, brand name insurance and payroll company 401(k) providers are the most expensive, while lesser-known, "open architecture" providers are the least expensive. One reason for the higher costs among insurance company plans, according to the analysis, is that nearly all of the

[221] Eric Droblyen, *(Possibly) The Biggest Small Business 401k Fee Study Ever!*, EMPLOYEE THE FIDUCIARY FRUGAL FIDUCIARY BLOG, August 24, 2016, http://bit.ly/2ogoDZr.
[222] This information must be supplied by the plan sponsor, as these documents are not publicly available.

insurance company 401(k) plans in Employee Fiduciary's sample use variable annuities in their fund line-ups. Variable annuities are basically mutual funds wrapped in a thin layer of insurance with additional fees and redemption restrictions. A "wrap" fee can be one percent or more, turning low cost mutual funds into costly variable annuities.

If one applies these average expenses of 2.22 percent just to the roughly $105 billion in plans with under $1 million, that would mean these very small plans are paying over $2.33 billion in total expenses every year. If these plans' costs were reduced by one percentage point -- an achievable goal since companies are available that provide services to this market at that lower cost -- that one percentage point reduction would save those small businesses more than $1 billion every year. That is money they could reinvest to grow the company, return to their owners in profits, or spend on increased employee benefits, such as higher 401(k) matching contributions, rather than handing it over to financial institutions.

Below is a summary of the fees Employee Fiduciary found in its review of 121 401(k) plans with less than $2 million in assets.

Provider	**Number of Plans**	**Average Plan Assets**	**Average Participants**	**Average Provider Fees (1)**	**Average Net Investment Fees(2)**	**Average All-In Fee %**
ADP	18	$757,088.01	26	$7,392.49	$4,252.42	2.46%
American Funds	12	$612,114.13	18	$6,112.60	$2,734.71	1.68%
Ascensus	6	$854,775.65	23	$6,690.76	$5,391.22	1.54%
CUNA	1	$868,995.52	23	$9,124.67	$1,813.99	1.26%
Digital Retirement Solutions	1	$651,335.42	30	$6,627.73	$4,080.24	1.64%
Empower	6	$1,060,094.25	37	$15,331.51	$5,481.75	2.34%
ePlan Services	3	$380,987.76	11	$4,817.04	$2,078.89	2.15%
John Hancock	20	$682,789.50	20	$8,781.13	$2,390.41	2.23%
MassMutual	7	$1,011,870.30	41	$12,269.88	$4,973.84	2.02%
Merchants	1	$305,221.88	4	$5,310.00	$2,240.87	2.47%
Mutual of Omaha	2	$541,684.79	40	$11,474.54	$1,998.04	2.60%
Nationwide	2	$595,382.84	25	$10,658.62	$3,374.24	2.52%
OneAmerica	3	$1,069,013.38	49	$17,046.56	$5,570.37	2.41%
PAi	5	$385,430.75	7	$5,163.26	$2,767.58	2.82%
Paychex	21	$491,222.76	16	$5,484.74	$3,939.98	2.26%

Pentegra	1	$1,124,832.17	18	$10,972.68	$1,272.49	1.09%
Principal	6	$504,277.09	22	$10,023.70	$1,626.32	2.87%
Securian	1	$1,255,285.00	38	$16,831.03	$5,201.44	1.76%
Sentry Insurance	1	$1,346,829.13	45	$13,408.26	$4,592.30	1.34%
Sharebuilder	1	$433,727.83	6	$5,105.76	$444.93	1.28%
The Standard	1	$357,168.26	5	$9,143.33	$671.20	2.75%
Transamerica	2	$260,039.79	8	$5,821.51	$1,087.99	2.86%
Averages		**$677,331.93**	**23**			**2.22%**

(1)Provider Fees - includes all direct and indirect compensation received by the various parties servicing the plan.
(2)Net Investment Fees - includes only the portion of the investment expenses retained by the investment manager, presented net of fees paid to other providers.

Employee Fiduciary has also included on its website the individual plan analyses.[223] We've included a sampling in Appendix C to give a sense of the exorbitant fees the most prominent service providers are charging small plans and their participants. It is reasonable to assume that the costs reported here are consistent with the costs these same companies charge to other similarly situated 401(k) plans.

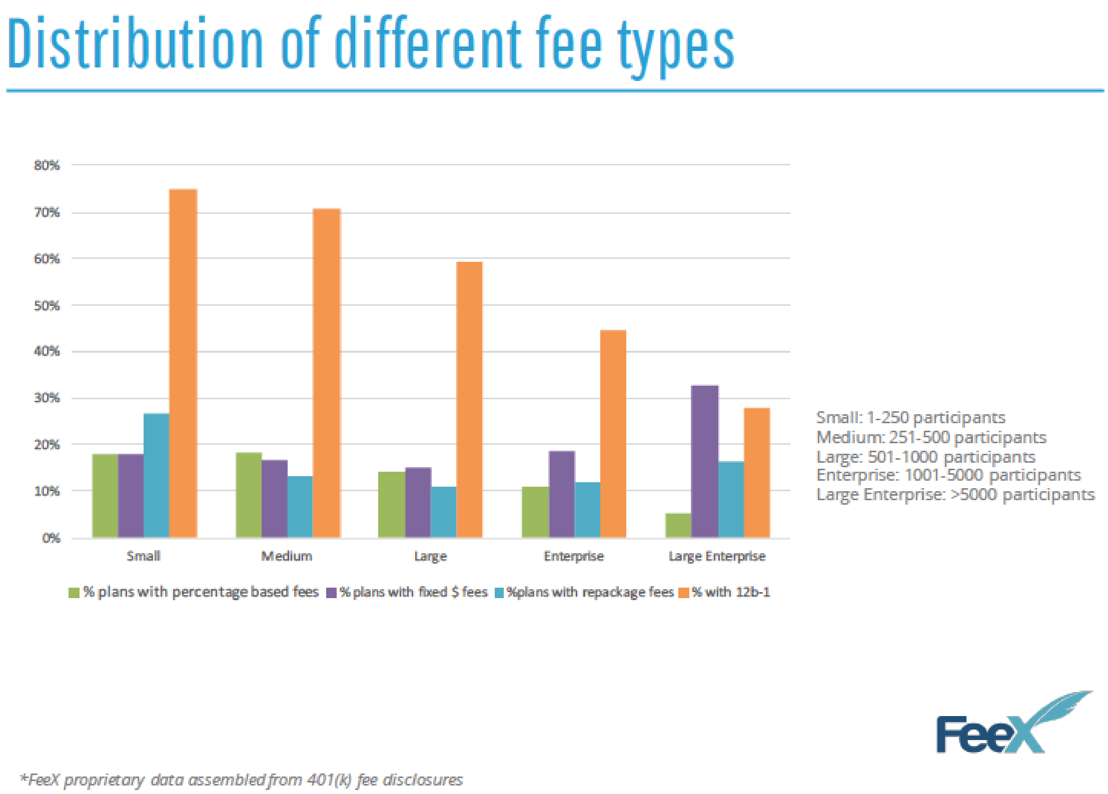
A recent highly-publicized example of how a small business can be peddled an overly-expensive and opaque plan was highlighted on Last Week Tonight with John Oliver.[224] After going through the process of setting up their company's 401(k), employees began asking questions about their plan costs. After repeated rounds of questions to their plan administrator, and analysis of their plan by outside experts, they discovered their John Hancock plan was being charged an annual 1.69 percent of plan assets for administrative expenses, plus $24 per participant per year, plus the underlying investment expenses. Embedded in the administrative costs was an ongoing "intermediary fee" to a broker of 0.50 percent. According to the show, the broker stated in response to questions about costs and services that he did a lot of things including "acting as [their] financial advisor." The segment highlights not just the problem of high costs in the small plan market, but the difficulty plan sponsors can have in getting clear information and straightforward answers about issues they need to understand in order to fulfill their responsibility as plan fiduciaries. This reinforces the importance of requiring financial professionals who assist plan sponsors in setting up plans and choosing plan investment menus to act as fiduciaries when providing that advice.

F. *Problem of excessive fees extends to plans of all sizes.*

FeeX -- a service that analyzes retirement and investment accounts for fees, services, past returns, menu selection, asset allocation and more -- analyzed information for plans in their database to determine which were charging various types of participant fees beyond investment

[223] *See* Appendix C for examples; *See* Employee Fiduciary, Compare Your 401k Fees, http://bit.ly/2pkqe1Y for complete list of plans and accompanying analysis.
[224] Retirement Plans: Last Week Tonight with John Oliver (HBO), viewable at http://bit.ly/25TgEWx.

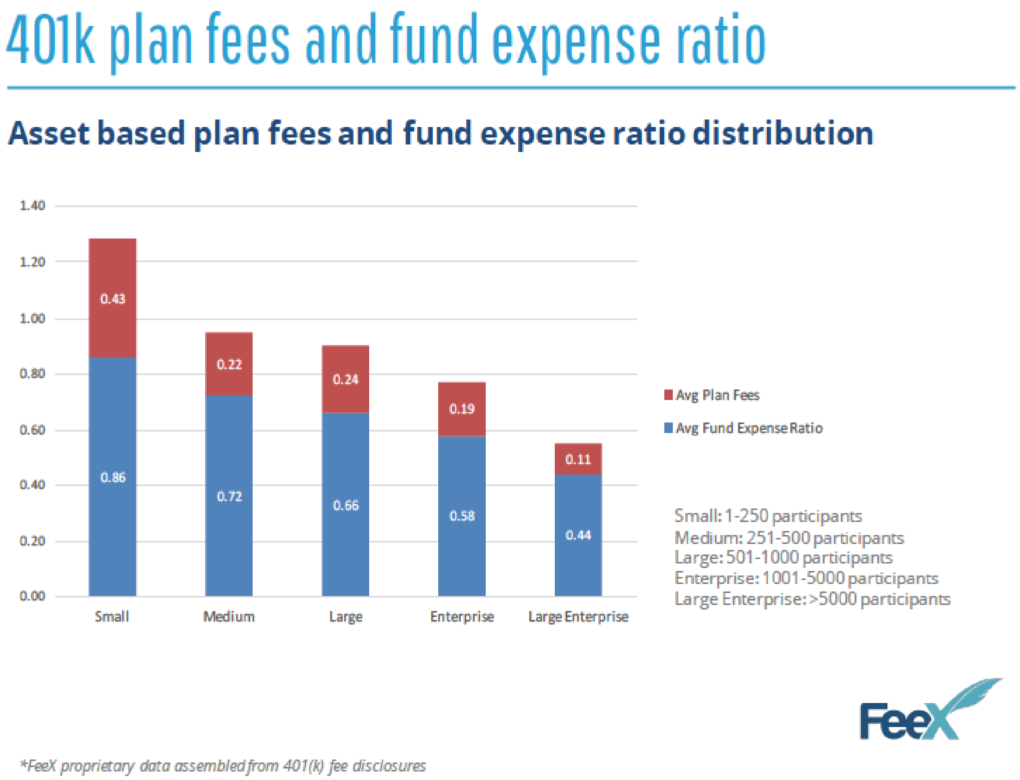
expense ratios. Using 404(a)(5) participant fee disclosures along with aggregated account data, public fund data, and Form 5500s, FeeX determined that, while small plans pay the highest fees, the problem of excessive fees also affects some of the largest plans. Categorizing plans by number of participants, FeeX found, for example, that more than 70 percent of small plans (those with 250 or fewer participants) and medium plans (those with 251 to 500 participants) charge 12b-1 fees. It found, moreover, that 12b-1 fees are common even among large plans (those with 501 to 1000 participants) and enterprise plans (those with 1001-5000 participants). Nearly 60 percent of large plans and roughly 45 percent of enterprise plans charge 12b-1 fees. (*See* distribution of different fee types, below) These findings strongly suggest that a significant percentage of the 401(k) market is in high-cost retail share classes, not low-cost institutional share classes. It further suggests that Brightscope and ICI's cost estimates significantly understate the actual costs 401(k) investors are paying, since they give plans the benefit of the doubt and assume the lowest cost share class where specific information is not available.



While much less common, a significant percentage of plans also charge "repackage fees." (*See* distribution of different fee types, above) A repackage fee effectively takes a low-cost fund, such as a Vanguard index fund, and then wraps it in an expensive proprietary variable annuity version of the same fund. For example, an insurance company might wrap a Vanguard Target Retirement Fund that would cost 0.16 percent on the open market with extra charges that result in the same fund costing 0.91 percent. The result would be that a 401(k) investor (and someone examining the plan's Form 5500 data) would reasonably assume she is receiving the same returns as if she were in the Vanguard Target Retirement Fund, but she would actually be receiving the Vanguard fund's performance minus the added costs, a 0.75

percent reduction in performance in this case.[225] According to FeeX data, more than a quarter of all small plans charge repackage fees. Among medium to large enterprise plans, more than 10 percent of plans in each category charge such fees.

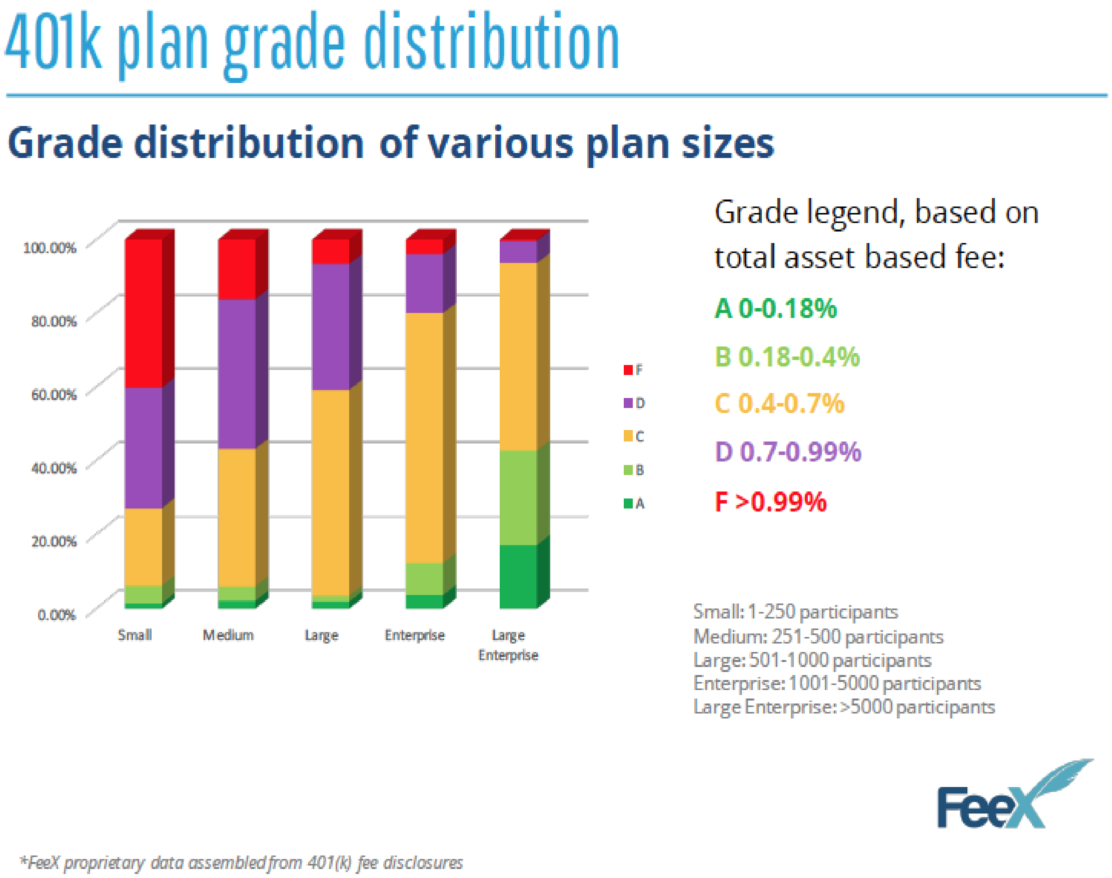
Here again, FeeX data suggests it is not just the smallest of plans that are paying excessive fees. When asset-based plan fees and fund expense ratios are combined, FeeX finds average fees ranging from a high of 1.29 percent for small plans, 0.94 percent for medium plans, 0.9 percent for large plans, 0.77 percent for enterprise plans, and 0.55 percent for large enterprise plans. In short, even plans with as many as 250 participants are paying well over 1 percent in total fees, comprised of an average expense ratio of 0.86 percent, and an average administrative fee of 0.43 percent. Administrative expenses may be shouldered by the employer, the employee, or shared between the two.



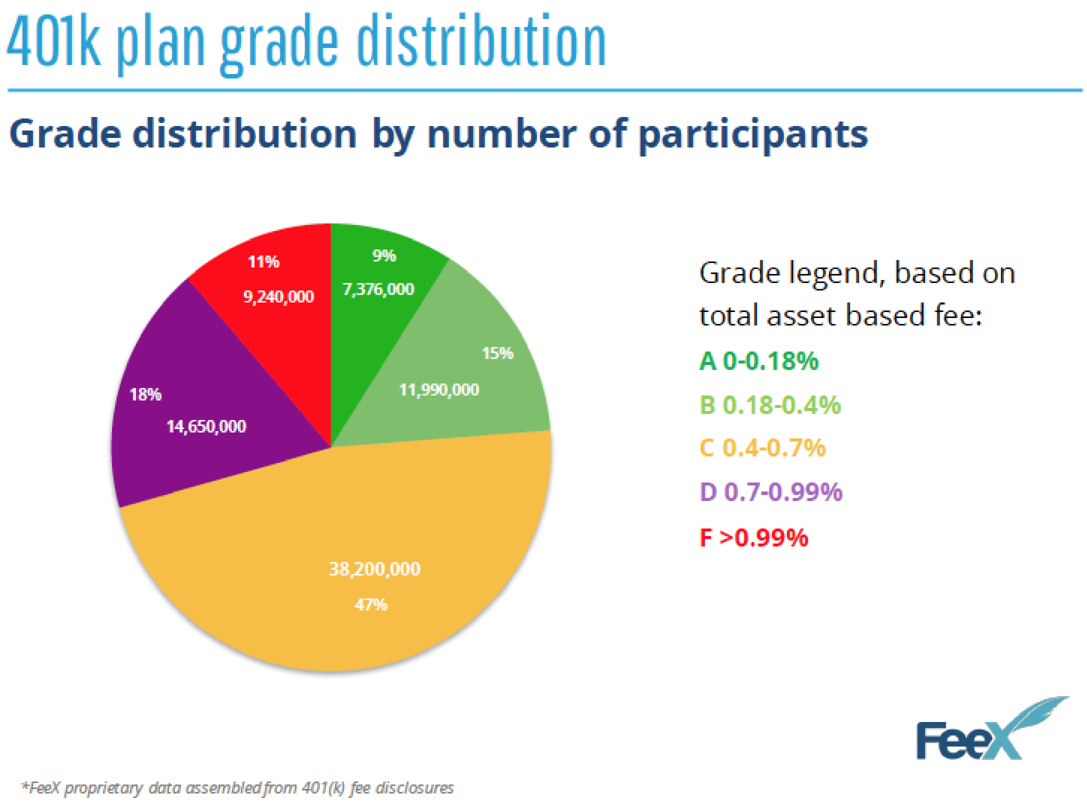
FeeX assigned grades to plans based on their total asset-based fees, assigning As to plans with fees below 0.18 percent, Bs to plans with fees between 0.18 and 0.4 percent, Cs to plans with fees between 0.4 and 0.7 percent, Ds to plans with fees between 0.7 and 0.99 percent, and Fs to plans with fees of 1.0 percent or more. Only among large enterprise plans (those with more than 5000 participants) did a significant percentage of plans score grades of A or B, and even among these plans fewer than 40 percent of plans scored top grades. On the contrary, a large majority of small plans as well as a majority of medium plans scored grades of D or F based on their total asset-based fees. This is particularly significant since, given the fact

[225] *See* Appendix C (Mutual of Omaha charging 2.02 and 2.03 percent for Vanguard Target Retirement Funds, TransAmerica charging 1.08 and 1.09 percent for Vanguard Target Retirement Funds)

that many of these plans have hundreds of participants, many of these plans also likely have assets above the $50 million cut-off for the seller's carve-out from fiduciary duties under the rule. (*See* 401k plan distribution, below)



FeeX specifically looked at what percentage of plan participants are in plans of each grade category. It found that only 24 percent of participants (19.366 million) are in plans that earn grades of A (9 percent, 7.376 million) or B (15 percent, 11.99 million). Significantly more (29 percent, 23.89 million) are in plans that earn grades of D (18 percent, 14.65 million) or F (11 percent, 9.24 million). The largest group (47 percent, 38.2 million) are in plans that earn a grade of C based on their asset-based fees. (*See* 401k plan grade distribution, below)



Finally, while 401(k) fees are coming down, they are doing so minimally and slowly. According to the newly released 17th Edition of the 401k Averages Book, investment expenses and total plan costs have been declining in all market segments.[226] At first blush, that appears to be terrific news. However, when one considers the number of participants and amount of assets in relation to costs, the results are actually much more concerning. For example, according to the published results, the average total plan cost for a plan with 100 participants and $5 million in assets declined a mere 3 basis points, from 1.28 percent to 1.25 percent over the past year. Even at 1.25 percent, these fees are unjustifiably high.

Similarly, the average total plan cost for a plan with 1,000 participants and $50 million in assets declined a single basis point in the past year, from 0.97 percent to 0.96 percent. For a very large plan with that many participants and assets to still be paying close to 1 percent a year is disturbing. It is even more troubling that a plan of that size ($50 million) is at the cusp of losing the protections of the rule. These results strongly suggest that the average sponsor of this size plan does not possess the requisite sophistication to understand that options are available that would considerably lower plan costs. These plan sponsors, perhaps having mistakenly relied on non-fiduciary advice from a financial professional in selecting fund options, could find themselves facing legal liability for failing to fulfill their fiduciary duties. Clearly, the financial professionals who provide that advice should at least be sharing that fiduciary responsibility.

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[226] Press Release: 401ksource, "Lower Investment Fees Help Push 401k Fees Down Last Year," 401k Averages Book, 401khelpcenter.com, March 7, 2017, http://bit.ly/2pCEXol.

G. Requiring financial professionals to act as fiduciaries when advising plans will lower, rather than increase, plan costs.

Rule opponents have argued that imposing a fiduciary duty on plan service providers when they provide investment advice would limit the availability of those services or increase their costs. As we discuss elsewhere, however, technology has made it possible to serve small plans affordably and there is an ample supply of firms prepared to serve the small plan market under a fiduciary standard. Additional analysis from Employee Fiduciary suggests that fiduciary advice is often the lower cost option.

In May 2015, Employee Fiduciary conducted a study examining the costs of fiduciary advice as well as the total administrative costs for 385 small plans that used its fiduciary adviser partners.[227] Employee Fiduciary found that the total costs small plans are paying, including the cost of fiduciary advice, are often significantly less than the cost of conflicted, non-fiduciary advice from broker-dealers and insurance companies. Employee Fiduciary recently updated its analysis, examining 525 plans that pay for fiduciary advice from Employee Fiduciary partners. It again found that the total costs small plans are paying, including the cost of fiduciary advice, are often significantly less than the costs paid by those receiving conflicted, non-fiduciary advice from broker-dealers and insurance companies.[228]

The chart below shows the costs Employee Fiduciary's partners charge plans for fiduciary advice. While the highest costs in each category can be quite high, particularly for plans with less than $250,000 in assets, there are also plans in each category that charge very low fees, far below those typically charged by non-fiduciary advisers.

Plan Asset Range	$0-$250k (151 plans)	$250k-$1M (212 plans)	$1M-$5M (162 plans)
Asset Average	$99,481.58	$590,880.80	$1,970,036.16
Participant Average	21	21	51
Range	0.25% - 18.86%[229]	0.11% - 1.90%	0.03% - 1.20%
Average	1.15%	0.70%	0.52%
Median	0.80%	0.75%	0.50%

[227] Eric Droblyen, *Is Conflict-Free Investment Advice More Expensive than Conflicted Advice?*, EMPLOYEE FIDUCIARY THE FRUGAL FIDUCIARY BLOG, May 20, 2015, http://bit.ly/2pm1KFV.

[228] Eric Droblyen, *Fee Study of 525 401(k) Financial Advisors – Why Trump Can't Reverse Tide of Fiduciary Advice,* EMPLOYEE FIDUCIARY THE FRUGAL FIDUCIARY BLOG, April 5, 2017, http://bit.ly/2p5c7gb.

[229] This very small plan is paying a flat fee instead of asset based fees so on a relative basis, those costs are initially high, but the costs are expected to amortize and fall precipitously as assets grow.

The chart below shows the combined costs that Employee Fiduciary's partners charge plans for fiduciary advice and that Employee Fiduciary charges for providing custody, recordkeeping, and administration. While investment expenses are not included, Employee Fiduciary stated that financial advisers that partner with Employee Fiduciary use low cost investments like index funds and ETFs in their menus. The average expense ratio of a menu using these funds can be as low as 0.15 percent of plan assets.

Plan Asset Range	$0-$250k (151 plans)	$250k-$1M (212 plans)	$1M-$5M (162 plans)
Employee Fiduciary Fees*	$1,579.59	$1,972.70	$3,706.03
Advisor Fees*	$1,148.72	$4,160.77	$10,182.04
Total Fees*	$2,728.30	$6,133.48	$13,888.07
Percentage of Assets*	2.74%	1.04%	0.70%

**Based on average plan assets and participant count.*

Plans under $250,000 are expensive, without a doubt, particularly when costs are measured as a percentage of assets. A 2.74 percent fee for plan administration and fiduciary advice and an additional 0.15 percent for investment expenses would mean that the plan's total costs are 2.9 percent. That is quite steep. However, once a plan gets beyond $250,000 in assets, the costs come down rapidly and are significantly less than plans that have the same amount of assets but are receiving conflicted, non-fiduciary services.

Regardless of the analytical approach adopted, evidence overwhelmingly suggests that plan participants are paying excessive costs. While this is particularly true in small plans, every analysis that's been conducted also shows huge room for improvement in the selection of investment menus for even many larger plans. This provides compelling proof that many plan sponsors are simply not up to the task of fulfilling their fiduciary responsibilities to ensure that plans are being run for the benefit of plan participants. As a result, they expose their employees to excess costs that can dramatically reduce their retirement savings. In light of this evidence, we urge the Department, as part of its reconsideration of the rule, to consider whether the threshold for the seller's carve-out for advice to retirement plans should be raised. At the very least, we believe the data supports a threshold of $100 million, as originally proposed by the Department. Certainly, the Department cannot reasonably conclude that protections for retirement plans afforded by the rule could be scaled back without causing enormous potential harm to retirement plan participants.

VII. Opponents' Claims that the Rule is Harming Retirement Investors are Unfounded

The Presidential Memorandum directs the Department to evaluate whether the rule has harmed or is likely to harm investors due to a reduction in financial advice, and the Department's request for comment asks a number of questions on this point. The Department specifically invites comments, for example, on "the emerging and expected effects of the final rule and exemptions on retirement investors' access to quality, affordable investment advice services …, including small investors' access." It also asks whether firms are "moving to abandon or deemphasize the small IRA investor," whether some are "aiming to expand in that segment," and what effects these developments will have "on different customer segments, especially small IRA investors." This line of questioning appears to be directly responsive to propaganda from financial firms and their lobbyists, who oppose the rule because it would eat into their profits, but mask their objections as concern that the rule is likely to harm retirement investors.

If their comment letters on the rule delay are a reliable guide, rule opponents' arguments on this point will unfold this way: 1) Using cherry picked anecdotes about what "some firms" are doing and speculative surveys about what some might do, they predict a significant withdrawal of advice for retirement savers, particularly small account holders. 2) They draw no distinction between non-fiduciary sales recommendations and fiduciary advice when describing the lost benefits retirement investors would supposedly suffer as a result of their imagined withdrawal of advice from this market. 3) They misleadingly point to the decision by some firms to shift to fee accounts as a harmful impact of the rule that will necessarily drive up costs to investors. 4) They claim that the rule will make it impossible to sell certain types of investments, including annuities. 5) And they attribute all this "harm" to overblown concerns regarding liability risks and regulatory complexity that they baselessly claim will drive firms away from reliance on the BIC. These predictions are no more reliable than their earlier predictions that the rule would prohibit commissions or that "no firm can or will use the BIC."[230]

With so much riding on this question of access to advice, it is crucial that the Department adopt an appropriate approach in weighing this issue. First, the Department must consider the extent to which broker-dealers and insurance agents offer advice today, in the absence of the rule. After all, these groups have gone into court and argued that the services they offer to retirement savers don't actually constitute advice, but rather are arms' length commercial sales transactions. If you accept their logic, and we do not, the rule can't be blamed for depriving investors of something they aren't receiving now. If, however, the rule forces commission-based financial advisers to move from offering biased sales recommendations to offering genuine fiduciary advice, it should be viewed as expanding access to beneficial advice, not restricting it. Second, the question of advice availability should be measured comprehensively, on an industry-wide basis, and not based on what isolated firms may choose to do in response to the rule. In other words, the fact that one firm may choose to withdraw from a portion of the market cannot be deemed to deny investors access to advice, if another firm is prepared to step in and serve that market. By this measure, access to affordable advice will clearly be maintained under the rule.

[230] This has been a common refrain of Davis & Harman attorney Kent Mason. See, for example, Melanie Waddell, *DOL Chief Perez Prepared to Explain Final Fiduciary Rule*, THINKADVISOR, Mar. 28, 2016, http://bit.ly/2oi362G.

A. By transforming biased sales recommendations into fiduciary advice, the rule expands access to genuine advice, to the benefit of retirement investors.

Industry rule opponents are highly selective in how they use the term "advice." When they are marketing their services to unsuspecting customers or challenging the RIA for not adequately considering the benefits they provide to clients, they portray themselves as trusted advisers. When they are seeking to avoid legal or regulatory accountability for acting in their customers' best interests, they paint a very different picture. In this sense, the arguments that financial industry lobbyists have made in their legal challenge to the fiduciary rule are instructive. For example, in legal filings in the Northern District of Texas, the U.S. Chamber of Commerce and several of its Texas affiliates, the Securities Industry and Financial Markets Association (SIFMA), the Financial Services Institute (FSI), the Financial Services Roundtable (FSR), the Insured Retirement Institute (IRI), the American Council of Life Insurers (ACLI), and the National Association of Insurance and Financial Advisors (NAIFA) claimed that broker-dealer representatives and insurance agents are not true advisers. According to their legal filings, brokers and insurance agents do not actually provide unbiased advice and are not engaged in relationships of trust and confidence with their clients. Instead, they claimed that broker-dealer representatives and insurance agents are just "salespeople" engaging in activity "whose essence is sales" that is no different from other commercial sales relationships in which "both parties understand that they are acting at arms' length."[231] (*See* Appendix A)

As noted above, that is an argument that was soundly rejected by the court, which held that these recommendations clearly fall within the ERISA definition of investment advice and thus are appropriately held to a fiduciary standard. Moreover, this sort of arm's length sales recommendation is not what investors expect when they turn to a "financial advisor" for advice about retirement savings. An AARP survey of 401(k) and 403(b) participants found, for example, that fewer than four in ten (36 percent) said they would trust advice from an adviser who is not required by law to provide advice that is in their best interest.[232] Nearly all (91 percent) said they favor requiring IRA providers to manage IRAs in the best interest of account holders.[233] Previous research found that most investors cannot distinguish between brokers and investment advisers, even after the differences are explained to them, and do not know which category their own adviser falls into.[234]

The reality, however, is that even though broker-dealers and insurance agents function as advisers, they are regulated as salespeople under securities and insurance law. While they are generally required to make recommendations that are suitable for their customers, they remain free to put their own financial interests ahead of their customers' interests and to recommend investments that are most profitable for them rather than those that are best for their customer. As a result, many of those today who hire a financial professional expecting to receive best

[231] Memorandum in Support of Summary Judgment, Chamber, et al. v. Thomas E. Perez, Secretary of Labor and U.S. Department of Labor, Civil Action No. 16-cv- 1476; Memorandum in Support of Summary Judgment, ACLI and NAIFA v. U.S. Department of Labor and Thomas E. Perez, Civil Action No. 1:16-cv-1530.
[232] S. Kathi Brown, AARP Research, Fiduciary Duty and Investment Advice: Attitudes of 401(k) and 403(b) Participants, Sept. 2013 http://bit.ly/1HO5d5f.
[233] *Id*.
[234] Angela A. Hung, et al., Investor and Industry Perspectives on Investment Advisers and Broker-Dealers. Santa Monica, CA: RAND Corporation, 2008, http://bit.ly/1OrrZ3v.

interest advice instead receive a self-interested sales pitch dressed up as advice. By requiring all those who provide personalized retirement investment recommendations for compensation to act in their customers' best interests, the DOL rule helps to transform these biased sales pitches into the fiduciary advice retirement investors deserve and expect. As such, it must be seen as expanding access to advice, not reducing access. This benefit of the rule is particularly important for those small account holders who are most likely today to be targeted by non-fiduciary broker-dealers and insurance agents offering arm's length sales recommendations dressed up as best interest advice.

B. *Rule opponents falsely attribute benefits of fiduciary advice to conflicted sales recommendations.*

The question of whether or to what extent investors would be harmed in the hypothetical event of a withdrawal of conflicted advisers from the retirement advice market[235] turns on the value one assigns to the services non-fiduciary advisers provide. In other words, what is the value of conflicted advice relative to fiduciary advice? Industry rule opponents fail to make this distinction between conflicted sales recommendations and fiduciary advice when discussing the benefits of "advice" that might be lost if certain sales-based "advisers" stop serving this market. The Chamber of Commerce, for one, incorrectly conflates biased sales recommendations with fiduciary advice when it faults the Department for failing to adequately account for the benefits of advice in preventing common investing mistakes before adopting the rule. In its comment letter on the rule delay, the Chamber writes, "The Department in 2011 stated that 'many participants make costly investment mistakes' when they do not have access to expert advice, and estimated $124 billion [sic] in investment losses in 2010 attributable to mistakes resulting from lack of advice for retirement savers … Given that the Department in 2011 was able to estimate that the rule it promulgated then to improve access to investment advice would yield benefits of between $7 billion and $18 billion annually, it was certainly within the ability of the Department to have estimated the monetary loss to retirement savers who may be expected to lose access to advice as a result of the restrictive April 2016 rule."[236]

But the Department already considered and responded to this point in the RIA. "One group of the comments that fails to distinguish between conflicted investment advice and impartial advice refers to the Department's analysis of its 2011 PPA advice PTE regulation," the RIA explains.[237] "That analysis found that DC and IRA investors' errors cost these investors $114 billion annually, and the increased access to advice pursuant to the PPA PTE would restore $7 billion to $18 billion annually to those investors. Importantly, the advice projected to be extended was *fiduciary* investment advice. Were the Department to project that the affected investors would receive conflicted investment advice the forecasted benefits of the PTE would be much lower and possibly negative."[238] In reconsidering the rule's impact on advice, the Department cannot reasonably abandon the distinction it has previously made between fiduciary advice and conflicted advice (arm's length sales recommendations) without

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[235] As we discuss at length elsewhere in this letter, the evidence that no such withdrawal is under way is conclusive.
[236] Letter from David T. Hirschmann, President and CEO, Center for Capital Markets Competitiveness, U.S. Chamber of Commerce, to the Department of Labor, March 13, 2017, http://bit.ly/2nDNV6K at 8-9.
[237] RIA at 315.
[238] *Id.*

providing concrete evidence that conflicted advice actually confers the benefits rule opponents attribute to it.

Others have pointed to studies by Morningstar[239] and Vanguard Research[240] as providing a basis for estimating the benefits that investors would lose if the rule caused them to lose access to conflicted advice. In its letter in support of the implementation delay, for example, the Insured Retirement Institute (IRI) cites the Morningstar study as the basis for its claim that, "Financial professionals have also been shown to help retirement savers earn 1.59 percent in additional returns, which over time historically has led to 22.8 percent more income in retirement."[241] It points to the Vanguard study as the basis for its statement that, "financial professionals help their clients overcome the emotional aspects of investing, which can add 1-2 percent in net return."[242] But both studies are specifically designed to highlight the value of high quality advice; neither suggests that all, or even most, conflicted advisers offer these benefits. The Vanguard study clearly states, for example, that it seeks to quantify the benefits that advisers can add "through relationship-oriented services such as providing cogent wealth management via financial planning, discipline, and guidance, rather than by trying to outperform the market" and to do so "relative to others who are not using such strategies."[243] Moreover, the specific finding of the Vanguard study cited by IRI is based on performance of target date funds; it says nothing about whether conflicted advisers actually provide these benefits.[244] There is persuasive evidence, including research cited in the RIA, that conflicted advisers, who only get paid when there is a transaction, actually worsen investors' timing decisions.[245]

IRI also selectively cites academic research[246] to suggest that those who work with a financial professional save more than those who do not. The research in question offers far less definitive findings, however, than those IRI attributes to it. In addition to citing a number of studies that find beneficial effects from advice, the study also reports that, "Contradictory results have been observed." To illustrate this point, the report cites studies that have found that financial advice (defined broadly to include conflicted advice) "may not improve investment

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239 Morningstar, *Alpha, Beta, and Now…Gamma*, http://bit.ly/2p5aRxs.

240 Vanguard Research, *Putting a Value on Your Value: Quantifying Vanguard Advisor's Alpha,* http://bit.ly/2oxQvd9. (Vanguard study)

241 Letter from Catherine J. Weatherford, President & CEO, Insured Retirement Institute, March 10, 2017, http://bit.ly/2mN4Stf at 3.

242 *Id*.

243 Vanguard study at 1.

244 *Id*. at 16.

245 *See* RIA at 152-153 (citing Friesen and Sapp (2007) and Bullard, Friesen, and Sapp 2008) (finding that investors who use brokers generally have poorer investment results than those who do not, engage in market timing that reduces returns at a greater rate than investors who do not use brokers, and that "timing underperformance is consistent with investor return-chasing behavior.") Based on this research, the Department stated that, "Conflicts in advice appear to exacerbate the tendency for IRA investors to chase returns and trade excessively, and the results presented here suggest that the consequences can be large." These findings are also consistent with Schoar et. al's audit study finding that non-fiduciary advisers did not correct investors' misconceptions, and in fact reinforced them if it made it easier to sell more expensive products

246 Claude Montmarquette, Nathalie Viennot-Briot. Centre for Interuniversity Research and Analysis on Organizations (CIRANO). *Econometric Models on the Value of Advice of a Financial Advisor*, http://bit.ly/2oBQs1T.

returns," may "have little or no bearing on investor outcomes," and that any correlation may be the result of "good client selection on the part of advisors," among others.[247] The authors also note that, "Several other studies allude to the moral hazard risks faced by individual investors who may be financially naive or perhaps illiterate when receiving advice from sales-incentivized advisers."[248]

In short, the available research simply does not support the declarations regarding the value of conflicted advice that IRI and others make in their comment letters. Our point is not to suggest that conflicted advice offers no benefits at all. On the contrary, claims that even conflicted advice encourages individuals to save more than they would on their own are reasonably credible. After all, this is an area where the adviser's interest in maximizing commission compensation by increasing the amount invested aligns with investors' need to increase saving. And doubtless there are individual conflicted advisers who offer excellent value to their customers. Our point is that the Department cannot reasonably assume that, as a general matter, conflicted advice offers all the benefits that industry rule opponents ascribe to it or that it offers the same benefits as fiduciary. The Department's own past analysis of available evidence has found that this is not the case, a point that is reinforced by the additional evidence discussed above regarding the harmful impact of conflicts in both the IRA and plan markets. Any benefits associated with conflicted advice are at best uncertain and are negligible when set beside the harms associated with such advice.

C. *Predictions that small accounts will lose access to advice are unfounded.*

It is already clear that the broad withdrawal from the retirement advice market that rule opponents earlier predicted has not and will not come to pass. While most rule opponents appear to be prepared to acknowledge that reality, many continue to maintain that many small accounts will be abandoned as a result of the rule. This scaled back argument, as presented in rule opponents' comment letters on the delay proposal, is based on a combination of anecdotal evidence about changes "some firms" are making in response to the rule (carefully curated to exclude conflicting examples) and references to two "studies" that predict that a portion of small accounts could lose access to advice. These do not create an accurate or complete picture on which the Department can reasonably base an assessment of the availability of retirement advice.

The availability of retirement investment advice must be judged based on the overall advice market, not on decisions made by individual firms. The whole point of the rule was to fundamentally change the deeply flawed way in which advice is offered in much of the industry. In keeping with that goal, the relevant question is not whether every firm will continue to offer retirement advice after the rule is implemented on precisely the same terms they did before the rule was adopted. The relevant questions are: 1) whether individuals who want retirement investment advice will be able to get fiduciary retirement investment advice on terms that are affordable and appropriate to their situation; and 2) whether they will have a choice about how to pay for that advice. The good news is that Americans today have more options for receiving affordable investment advice than ever before, and the rule will not

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[247] *Id*. at 6.
[248] *Id*. at 6-7.

change that, even if isolated firms withdraw from the retirement market or change the terms on which they choose to offer retirement investment advice.

Rule opponents point to two new "studies" to support their prediction that small accounts will lose access to advice as a result of the rule. The first is a recent survey of 552 U.S. "financial advisors" by CoreData Research which found that 71 percent "plan to disengage from some mass-market investors" as a result of the rule, with those advisers estimating they will no longer service a quarter of the mass-market clients.[249] The publicly available version of the report tells us nothing about the survey sample, including the nature of the services they provide or the terms on which they currently serve a "mass market" customer base. The fact that 60 percent say they will decrease allocations to non-traded REITs in response to the rule, and 57 percent say they will limit offering variable annuities in retirement accounts suggests: 1) that the survey sample is heavily weighted toward brokers making exactly the sort of high-cost, low-value investment recommendations that the rule is intended to address and 2) that the rule is working as intended to end these practices.

The second of these studies is a report by management consultant A.T. Kearney which predicts the rule will cause the "U.S. wealth management industry" as a whole to lose $20 billion in revenue through 2020.[250] The study attributes the loss of revenue to a variety of factors, including some that represent clear benefits of the rule to retirement investors -- fewer rollovers, a shift from higher- to lower-cost products, and increased competition bringing down asset-based fees. The report also predicts that a shift to fee accounts -- a shift that pre-dates but is likely to accelerate in response to the rule -- could cause some firms to stop serving lower balance accounts or to shift them to robo or self-service accounts. It recommends that firms, as part of their planning for implementation of the rule, evaluate the affordability of serving smaller accounts, but it does not, as at least one commenter has implied, recommend cutting off accounts below a certain asset level. While the authors see the rule as posing more significant challenges to some segments of the industry than others, they conclude that, "In all cases, industry players can take targeted actions to both minimize disruption and position themselves for longer-term growth."[251]

D. Advice will continue to be available to small accounts under a variety of business models and at an affordable price.

Both the CoreData survey and the A.T. Kearney report offer speculation on changes that might occur as a result of the rule. But the Department cannot reasonably rely on such speculation to form its view of how the rule is affecting the availability of advice, particularly since so many of industry rule opponents' similar previous predictions have been proven wrong. A better source of information are the announcements firms themselves have made about how they plan to implement the rule. One source cited by some rule opponents -- an article by American Action Forum's Sam Batkins -- presents grossly inaccurate information, a

[249] Press Release, Core Data research, "Fiduciary rule to leave US mass-market investors stranded, study shows," November 2016, http://bit.ly/2op4cLa.
[250] A.T.Kearney study: The $20 billion impact of the new fiduciary rule on the U.S. wealth management industry, August 2016, http://bit.ly/2op0ste.
[251] *Id*.

fact that should have been readily apparent to those, like Financial Services Roundtable, that cited it in their comment letters.[252] Other rule opponents avoid this sort of outright inaccuracy, but apply a negative filter to the experience to date in order to support their message that the rule will result in "more limited product choice, a move to more expensive asset-based fee arrangements, and an increase in account minimums for commission-based accounts."[253]

Many of the examples rule opponents cite in support of this argument -- particularly with regard to the shift to fee accounts and the limitations on product offerings -- simply do not support the negative cast they seek to put on them. And for every "negative" example they cite, there are examples of firms that have chosen to continue to offer commission accounts, lower account minimums on fee accounts, and lower fees and cut commissions in response to the rule. The most significant benefit of the rule in the product space -- the development of mutual fund "clean shares" -- barely deserves a mention by rule opponents, despite its enormous potential to expose broker compensation for mutual fund sales to the same market forces that have been so effective in driving down brokerage commissions for stocks and ETFs. In short, the effect of the rule on the retirement advice market is far more complex, nuanced, and positive than rule opponents would have you believe.

As part of its consideration of this topic, the Department invites comment on whether the rule and exemptions are moving "markets toward a more optimal mix of advisory services and financial products." And it further asks about changes firms are making to their product line-ups and pricing and the extent to which those changes will advance or undermine firms' abilities to serve their customers' needs. As we discuss further below, the evidence demonstrates that the rule is having a beneficial effect in both areas, a fact that is reinforced by statements from industry executives as well as expert observers.

Americans today can choose among a wide variety of sources of retirement investment advice and have a number of options for how to pay for that advice.[254] Sources of advice include traditional full service brokerage firms offering securities sales and wealth managers offering portfolio management services, independent brokers and dual registrants combining brokerage and advisory services, financial planners offering comprehensive financial advice, insurance agents selling various types of annuities, and new entrants, such as robo-advisers and hybrid advisers that combine digital services with access to a human adviser. Investors have the option of paying for these services in a variety of ways, including through commissions and other transaction-based fees, asset-based fees, hourly fees, engagement fees, retainer fees, or some combination of fees and commissions. In many cases, several of these options are

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[252] Sam Batkins, *Fiduciary Rule Has Already Taken Its Toll: $100 Million in Costs, Fewer Options,* AMERICAN ACTION FORUM, Feb. 22, 2017, http://bit.ly/2ntIMM0. Among other things, the article lists Merrill Lynch as being "out of the market," which is categorically untrue. Similarly, it lists LPL and Raymond James as "switching to fees," even though both firms have publicly announced their intention to keep commission accounts as an option under the rule. This is just a few of the factual errors, but enough to make clear that the article is a completely unreliable source of information about the likely impact of the rule. It is frankly shocking that Financial Services Roundtable cited to this article in its letter, given that Merrill Lynch is a member of FSR, so they presumably know that the claim that Merrill Lynch is "out of the market" is completely false.

[253] Letter from Brian Reid and David Blass, Investment Company Institute, to the Department of Labor, at 8, http://bit.ly/2niSeBZ.

[254] For ease of expression, we use the word "advice" here to include the sales recommendations that have previously been marketed as advice and which will, as a result of the rule, finally also be regulated as advice.

available within the same firm. Moreover, while some firms specialize in serving high net worth individuals, others operating under a variety of business models make their services available to even the smallest account holders.

Evidence from firms' public announcements makes clear that, regardless of what a few individual firms may choose to do, retirement investment advice will continue to be available through all of these business models under the rule. In other words, although compliance with the rule may be more challenging for some types of advisers than it is for others, the rule has proven to be "workable" for all types of advisers, operating under all types of business models.[255] The fact that different firms are deciding to comply with the rule in different ways proves that the rule provides sufficient flexibility to enable firms to choose an approach that best fits with their particular business interests.

Instead of acknowledging this flexibility, rule opponents point to the fact that certain high profile companies, including Merrill Lynch and J.P. Morgan, have chosen to offer only fee-based IRAs under the rule as evidence that the rule is forcing a shift away from commissions. This ignores the fact that a number of other prominent firms -- including firms with less of a focus on serving high net worth investors -- have announced that they plan to continue to offer a choice between fee and commission IRAs. These include, among others, Morgan Stanley, Ameriprise Financial Inc., Raymond James Financial Inc., LPL, and Edward Jones, among many others.[256] Major insurance firms have also adopted this approach, including Nationwide, Allstate, and USAA.[257] Similarly, rule opponents point to the decision by MetLife and AIG to spin off their brokerage operations as evidence that the rule is causing firms to withdraw from the retirement advice market, but they fail to acknowledge that both companies found ready buyers for the units which will continue to offer services to customers.[258] In short, despite rule opponents' dire predictions to the contrary, retirement investors who prefer to pay for advice through commissions will continue to have that option widely available to them. And, thanks to the rule, they will no longer have to give up their right to get best interest advice if they choose to pay through commissions.

E. Technology makes it possible to serve small accounts affordably.

The Department invites comment on "ongoing and emerging innovation trends in markets for investment advice" and the degree to which they will make it possible for firms to serve small accounts under the rule. One area where this has emphatically been the case is in

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[255] As we discuss below, compliance for commission-based advisers will only get easier as more products are brought to market that help to eliminate the differential compensation that does so much to introduce unnecessary and insidious conflicts into commission-based advice. As it reconsiders the rule in the midst of this transformation, the Department must take the rapid development of new fiduciary-friendly products into account.

[256] Greg Iacurci and Christine Idzelis, *Broker-dealers split on commissions in wake of DOL fiduciary rule,* INVESTMENT NEWS, Oct. 30, 2016, http://bit.ly/2ehBPIm.

[257] Arthur D. Postal, *DOL Fiduciary Rule Causes Pullback on Sale of Annuities, Funds by Insurers,* THINKADVISOR, Sept. 20, 2016, http://bit.ly/2omwE3f.

[258] Christine Idzelis, *MetLife is second major insurer to exit the brokerage business, in the sale of adviser unit to MassMutual,* INVESTMENT NEWS, Feb. 29, 2016, http://bit.ly/2oms3hu .(The article notes that, while the DOL rule was an important trigger for the decision to spin off the brokerage units, other factors likely also played a role. "I think they found it was a lot harder to make money in that space than they thought it would," said Mr. Edde, who's based in San Diego, Calif. It's difficult recruiting "top talent to an insurance first, securities second, type of firm.")

the area of technological innovations that have transformed the market, making it possible to serve small accounts affordably and in a form that is attractive to investors. FolioDynamix, a leading provider of wealth management technology and advisory services focused on serving small accounts, debunked the argument that small accounts would lose access to advice in a white paper on the rule.[259] In it, the firm states, "While automated robo platforms have been suggested as an alternative, many firms—conscious of the fact that small investors have the possibility to become larger investors, with guidance and support—are hesitant to simply jettison those investors (these investors, after all, are often those who might benefit most from informed advice vs. a self-service approach)."[260] Fortunately, the authors argue, it is possible to "offer small-balance advisory accounts that can be made efficient even with low balances through a combination of low-fee underlying investments and a technology component that allows for automation of client account opening, rebalancing, and reporting."[261] Contrary to the claims made by rule opponents, this does not mean investors will lose access to human advice. As FolioDynamix's President Steve Dunlap recently explained it, "The future is not about robots—or robo advisors—replacing human advisors. It is about advisors taking advantage of technology to work efficiently ... Advisors and firms who leverage technology effectively will be ahead."[262] That model has the advantage of freeing up advisers to focus their efforts in areas where they are most able to add value, he said.[263]

Research has shown that this particular business model is very attractive to clients as well. A recent study by Accenture found, for example, that investors value and prefer a hybrid model, combining human advisers with automated digital advice, and that the future of wealth management is not an either/or scenario.[264] According to Kendra Thompson, managing director and head of Accenture's global wealth management practice, "The robo-versus-human advisor debate has lost relevance for investors and wealth and asset managers in North America."[265] Rather, "providing an automated platform with periodic access to a human advisor ranks as the most preferred scenario across a range of investor profiles. Combining the best of both worlds—the low cost and access of robo-platforms with an advisor's expertise in handling more nuanced or complex investing scenarios—hybrid firms ranked higher than all others in several dimensions critical to customer loyalty and satisfaction, from 'customized service' to 'low-cost products.'"[266] This is not just true for younger investors, according to recent research by MoneyGuidePro, which shows that consumers between 50 and 70 years old prefer virtual

[259] FolioDynamix, Success in the Wake of the DOL Fiduciary Rule (*See* Appendix D).
[260] *Id*.
[261] *Id*.
[262] Press Release, FolioDynamix, "FolioDynamix and Scivantage Partner To Deliver Enterprise-Grade Digital Advice Robo Solution," September 22, 2016, http://bit.ly/2o5Qih2.
[263] Press Release, FolioDynamix, "FolioDynamix Announces Collaborative Partnership with PIEtech Enhancing Comprehensive DOL Solution," November 16, 2016, http://bit.ly/2oKwbaC. ("[T]he adoption of technology [ ] enable and empower advisors, automating non-revenue generating activities and providing the tools for an advisor to maximize time spent collaborating with clients.")
[264] Kendra Thompson and Edward Blomquist, The New Face of Wealth Management, Accenture Consulting, https://accntu.re/2nSVcxb.
[265] *Id*.
[266] Karen DeMasters, *Human Advisors Vs. Robo: Both Are Winning*, FINANCIAL ADVISOR MAGAZINE, March 30, 2017, http://bit.ly/2nSNh2Z.

meetings with advisers over in person discussions.[267] Conversely, Scivantage's Chief Commercial Officer of Digital Wealth Strategies, Joe Stensland, has stated, "Ongoing research has shown that investors—even millennials, who are comfortable with technology—are searching for a hybrid model when it comes to wealth management."[268]

Consistent with this view that technology offers a solution to the small account problem, a growing number of firms now offer fee accounts for even very small investors. Evidence since the rule was finalized makes clear that fee accounts will continue to be widely available, including to investors with only a few thousand dollars (or less) to invest. Nor will these accounts be available exclusively through robo-advisers, as some rule opponents suggest. On the contrary, two traditional brokerage firms that have specialized in serving more middle income customers -- Edward Jones and LPL Financial -- announced shortly after the rule was finalized that they were lowering the minimums for their fee accounts to $5,000 and $10,000 respectively, and LPL simultaneously announced that it was lowering the fees on those accounts.[269] Two other leading national firms -- Vanguard and Schwab -- offer advisory services that combine digital services with access to a human adviser at a very low cost to slightly larger accounts. The account minimum at Vanguard is $50,000, while the minimum at Schwab is just $25,000. And minimums at other robo and hybrid advisers are either non-existent (Betterment) or insignificant ($500 at Wealthfront and $5,000 at Fidelity Go).[270] We doubt most commission-based advisers are willing to serve accounts of that size. In short, affordable non-robo fee-based investment advice is available for accounts at well below the $100,000 asset level ICI previously predicted would be the cutoff below which fee accounts would not be offered, and robo advice is available to essentially anyone with money to invest.[271]

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267 Ian McKenna, *Stunned, amazed and in awe - a day of exceptional revelations at T3*, DIGITAL WEALTH INSIGHTS, February 17, 2017, http://bit.ly/2kwjBeh.
268 Press Release, FolioDynamix, "FolioDynamix and Scivantage Partner To Deliver Enterprise-Grade Digital Advice Robo Solution," September 22, 2016, http://bit.ly/2o5Qih2.
269 Michael Wursthorn, *Brokerages Adapt to Pending Labor Rule*, WALL STREET JOURNAL, http://on.wsj.com/2nWHUCu
270 Arielle O'Shea, *Best Robo-Advisors: 2017 Top Picks*, NERDWALLET, Jan. 5, 2017 https://nerd.me/29C4nx6 In addition, Wells Fargo recently announced that it was launching a robo adviser, with call center access, and account minimum of $10,000, and a .50 percent asset fee. Michael Wursthorn, *Wells Fargo's Robo Adviser to Cost More Than Rivals' Options*, WALL STREET JOURNAL, March 27, 2017, http://on.wsj.com/2oaxAI0.
271 Letter from Brian Reid and David Blass, Investment Company Institute, to the Department of Labor, July 21, 2015, http://bit.ly/2p5qLrO. ("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….Assuming that investors with less than $100,000 no longer have access to advice because the BIC Exemption is not workable….As we discuss in the comment letter, it is very likely that under the current proposal investors with less than $100,000 in IRA balances would not be able to get access to fee-based accounts.") *But see* Letter from Barbara Roper and Micah Hauptman, Consumer Federation of America, to the Department of Labor, July 21, 2015, http://bit.ly/2omHMxq. ("In short, to believe ICI's claims, one has to believe their assumptions that everyone who is providing transaction-based advice will suddenly stop providing transaction-based advice to retirement investors, all of the firms already providing non-transaction based advice to the under $100,000 market will mysteriously stop providing non-transaction based advice, and no one will fill their shoes by providing either transaction-based or non-transaction based advice. These predictions can't be supported, are not credible, and are belied by existing market conditions. The Department should not accept them.")

Based on this evidence, the Department cannot reasonably conclude that the rule is causing small investors to be priced out of the retirement advice market or forcing them exclusively into fee accounts.

F. Rule opponents' characterization of the shift to fee accounts as a harmful consequence of the rule are equally unfounded.

The Department invites comment on whether firms are "changing the means by which customers pay for advisory services." And it further asks whether "firms moving to increase or reduce their use of commission arrangements, asset-based fee arrangements, or other arrangements" and whether these changes "advance or undermine firms' abilities to serve their customers' needs." From the outset of this debate, rule opponents have sought to portray a shift to fee accounts as harmful, on the grounds that it would increase investor costs. But this argument is entirely unfounded, as we illustrated in our original comment letter on the rule proposal and discuss further below.[272] It is particularly ironic that this argument is being advanced by industry groups that have for two decades promoted fee accounts as a better alternative for many investors. Moreover, to the degree that firms seek to use the conversion to fee accounts to milk retirement investors for increased revenue, the rule itself includes provisions that will help to discipline those costs.

The shift toward fee-based accounts began two decades ago and has its roots in an effort by the Securities and Exchange Commission to better align the interests of brokerage firms, their registered representatives, and their customers. Then SEC Chairman Arthur Levitt appointed a blue ribbon panel, headed by Merrill Lynch Chairman and CEO Daniel Tully, to review industry compensation practices, identify actual and perceived conflicts of interest, and identify the best practices used in the industry to eliminate, reduce, or mitigate these conflicts.[273] Among the recommended "best practices" identified was paying a portion of registered representative (RR) compensation "based on client assets in an account, regardless of transaction activity, so the RRs receive some compensation even if they advise a client to 'do nothing.'"[274]

The Tully Commission explained the rationale behind its recommendations this way: "If the retail brokerage industry were being created today from the ground up, a majority of the Committee that developed this report would not design a compensation system based only on commissions paid for completed transactions. The most important role of the registered representative is, after all, to provide investment counsel to individual clients, not to generate transaction revenues. The prevailing commission-based compensation system inevitably leads

[272] Letter from Barbara Roper and Micah Hauptman, Consumer Federation of America, to the Department of Labor, July 21, 2015, at 21-15, http://bit.ly/2omHMxq.
[273] Report of the Committee on Compensation Practices, April 10, 1995 http://bit.ly/2nwNb0E
[274] *Id*. Foreshadowing issues addressed in the DOL conflict of interest rule, the report also recommended paying identical commissions for the sale of proprietary and non-proprietary products within a product category "so that with respect to products in the same category at least, RRs are indifferent to incentives" and prohibiting sales contests, or permitting them only when based on broad measures, rather than on single products. The report also highlighted concerns about "undisclosed bonuses and higher commission payouts made to RRs who move from one broker-dealer to another" as well as conflicts that result from "differentiated compensation by product or source of product."

to conflicts of interest among the parties involved."[275] Elsewhere, the report noted that in many cases the best advice an RR can give a client at a given time is to "do nothing," but since this advice would earn the RR and the firm no compensation, the RR would be under pressure to have the customer "do something." While the Tully Commission concluded in 1995 that "the current compensation system is too deeply rooted to accommodate radical alteration in the near-term," they pointed to the "beginnings of a shift towards other forms of compensation, such as fee-based charges for various investment-related services," as a hopeful sign. As the Securities Industry Association (SIA), a precursor to SIFMA, later explained it, "Clearly, the Tully Report saw fee-based brokerage as a best practice to better align the interests of RR's and clients."[276]

In 1996, SIA also endorsed fee accounts as a "best practice."[277] In doing so, SIA argued that the benefits of fee accounts extended to buy and hold investors as well as to more active traders. "As is pointed out in the Tully Report, sometimes the best advice to a client is to 'do nothing,'" SIA's Hammerman wrote in 2004.[278] "SIA strongly believes that many clients in fee-based accounts are better off today because they were dissuaded by their brokers from selling positions in which substantial unrealized losses had occurred after the sharp market declines that occurred between 2000 and 2002. Thus, fee-based accounts can create an environment in which 'buy and hold' behavior flourishes to the benefit of investors."[279] SIA also argued that, "Fee-based programs also enable investors to better control their investment costs because they make overall fees more transparent."[280]

The mystery of why groups that argued so passionately for the benefits of fee accounts in 2004 have been largely silent on these benefits today is more easily explained when you understand the context. As brokerage firms began to offer more fee accounts in the late 1990s, a question quickly arose over whether the accounts would be regulated as advisory accounts under the Investment Advisers Act on the grounds that "special compensation" was being charged for investment advice. Broker-dealers are excluded from regulation under the Investment Advisers Act only so long as they limit themselves to giving advice that is "solely incidental to" their activities as broker-dealers and charge no special compensation for that advice. By 2004, SIA was attempting to persuade the SEC that a decision to regulate the accounts as advisory accounts would "deny investors the benefits of choice and transparency" because brokers would be unwilling to offer the accounts on those terms.[281] The primary concern, according to contemporary press accounts, was that having to act in the client's best interest, as opposed to having to ensure that a particular transaction is suitable, "opens the door to all kinds of lawsuits."[282] This suggests that SIA/SIFMA simply adjusts its messaging on fee

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[275] *Id*.
[276] Letter from Ira D. Hammerman, General Counsel, Securities Industry Association, to the Securities and Exchange Commission regarding Release No. IA-2278, Certain Broker-Dealers Deemed Not To Be Investment Advisers, September 22, 2004, http://bit.ly/2oxtk2w.
[277] *Id*. at 3.
[278] *Id*.
[279] *Id*. at 5.
[280] *Id*. at 6.
[281] *Id*.
[282] Susan Konig, *End of 'Merrill Lynch' Rule Leaves BOMs in a Muddle*, WEALTH MANAGEMENT, June 21, 2007, http://bit.ly/2n1vmea.

accounts in pursuit of its larger goal -- to avoid being held legally accountable for acting in customers' best interests.

Although SIA and others were ultimately able to convince the SEC to exempt the accounts from regulation under the Advisers Act, that decision was overturned in court in 2007, and the SEC did not appeal the decision.[283] As a result, we have a decade's worth of experience on which to judge the validity of industry arguments that regulating broker-dealers' fee accounts as advisory accounts, and subjecting them to a fiduciary standard, would cause their demise. What we find, of course, is that the shift to fee accounts has continued unabated, in part because the threat of legal liability had been greatly exaggerated and in part because of the obvious benefit the accounts offer firms in the form of a more reliable and predictable revenue stream.[284]

Even as industry lobbyists have tried to label the shift to fee accounts as a harmful consequence of the rule, a number of industry leaders have acknowledged that the shift predates the rule and is motivated by other considerations. As former LPL Financial CEO Mark Casady explained it in an earnings call last fall, "Our industry continues to experience long-term secular trends, including the movement from brokerage assets to advisory assets, and among brokerage, from sales commissions to trailing commissions. The same is true for our business. Most of our gross profit is recurring from advisory assets that are already managed to a fiduciary standard, and most of our brokerage commissions come from recurring trailing revenues that are grandfathered under the DOL Rule."[285] Similarly, Legg Mason Chairman and CEO Joseph Sullivan said, "So what you've seen in the industry over the last few years is a lot of advisors increasingly moving to advisory from brokerage. And that's going to continue, that's going to accelerate as a result of DOL. But it's not something that's just starting, right. This move from advisory – or from brokerage to advisory has been underway."[286] Or, as Envestnet put it, "What we expect to see is that the long-term trend of moving from commission-based to fee-based will be slightly accelerated by the DOL regulations."[287]

Clearly, regulating fee accounts under the Investment Advisers Act had none of the harmful effects that industry lobbyists predicted at the time. The Department should bear that in mind as it assesses rule opponents' equally exaggerated claims about the supposedly harmful impact of its fiduciary rule. Moreover, although firms may have self-interested reasons for shifting to fee accounts, including the fact that they ease compliance with the Department's fiduciary rule, that does not mean that investors don't also benefit from a shift that decreases the incentive for brokers to engage in excessive trading and to recommend higher cost investments in order to boost income.

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[283] FPA v. SEC, 482 F.3d 481 (D.C. Cir. 2007).

[284] Michael Kitces, *The Business Benefits Of Transitioning From Commissions To Fee-Based Advisory Accounts,* NERD'S EYE VIEW, March 27, 2017, http://bit.ly/2opXo3h.

[285] LPL Financial Holdings (LPLA) Q3 2016 Results - Earnings Call Transcript, November 02, 2016, SEEKING ALPHA, http://bit.ly/2nPHoYf.

[286] Legg Mason (LM) Q2 2017 Results - Earnings Call Transcript, October 28, 2016, SEEKING ALPHA, http://bit.ly/2p5EVcr.

[287] Envestnet (ENV) Q2 2016 Results - Earnings Call Transcript, August 08, 2016, SEEKING ALPHA, http://bit.ly/2nPBpTg.

The question of the cost of fee versus commission accounts is also much more complex than rule opponents would have you believe. Many opponents simply state, as if it were a given, that fee accounts are more costly than commission accounts "particularly for small account holders and buy-and-hold investors," as ICI stated in its comment in support of the delay. ICI seeks to attach a numerical value to that difference. Using numbers from the RIA, they estimate that the cost for brokerage services for those investing in front-load mutual funds is roughly 50 basis points a year, which they contrast with an average of 111 basis points for advice in fee accounts, a figure apparently taken from a Cerulli Associates study.[288] They then estimate that the rule will cause a shift to fee accounts that will have a net cost over ten years of $47 billion.

There are, however, a number of obvious flaws in this calculation that are evident even to a non-economist. First, as the RIA itself has shown, it is not enough to compare the costs attributable to the services of the broker and adviser in recommending a fund without also considering the costs of the products recommended. Evidence abounds that administrative costs among broker-sold mutual funds are measurably higher than costs for funds sold directly or through fee accounts. CFA found this to be the case, for example, when we compared direct-marketed and broker-sold S&P 500 index funds.[289] Yet ICI has completely ignored those costs in its estimate of the costs of brokerage advice.

This is a point that Vanguard Research makes more broadly in its analysis of how quality, fee-based advice can result in better returns for investors that more than make up for the higher costs of the advice itself.[290] The authors of the Vanguard study estimate that implementing advice using low-cost funds can provide a value-add of 40 basis points relative to the asset-weighted expense ratios, and they note that the difference is even greater for those who switch from using funds with expense ratios that are higher than the asset-weighted average. Given the high level of fee dispersion among mutual funds, that one difference -- implementing through lower cost rather than higher cost funds -- could erase the entire cost advantage ICI attributes to commission accounts for many commission-based advisers.

Moreover, even relatively high cost mutual funds are among the more affordable investments sold by brokers and insurance agents. Conduct a similar evaluation using cost estimates for annuities or non-traded REITs and the higher total costs of investing through commission accounts become readily apparent. As Michael Kitces points out in his blog on the business benefits of transitioning from commissions to fee-based advisory accounts, brokers and insurance agents whose income depends on sales commissions will eventually hit the limit on how many prospects they can see and how many sales they can close.[291] The only way left for them to grow their income is either to make bigger sales or to sell products that pay bigger commissions. Unfortunately, the products that pay the biggest commissions are often the ones

[288] Letter from Brian Reid and David Blass, Investment Company Institute, to the Department of Labor, July 21, 2015, at 17, http://bit.ly/2niSeBZ.
[289] Letter from Barbara Roper and Micah Hauptman, Consumer Federation of America, to the Department of Labor, July 21, 2015, at 16-18, http://bit.ly/2omHMxq.
[290] Vanguard study at 12.
[291] Michael Kitces, *The Business Benefits Of Transitioning From Commissions To Fee-Based Advisory Accounts*, NERD'S EYE VIEW, March 27, 2017 http://bit.ly/2opXo3h.

that are the worst for investors, leading to total costs for many commission accounts that are far higher than those projected by ICI.

Those who compare the costs of fee and commission accounts also tend to gloss over the different level of service provided under the two different payment methods. Earning annual fees carries with it the obligation to provide ongoing account management; commission-based sales recommendations carry no such ongoing obligation under securities and insurance laws. But when rule opponents talk about the benefits of advice, they rarely if ever draw attention to this distinction. Of course, not all investors need or want ongoing advice. But for those true buy-and-hold investors, particularly those with very small amounts to invest, robo or self-directed accounts should provide a good alternative at a much lower cost and without the incentive for a commission-based adviser to recommend unnecessary trades or higher cost investments.

Finally, we fully recognize that not all fee accounts are equally beneficial to investors. There are fee accounts at some firms where the fees seem exorbitant. But the rule includes provisions that should help to discipline those costs. Fees are required to be reasonable in light of services rendered. That should put pressure on firms to ensure that their fees aren't completely out of line with competitors who are providing a similar level of service. Justifying rollovers from low-cost retirement accounts to high-cost IRAs will be particularly difficult, since the rollover must be shown to be in the best interests of the customer. And, where firms have both fee and commission options available, the firm is required under the rule to recommend the type of account that is best for the customer. It is difficult to see how firms could justify charging ongoing fees to customers who neither need nor want ongoing advice. And firms that prefer to shift retirement accounts to fees will have to take steps to ensure that customers don't face an inappropriate rise in costs.[292]

Ironically, far from disadvantaging commission accounts, the fiduciary rule has the potential to turn these accounts into the more attractive option rule opponents claim them to be. By imposing a best interest standard and reducing incentives to recommend investments that are not in customers' best interests, the rule increases the likelihood that commission-based advisers will recommend lower cost investments, thus lowering investors' total costs of investing. And that, in turn, should spark market competition among broker sold funds based on the best interests of the customer rather than compensation to the adviser. Indeed, we are already seeing this occur in response to the rule. Annuities have been introduced in response to the rule that have lower surrender fees and shorter surrender periods and other features that make them more attractive options for investors. The mutual fund share classes being introduced to comply with the rule also have the potential to significantly reduce costs for the majority of investors. In short, the rule could actually turn commission accounts into the lower cost option. Without the rule, however, that is generally not the case.

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[292] The *Wall Street Journal* recently reported that Merrill Lynch had negotiated down the fee for one IRA down to 0.3 percent when a client complained that the proposed one percent fee was excessive in light of his infrequent trades. Moreover, that one percent fee the client was initially offered is well below Merrill's maximum. See, Michael Wursthorn, *New Retirement Rule Is Delayed, but Not Its Impact,* WALL STREET JOURNAL, April 8, 2017, http://on.wsj.com/2of5Y1X

G. Rule opponents distort U.K. experience, which has been overwhelmingly positive for investors.

The Department invites comment on how the response to the Department's fiduciary rule has compared to response to the United Kingdom's recent investment advice reforms. This is a topic where rule opponents have been guilty of chronic misrepresentations. We discussed the issue, including industry rule opponents' misrepresentations, at some length in our September 24, 2015 comment letter.[293] We updated our analysis in March of 2016, when release of a new report by the U.K. Financial Conduct Authority on the state of the U.K.'s financial advice market prompted a new round of misrepresentations by opponents of the DOL fiduciary rule.[294] The report presented a largely positive picture, indicating that the Retail Distribution Review (RDR) reforms have significantly improved the quality of financial advice, but it also suggested that more could and should be done to make the provision of advice and guidance to the mass market "more cost-effective." Rule opponents seized on that to repeat their claim that the effect of the DOL rule would be "identical" to the effects of the U.K.'s RDR and that the result would be a loss of advice for small savers.[295] But to reach that conclusion, rule opponents conveniently glossed over fundamental differences between the two regulatory approaches, painted a misleadingly negative picture of the effect of the RDR on the U.K.'s financial advice market, and blamed the commission ban for effects that cannot reasonably be attributed to it.

As has been well established, there are fundamental differences between the Department's fiduciary rule and the U.K.'s RDR. First, of course, the Department's rule does not ban commissions. Moreover, it has become clear in the last year that commission accounts will continue to be available under the rule and that fee accounts will be available to even very small investors. Second, the RDR imposed new education and credentialing requirements on advisers, and it imposed a new financial levy on advisory firms to support a Financial Services Compensation Scheme.[296] DOL's Fiduciary rule does neither of those things. Thus, for rule opponents to claim, as they continue to do, that these are "similar" regulations is simply deceptive.

Contrary to the grim picture painted by rule opponents, the U.K. report found that the majority of those who submitted comments agreed that the ban on commissions had "produced good outcomes for consumers, and there was not a case for a return to the pre-RDR rules on charging structures."[297] The "advice gap" that DOL rule opponents seeks to blame on the U.K.'s commission ban, the report itself attributes to other factors. These include the significant fixed costs associated with providing face-to-face advice, which may make it uneconomical for firms to serve smaller accounts regardless of the compensation model. Other factors mentioned appear to be specific to the U.K. market and not relevant here, including: lack of clarity under

[293] Letter from Barbara Roper and Micah Hauptman, Consumer Federation of America, to the Department of Labor, September 24, 2015, at 38-41, http://bit.ly/2nK64ge.

[294] Consumer Federation of America, U.K. Experience Suggests Retirement Savers Will Benefit from DOL Rule to Rein in Conflicts of Interest, Promote Best Interest Advice, March 2016 http://bit.ly/1MnWqLr

[295] Email from Kent A. Mason to members of the Senate HELP Committee re UK government study shows advice gap that DOL has long denied, March 15, 2016 on file with author.

[296] The Financial Services Compensation Scheme was created to compensate victims of bad advice from firms that have since become insolvent or are otherwise unable to pay valid claims.

[297] HM Treasury, Financial Advice Market Review -- Final Report, March 2016, at 46, http://bit.ly/2dNSZzs.

the RDR about the ability of firms to offer guidance or streamlined advice that does not cover an individual's complete financial situation, and failure of firms to recognize and take advantage of the flexibility under the regulations to charge for advice through installment-based payments rather than exclusively through up-front fees, an approach that is particularly daunting for small account holders. None of these key factors is the result of the ban on commissions, and none raises concerns regarding the DOL's regulatory approach.

In addition, while DOL rule opponents use the term "advice gap" to imply that consumers are unable to access desired services, this is not consistent with how the issue is discussed in the U.K. report. First, the U.K. report uses the term "advice gap" to include factors that reduce consumer demand for advice. These demand-related factors include concerns about the cost of advice, "limited confidence in engaging with financial issues," and "lack of trust following past instances of mis-selling." While the report does find that the RDR led to a decline in the number of advisers immediately before and after enactment of the RDR, it attributes that decline to factors other than the ban on commissions. Among the most significant are the RDR's increased education and credentialing requirement for advisers, which forced some in the industry to return to school before they could resume offering advisory services, and its newly imposed levies to pay for a Financial Services Compensation Scheme, which firms have complained imposes significant and unpredictable costs even where they themselves are not culpable for creating those costs.

Based on these fundamental differences between the DOL rule and the U.K.'s RDR, and recognizing the largely positive effect the U.K. law has had, the Department cannot reasonably conclude based on that example that its rule would be likely to deny small investors access to retirement investment advice. On the contrary, experience in the U.K. provides support for the conclusion that reducing conflicts will have a positive impact on the quality of retirement investment advice.

H. Predictions that small plans would lose access to advice are similarly unfounded.

The Department invites comment on whether some firms are "moving to abandon or deemphasize the ... small plan market segment. While some rule opponents have suggested that employers who operate small 401(k) plans will not be able to get access to investment advice if brokers and insurers that serve the small plan market are subject to a fiduciary standard, this has not occurred. Writing in a blog on the impact of the rule, ERISA expert Fred Reisch dismissed this concern: "My suspicion is that, for most ERISA retirement plans, there will not be a great impact on advisers—because, to a large degree, advisers to retirement plans already are acknowledged fiduciaries."[298] He indicated that this is less likely to be the case for smaller plans, "where some insurance companies and broker-dealers have, in the past, taken the position that their advisers are not fiduciaries. Nonetheless, based on my recent experience in working with broker-dealers, the adjustments are being made without a great deal of difficulty," he wrote.[299]

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[298] Fred Reisch, *Interesting Angles on the DOL's Fiduciary Rule #23*, FREDREISCH.COM, http://bit.ly/2p5JOSP.
[299] *Id.*

This argument that small plans could lose access to advice ignores the lively competition that has grown up to serve this market and to do so at an affordable price under a fiduciary standard. (*See* discussion below regarding how technology is making it profitable to serve even the smallest plans.) In addition to the technology-based providers discussed below, a number of brokers and insurers have recently updated their plans for serving this market in response to the rule. Merrill Lynch and Morgan Stanley, for example, recently announced "substantive changes" to their 401(k) businesses, making clear that both firms plan to continue serving the small plan market.[300] Morgan Stanley developed a new product, called ClearFit, specifically for the small plan market. Under this approach, "Morgan Stanley, rather than the adviser, assumes the fiduciary investment responsibility, monitoring and selecting the investments for the product's fund lineup."[301] It indicated, however, that it is also "working with 'several' approved third-party 401(k) providers for the small market to provide investment fiduciary services." In contrast, Merrill Lynch is broadening the pool of advisers eligible to receive the training to become a designated retirement plan specialist, making the designation more readily available to those serving small plans.[302]

MassMutual also recently announced plans to level the compensation its brokers receive for working with 401(k) plans. The change is being adopted, not just to ease compliance with the DOL rule, according to a MassMutual e-mail sent last month to retirement plan advisers, but because of "increased awareness of plan trustees regarding their fiduciary responsibility and potential need for support in selecting their plan's fund line-up, whether or not the Department of Labor (DOL) fiduciary regulation becomes applicable in the near future."[303] *InvestmentNews* reported that, "MassMutual's decision appears to be a play at eliminating variability in levels of adviser compensation and ensuring fees for service are reasonable, said Jason Roberts, CEO of the Pension Resource Institute, an ERISA compliance consulting firm. 'That's where most firms are headed,' Mr. Roberts said."

In short, evidence since the rule was finalized suggest that new companies are developing fiduciary offerings and traditional providers are adjusting their approach in order to continue to serve the small plan market, and these changes are directly attributable to the rule.

VIII. Retirement Investors are Not Being Harmed by Lack of Access to Investment Products

The Department invites comment regarding the rule's effect on "retirement investors' access to quality, affordable ... investment products" and whether it is likely to move the market toward a "more optimal mix" of products. Despite dire predictions of rule opponents, the news here is nothing but good. On the contrary, pro-investor product changes are among the most dramatic, tangible benefits attributable to the rule.

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[300] Greg Iacurci, *Merrill Lynch and Morgan Stanley: A tale of two fiduciary 401(k) business models*, INVESTMENTNEWS, March 24, 2017, http://bit.ly/2o3C03s.
[301] *Id*.
[302] *Id*.
[303] Greg Iacurci, *MassMutual to level 401(k) fees for its brokers*, INVESTMENTNEWS, March 30, 2017, http://bit.ly/2nXBz6Z.

Industry rule opponents have maintained that the fiduciary rule -- and in particular the BIC -- would result in retirement investors' losing access to valued investment products. They attribute this primarily to: 1) the BIC's requirement that firms eliminate incentives, including differential compensation, that create incentives for financial professionals to base their recommendations on their own financial interests rather than the best interests of the customer; and 2) the requirement that financial firms take responsibility for establishing and overseeing policies and procedures to eliminate any such conflicts. The latter poses challenges for independent insurance agents selling fixed-indexed annuities whose sales are not directly overseen by a financial institution, as that is defined in the rule. But, while these provisions may force adoption of significant changes to industry practices, there is no credible evidence that they will cause retirement investors to lose access to beneficial products. Concerns that an accelerating shift to fee accounts will preclude the sale of annuities to retirement investors are similarly unfounded. On the contrary, early evidence since the rule was finalized suggests that it will cause often dramatic improvements in investment products sold to retirement investors.

Some rule opponents have nonetheless sought to suggest that there are not enough products available that meet these criteria for implementation of the rule to go forward as scheduled without hurting investors. Others have questioned the merits of investments, particularly mutual fund T shares, that have been introduced to fill this gap. And still others have pointed to the declining sale of non-traded REITs and variable annuities inside IRAs as evidence that the rule is harming retirement investors. None of these arguments holds water.

A. *Firms are adapting to the BIC requirement to limit differential compensation, preserving access to a wide variety of investment products.*

Among the most important provisions of the rule is its requirement that firms eliminate incentives that encourage and reward advice that is not in customers' best interests. This provision is needed to ensure that the commitment to make recommendations in customers' best interests is more than mere window-dressing. As evidence of just how deeply ingrained those anti-investor incentives had become, this is also the provision that is requiring some of the most extensive operational changes among firms that plan to rely on the BIC. It has also affected companies that develop investment products sold through these accounts. That's because differential compensation arrangements have been baked into the investment products themselves; eliminating the incentives requires changes to the investments. The good news here, however, is that the financial services industry has done what it does best -- they have innovated by adjusting existing products and introducing new product lines and share classes that reduce incentives to favor one product over another. Indeed, those changes have come in record time, with many products already available that meet the rule's requirements. The following discussion responds to the Department's invitation to comment both on how the rule is affecting adviser compensation methods and how it is affecting the development of investor-friendly products, as these two issues are deeply intertwined.

Suggestions that the rule has led to a reduction in available products are greatly exaggerated, particularly with regard to the harmful impact attributed to any such reduction. As part of our assessment of whether the rule was having the disruptive effect some have attributed to it, we reviewed statements industry leaders have made since the rule was finalized in quarterly earnings calls and statements to the media. A number of those statements, quoted extensively below, are directly relevant to this question of the availability of investment products to comply with the rule. Annuities producers and mutual fund companies alike expressed strong confidence that they would have products on the market to support implementation under the BIC in time for the April implementation date. Annuities companies also touted new versions of their products that would be suitable and available for those who choose to implement the rule through fee-based accounts. (*See* below) A recent survey of independent broker-dealers supports this finding, with 74 percent of respondents indicating that their firm had not reduced the number of products on the platform as a result of the DOL rule.[304] Nearly two-thirds (62.5 percent) indicated their firm had realigned the products/account mix, by introducing new share classes and low-cost funds, for example.

In a recent quarterly earnings call, LPL Chairman and CEO Mark Casady specifically refuted the concern that the narrowing of available mutual fund options would be harmful to customers.[305] LPL was one of the first firms to announce it would continue to offer commission accounts under the BIC, and it indicated that it was working with fund companies to develop new share classes to enable the firm to levelize compensation across fund families and fund types. As part of that process, Casady acknowledged that LPL had cut back dramatically on the number of fund families that would be available to its brokers. “We have 130 fund families today in brokerage,” Casady said. “We are going to have fewer in the new world because we have to standardize commissions, and that won’t work for all of the mutual fund companies.”[306] Far from hurting investors, however, Casady said the change was beneficial. Some of the reduction reflects the company’s decision to “curate the shelf and think about it in context of the DOL and just in general making sure we’re doing the right job by investors,” he said.[307] Even though the number of fund companies will drop dramatically, to “around 15,” Casady said the remaining 15 companies account for “almost 100% of the assets.”[308] In the end, he said, “We do see the number of relationships narrowing, and we see that creating a better ecosystem for the investor, the end client for the advisor, for the money manager, and, of course, for LPL.”[309]

As Casady’s statement helps to illustrate, it is not enough to look solely at the number of investment options available before and after the rule to determine whether investors are being harmed by a lack of access to investment products. This is particularly true since new options are likely to become quickly available once uncertainty over the rule’s fate is eliminated. Rather than engage in a simplistic numbers game, therefore, the Department must also consider the quality of investments that are recommended to retirement investors. Here, the evidence is overwhelming that the rule is having a beneficial effect, both by spurring changes to improve the pricing and features of products that are sold to retirement investors and by reducing the sale of harmful investment products through retirement accounts. These benefits far outweigh any perceived harm from any temporary reduction in the number of

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[304] Diana Britton, *The 2017 Independent Broker/Dealer Report Card*, WEALTHMANAGEMENT.com, April 6, 2017 http://bit.ly/2pllh8B.
[305] LPL Financial Holdings (LPLA) Q3 2016 Results - Earnings Call Transcript, SEEKING ALPHA, November 02, 2016, http://bit.ly/2oigXG7.
[306] *Id*.
[307] *Id*.
[308] *Id*.
[309] *Id*.

investment options that are immediately available to firms that choose to implement the rule in reliance on the BIC exemption. Moreover, product sponsors express great confidence that they will have a robust suite of products ready to support implementation, as evidenced by their statements in earnings calls and media reports. (*See* below)

B. Annuities, including fixed-indexed annuities, will continue to be available under the rule.

Despite dire predictions that the rule would make it impossible to sell fixed-indexed annuities (FIAs) to retirement investors, mounting evidence indicates that the FIA industry will adapt to the rule. Insurance companies and IMOs are fashioning solutions to the challenges of operating under the BIC, including the development of new distribution networks. For example:

- Annexus, an independent insurance-product design and distribution company, which comprises a network of 17 IMOs and accounts for more than $4 billion in FIA sales, has announced that it plans to establish an affiliated broker-dealer through which to sell FIAs. David Rauch, COO and General Counsel at Annexus, stated that it is "full speed ahead" for the firm and that he expects "there are more independent industry players like us who are contemplating the same thing."[310]
- Voya Financial has created a line of FIAs with lower surrender fees, designed with flexibility to make them a more attractive product to their distributors. Carolyn Johnson, president of annuities at Voya, stated that the firm "plans to adjust its 'business model as new trends and the regulatory landscape evolves.' "[311]
- Allianz Life has stated that its sales of FIAs could grow with the current version of the BIC and that the firm does not see itself as disadvantaged in the annuity market. Dieter Wemmer, CFO of Allianz, believes that "overall the fixed-index annuity market will not get smaller."[312]
- American Financial Group, which provides insurance products through Great American Insurance Group, believes their "products have a simpler product design with shorter surrender charge periods, lower commissions and trail commission options . . . our distribution channels include banks, broker-dealers, registered investment advisors, and large national marketing organizations that will be best positioned to comply with the more rigorous compliance requirements."[313]

Industry analysts and experts provide additional confirmation that the fixed-indexed annuity industry will not be irreparably harmed. Sheryl Moore, CEO of Moore Market Intelligence, states that while she believes "there is a possibility" for an initial decline in indexed annuity

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[310] Greg Iacurci, *Indexed annuity distributors weigh launching B-Ds due to DOL fiduciary rule*, INVESTMENTNEWS, June 23, 2016, http://bit.ly/2oemBtA; *See also* Rachel Summit, *FMOs Retain Fixed Indexed Annuity Dominance by Launching Own Broker-Dealer*, LOOKTOWINK, July 13, 2016, http://bit.ly/2oyMrti.
[311] Nick Thorton, *Voya rolls out new, less expensive FIAs*, BENEFITSPRO, June 15, 2016, http://bit.ly/2oeyQXd.
[312] Cyril Touhy, *Allianz: DOL Might Pull FIAs Out Of BICE*, INSURANCENEWSNET, May 12, 2016, http://bit.ly/1Wsr8GN.
[313] Thompson Reuters, Edited Transcript of AFG earnings conference call or presentation (May 3, 2016), https://yhoo.it/2pnD27R.

sales as a result of the BIC, it will be temporary and that "once the industry has had time to adjust to the 'new normal,' sales will pick up again."[314]

C. More fee-based annuities are rapidly being introduced.

Concerns that an accelerating shift to fee accounts could cause investors to lose access to annuities are equally unfounded. Instead, companies are supplementing their existing menu of commission-based products with new fee-based alternatives, as described in a recent *ThinkAdvisor* article.[315] Typically, the new fee-based versions carry lower fees and penalties, which make the product more valuable to the client and allow advisers to justify them for reasonableness of fees, according to the article. For example, some of the new fee-based products that have been introduced have very short surrender periods, relative to commission-based alternatives, which add value to consumers by limiting the period of time that their investments are locked up. According to the article's authors, "many expect that the trend of fee-based annuities with short (or no) surrender periods and low surrender charges will continue as fees must be disclosed and the client's best interests must be taken into account."[316] Others have reported on the same phenomenon. Zachary Parker, first vice president of income distribution and product strategy at Securities America Inc., reportedly told *InvestmentNews* that, "All the carriers are trying to build out the advisory-type approach for a post-DOL environment."[317] Paula Nelson, head of annuity distribution, retirement, with Global Atlantic Financial Group, told *Insurancenewsnet.com* that, "Commission-based products will survive post April but there's much inquiry around fee-based platforms."[318]

A review of recent product offerings confirms expert predictions both that fee-based alternatives of both fixed-indexed and variable annuities will be available and that they often come with more investor-friendly features than commission-based features.

- Jefferson National, recently bought by Nationwide, offers fee-based annuities, including the Monument Advisor VA, popular among RIAs.[319] This contract costs $20 per month and does not charge any M&E charge or surrender charges. The subaccounts for this contract use low-cost funds ranging from 0.10 percent to 0.35 percent.
- In February, AIG announced its Polaris Advisory Income Variable Annuity, its first fee-only annuity designed specifically for advisory platforms.[320] The new offering "features lower-cost investment options without 12b-1 fees—consistent with what we understand advisors prefer for investment options offered through advisory programs," according the Bryan Pinsky, AIG senior vice president for individual retirement products.

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[314] Arthur Postal, *Industry insiders react cautiously to DOL fiduciary rule*, LIFEHEALTHPRO.COM, Apr. 7, 2016, http://bit.ly/2pk3rWW.
[315] Robert Bloink, and William H. Byrnes, *After the DOL Fiduciary Rule Enter the Fee-Based Variable Annuity*, THINKADVISOR, July 4, 2016, http://bit.ly/29xyBnk.
[316] *Id*.
[317] Greg Iacurci, *DOL fiduciary rule hastening death of L-share variable annuities*, INVESTMENTNEWS, January 11, 2017, http://bit.ly/2oyQgyu.
[318] Cyril Tuohy, *DOL Rule Will Lead To Simplification Of Many Retirement Products*, INSURANCENEWSNET, September 27, 2016, http://bit.ly/2p60Ikv.
[319] Jefferson National, Monument Advisor, http://bit.ly/2lOirvk.
[320] Christopher Robbins, *AIG Enters Fee-Only VA Business*, FINANCIAL ADVISOR MAGAZINE, February 10, 2017, http://bit.ly/2mdTYvz.

- Jackson National, the nation's variable annuity sales leader, announced it was developing its first-ever fee-based variable annuity back in June 2016.[321] The annuity has low contract charges (30 basis points for mortality, expense and administration costs, as opposed to the typical 1.15-1.25 percent), a range of optional living and death benefit riders, and a relatively short surrender-charge period (three years).
- In January Jackson launched the Elite Access (EA) Advisory, the company's first fee-based investment only variable annuity (IOVA) specifically to support compliance with the DOL fiduciary rule.[322] This product has a contract charge of only $10 per month. There is no mortality, expense and administration charge. And there is a three-year surrender charge schedule of two percent (in the first year), two percent (in the second year), one percent (in the third year) and zero percent thereafter.
- In January, Transamerica announced its new no-commission annuity contract, Variable Annuity I-Share.[323]
- In February, Lincoln announced it was broadening its suite of annuities with new fee-based variable and fixed indexed annuities, which would "provide greater choice and flexibility for advisors and their clients."[324] According to the company's press release, these products will have no surrender charges.
- The following week, Lincoln announced the launch of the industry's first ETF-only variable annuity, built with iShares, further lowering investors' costs.[325] The product has no surrender charge, all in costs of 1.9 percent or less, and a guaranteed lifetime income equal to four percent of the initial deposit that increases annually by a two percent cost of living adjustment.[326]
- In February, Allianz announced its first fee-based fixed-indexed annuity, Retirement Foundation ADV℠ Annuity.[327] Retirement Foundation ADV has a seven-year withdrawal charge period. It also uses a simplified design, with one crediting method and four index allocation options or a fixed interest allocation option.
- Last August, Great American Life Insurance Company® expanded its product offerings to include its first fee-based fixed-indexed annuity, the Index Protector℠ 7.[328] It has a seven-year declining early withdrawal charge starting at seven percent. The annuity will also be available through several independent broker-dealers, including Raymond James and Commonwealth Financial Network, according to the company.[329]

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321 Press Release, Jackson, "Jackson Launches Perspective Advisory," September 21, 2016, http://bit.ly/2oyQTYS.
322 Press Release, Jackson, "Jackson Launches Elite Access Advisory," January 23, 2017, http://bit.ly/2mdi7S1.
323 Joe Boan, Senior vice president, Transamerica's statement on its new no-commission VA with income benefits, Retirement Income Journal, January 20, 2017, http://bit.ly/2oCw68M.
324 Press Release, Lincoln Financial Group, "Lincoln Financial Group Broadens Its Suite of Guaranteed Lifetime Income Solutions with New Fee-Based Options," February 13, 2017, http://bit.ly/2nPGSJT.
325 Press Release, Lincoln Financial Group, Lincoln Financial Group Launches Lincoln Core Income, Built With iShares, February 21, 2017, http://bit.ly/2oittp6.
326 *Id*.
327 Press Release, Allianz, "Allianz Life Launches New Retirement Foundation ADV Annuity," February 7, 2017, http://bit.ly/2oLjEUt.
328 Press Release, Great American Life, "Great American Life Launches New Fixed-Indexed Annuity and Guaranteed Income Rider for Fee-Based Advisors," August 11, 2016 http://bit.ly/2oCFfho.
329 Press Release, Great American Life, "Great American Life's New Fee-Based Annuity Now Available Through Raymond James," October 12, 2016, http://bit.ly/2nPOJaj; Press Release, Great American Life, "Great American Life's Fee-Based Annuity Now Available Through Commonwealth Financial Network," March 01, 2017, http://bit.ly/2oCwiER.

Experts and industry leaders predict that new fee-based versions of both variable and fixed-indexed annuities will continue to be developed. Based on these developments, the Department cannot reasonably conclude that investors will lose access to annuities, even if the rule prompts a shift toward fee accounts. On the contrary, far from causing investors to lose access to products, the rule has prompted product innovations that expand investor choice and, as we discuss further below, improve product quality.

D. The rule has spurred pro-investor innovations in investment products.

As discussed above, BIC provisions designed to minimize conflicts have in some cases forced a redesign of those investment products where incentives are baked into the products themselves. This has had overwhelmingly positive results for retirement investors, which is directly attributable to the rule. The rule has, for example, spurred introduction of two new mutual fund share classes with the potential not only to reduce conflicts of interest but also to greatly decrease costs for most investors. The rule has also led to the creation of new fee- and commission-based annuities offerings with far more favorable features than those that had previously dominated the market. The result is a more optimal mix of investment products, just as the Department predicted would occur.

<u>Mutual Fund T Shares</u>: A number of fund companies either have issued or are preparing to offer a new fund share class, known as T shares, which create level compensation across fund categories and fund families. The T shares in question charge a 2.5 percent front-end load and an ongoing 12b-1 fee of 25 basis points.[330] According to Morningstar, two fund families had issued a total of 50 T-shares conforming to this description as of the end of March, with another nine firms expected to issue a total of 235 additional T shares by the end of May. A further 871 T shares from 74 firms are reportedly in the pipeline but without an announced "inception" date, in part because of uncertainty caused by reconsideration of the rule.[331]

T shares offer an attractive alternative for implementing the rule, since they support a compensation-neutral approach to mutual fund sales in commission accounts across fund types and fund families. They also offer significantly lower costs over A shares for the majority of investors. Most A shares, like the new T shares, charge an ongoing 12b-1 fee of about 25 basis points. But whereas T shares charge a maximum front-end load of 2.5 percent, A shares can charge front-end loads as high as 5.75 percent, with an industry standard of 4.75 percent, according to Morningstar. For investors with less than $100,000 invested in a single fund family, the T shares should cut up-front sales charges nearly in half in most cases, though the cost savings would be lower for certain types of funds.[332]

Despite these obvious cost savings, some have sought to discount the benefits offered by T shares on the grounds that they offer "few if any breakpoints, no rights of accumulation

[330] These should not be confused with other share classes called T shares before the rule.
[331] Daisy Maxey, *5 Things Mutual-Fund Investors Should Know About Mutual-Fund 'T' Shares*, WALL STREET JOURNAL, April 9, 2017 http://on.wsj.com/2oY1S0U.
[332] A shares of short-term bond funds, for example, typically carry lower sales loads than stock funds.

and no free exchanges within fund families."[333] Of course, the key reason T shares offer fewer breakpoints is that the sales load on T shares start at a much lower level, leaving less room for additional discounts. While breakpoints are not standardized and vary among firms, our quick review of fee tables for several major fund families found that an investment of at least $250,000 is needed to match the 2.5 percent maximum front-end load on T shares and an investment of at least $500,000 in A shares is typically needed to qualify for a front load lower than 2.5 percent.[334]

Even assuming that the T shares offer no breakpoints whatsoever, and that the A shares offer rights of accumulation, the larger number of breakpoints offered by A shares is simply not a relevant consideration for the majority of retirement investors.[335] After all, the typical retirement investor does not have $500,000 in mutual fund investments in total, let alone the $500,000 invested within a single mutual fund family needed to qualify for a discounted rate that is the lower than the cost of T shares. A recent survey by PwC found, for example, that even among Baby Boomers, those closest to retirement and with the largest amount of money saved toward retirement, only 15 percent have $500,000 or more in savings, while roughly half have savings of $100,000 or less.[336]

The availability of free exchanges within a fund family raises a somewhat different set of considerations when determining whether A shares or T shares offer the better option for a particular investor. But here again, most investors, who do not qualify for deep discounts on A shares, would have to do at least a couple of free exchanges before the A shares would offer a more affordable alternative than the T share. Without reliable information on the frequency of such free exchanges, it is impossible to estimate the relative benefits of these two types of share classes. To the degree that the Department determines that this poses a concern, it could largely eliminate that concern by providing guidance that free exchanges within T shares wouldn't trigger the restraints on differential compensation, particularly where those free exchanges are used for the purposes of rebalancing.

In general, however, in evaluating the relative merits of the various share classes, the Department must look beyond a dollar-for-dollar comparison. Based on the Department's previous findings, it is reasonable to assume that some advisers recommend funds from a variety of fund families to avoid triggering breakpoints, or in preference to doing free exchanges among funds within a particular fund family, with the specific intent of maximizing their compensation on each sale. Nor do we have clear evidence on the extent to which brokers, who are exempt from an ongoing duty of care, actually provide account rebalancing through

333 Letter from Paul Reilly, Chairman and CEO, Raymond James Financial, March 10, 2017, at 3, http://bit.ly/2nuw3JN.
334 We did a quick review of fee charts for American Funds, Oppenheimer, Janus, and Davis, all of which appear to require investments of $500,000 to trigger a load that is lower than the 2.5 percent charged on T shares. Among Fidelity A shares, a quick review suggests that an investment of $250,000 would be needed to qualify for a front-end load of less than 2.5 percent, but that drops to as little as $50,000 on some funds (a short-term bond fund, for example).
335 Rights of accumulation count existing fund holdings, as well as the purchase amount, when calculating whether the investor qualifies for a breakpoint.
336 Todd Campbell, *Baby Boomers' Average Savings for Retirement*, THE MOTLEY FOOL, Dec. 17, 2016, http://bit.ly/2kUANqG.

free exchanges within fund families. Reducing differential conflicts has the additional potential to improve asset allocations, since the higher compensation typically paid for higher risk funds could have a distorting effect on the recommendations of conflicted advisers. All of these factors must be weighed as you consider the benefits to retirement investors from new product offerings.

Overall, when you combine the minimization of conflicts with the lower costs that most investors are likely to pay, T shares will clearly lead to better outcomes for most retirement investors, and particularly for those small savers the rule opponents profess to care so much about. Unfortunately, some fund companies appear to be using the ongoing reconsideration of the rule as a justification for delaying bringing the T shares to market. "Our members … would like to know the DOL's decision about revising or rescinding the rule, following President Trump's directive," ICI general counsel David Blass reportedly told the *Wall Street Journal*.[337] A spokesman for Lord, Abbett & Co. LLC reportedly said, "Depending on the outcome of the DOL rule, and if there is a continued demand by our partners in the marketplace, we would offer them."[338] In other words, it is the uncertainty caused by the reconsideration of the rule, and not any problematic timing associated with the rule itself, that has slowed the pace of the T share roll-out. The Department cannot reasonably attribute any such slowdown, and any resulting shortage of suitable fund offerings to support implementation of the rule, as a harmful consequence of the rule or evidence of the need for further delay.

Clean Shares: Even more promising than T shares are the new "clean shares" approved by the SEC earlier this year.[339] These mutual fund shares eliminate payments for distribution entirely, leaving those charges to be negotiated separately by the broker and the customer. Under this approach, commissions on mutual fund transactions would be set in the same way they currently are for purchases and sales of individual stocks and ETFs. American Funds, a leader among broker-sold funds and actively managed funds in particular, became the first fund family to win approval of the shares in January, and Janus received approval shortly thereafter.

By taking the mutual fund out of the role of setting the broker's compensation, these share classes make it a simple matter for firms to adopt product-neutral compensation in commission-based retirement accounts. As a Ropes & Gray alert issued shortly after the SEC decision explains, "Clean Shares appear to be tailor-made for a broker-dealer offering commission-based advice to retirement investors and relying on the regular BIC Exemption."[340] They enable such brokers to establish their own fee schedules based on the level of service provided. "Because this type of broker-dealer will be able to charge a client similar commissions or transaction fees regardless of the products recommended and would not accept Third-Party Payments, compliance with the DOL's Impartial Conduct Standards is likely to be

[337] Daisy Maxey, *5 Things Mutual-Fund Investors Should Know About Mutual-Fund 'T' Shares*, WALL STREET JOURNAL, April 9, 2017, http://on.wsj.com/2oY1S0U.
[338] *Id*.
[339] Rachel Loko, Senior Counsel, Response of the Office of Chief Counsel, Division of Investment Management, Securities and Exchange Commission, to Capital Group, Re: Investment Company Act of 1940 Section 22(d), January 11, 2017, http://bit.ly/2ihls0z.
[340] Ropes & Gray LLP, "DOL Fiduciary Rule Compliance—SEC Says Brokers Can Impose Their Own Commissions on Sales of "Clean" Fund Shares," http://bit.ly/2osqP3E.

less burdensome than it would be if, instead, the broker-dealer received variable one-time sales loads/fees," according to the Ropes & Gray alert.

History suggests that "clean shares" will also significantly reduce investor costs by finally bringing market forces to bear on broker compensation for mutual fund sales. This has the potential to dramatically reduce transaction costs for mutual funds, just as market competition has driven down transaction costs for purchases and sales of stocks and ETFs. Indeed, if the approval of "clean shares" for mutual funds is even a fraction as consequential as the 1975 deregulation of trading commissions for stock transactions has been, the cost savings to retirement investors are likely to far exceed the estimated benefit of the rule in the current economic analysis. It is worth noting, in this regard, that the SEC decision to ban fixed commissions also faced heavy opposition from Wall Street, which argued that it would have a devastating impact on the industry.[341] In reality, however, that decision paved the way for a whole new industry -- discount brokerage -- and public participation in the markets skyrocketed.[342] Meanwhile, stock trading costs have declined more than 70 percent in the last 20 years alone, according to one estimate, even as execution speeds have improved dramatically.[343]

If more broadly adopted by fund firms, clean shares (like T shares) have the potential to eliminate the concerns that have apparently made some brokerage firms hesitant to offer mutual funds within commission retirement accounts. We are hopeful that the Department's recent announcement that it does not expect further delays of the impartial conduct standards beyond the June 9 implementation date will spur more fund companies to offer clean shares. We are concerned, however, that some fund companies will use the uncertainty caused by reconsideration of the rule as an excuse to justify further delays. Brokerage firms, which could see their revenues reduced if the shares result as expected in lower transaction costs, have incentives to encourage that delay. Now that the promise of clean shares has been realized, however, the Department must base its evaluation of the impact of the rule, not on the state of the market during this interrupted stage of its development, but on the realistic expectation that mutual funds will be widely available in commission retirement accounts once the market is allowed to develop normally. It must consider, moreover, that both costs and conflicts will be dramatically reduced as a result.

<u>More Investor-Friendly Annuities</u>: The rule has also prompted development of more investor-friendly annuities, just as experts predicted it would. A survey of retail annuity manufacturers found that 45 percent either have already or will introduce new annuity products in response to the DOL fiduciary rule.[344] Moreover, at least one in four variable annuity writers and one in three fixed-indexed annuity companies said they expect to be more innovative with

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[341] Kenneth Silber, *The Great Unfixing*, RESEARCH MAGAZINE, May 1, 2010, http://bit.ly/2nWuDXe

[342] Jenny Strasburg, *The genesis of discount brokerage / 1975 SEC deregulation offered an opening; Schwab stepped in*, SFGATE, May 1, 2005 http://bit.ly/2p0Akov

[343] Business Wire, *On May 1, 1975, The SEC Deregulated Brokerage Commissions And, Through New Competition, The Doors Of Wall Street Slowly Opened To Main Street Investors*, THESTREET.COM, May 1, 2015 http://bit.ly/2osDELz.

[344] Disruption leads to innovation in the annuity market, Insurance Forums, January 17, 2017, http://bit.ly/2oBwJxn; DOL Viewpoints, The Dol Fiduciary Rule, Retail Annuity Manufacturers' Perspective, LIMRA Secure Retirement Institute http://bit.ly/2oByVFo. (*See* Appendix D)

their product design in 2017. Industry leaders and experts have predicted that, in addition to prompting development of more fee-based alternatives, as discussed above, the BIC's best interest and reasonable fees requirements would also lead to development of commission-based products with more investor-friendly features. Annuity expert Stan Haithcock credited the DOL rule with returning annuities to their former glory, when they were simple, consumer friendly, and provided value.[345]

That has been a common theme among experts who have written about the rule's impact on the annuity industry. Writing shortly before the rule was finalized, for example, Scott Stolz, a senior vice president with Raymond James, predicted that the rule would result in commission compression and the elimination of long surrender periods and high surrender charges, as companies develop products designed to ease compliance with the rule.[346] Two Texas A&M law professors, writing in *ThinkAdvisor*, credited the rule with providing an impetus for innovation in the annuity market, particularly with regard to variable and fixed-indexed annuities, which in recent years have included harmful features and been driven by harmful incentives, according to the authors.[347] "Many recently announced fee-based variable annuity products have sought to lower overall fees and penalties that clients may be held responsible for, developing features that can make the product more valuable to the client (also providing justification for the reasonableness of the fee)," the wrote. They cited as an example the fact that "some of these products provide for very short surrender charge periods, an option that adds value because it limits the period of time during which the client is locked into the product." As a result of features such as these, new annuity products being developed in response to the rule "may actually add value for clients," they concluded.

Shortly after the rule was finalized, Kitces devoted a blog to a discussion of how the rule would benefit annuities. "I think ultimately, what you're going to find when we look back on this in 5 or 10 years, is that this was not the beginning of the end of annuities. This was the beginning of annuities actually getting a lot better," he wrote.[348] When companies can no longer drive sales by offering the highest commission, they'll learn to compete by offering a good product and persuading advisers of its benefits, he said. "[I]t will take a while for this to play out," he added, but he predicted that the rule would result in: annuity costs coming down; benefits getting "less gimmicky;" and surrender charges largely disappearing, "because the truth of a surrender charge is it's nothing more than the penalty that the company looms over the client in order to recover the commissions that were paid upfront to the agent." Kitces also predicted that product illustrations would become more realistic, "because no broker/dealer is going to want to encourage an annuity on their platform with all their brokers using aggressive or unrealistic sales illustrations that over-project the returns." He said advisers would get "better clarity about how the annuity products are working under the hood, because that's what

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[345] Stan Haithcock, *The Department of Labor's version of an indexed annuity has arrived,* MARKETWATCH, August 23, 2016, http://on.mktw.net/2oNv8qq.
[346] Scott Stolz, *How Annuities Will Be Transformed by DOL Fiduciary Rule*, THINKADVISOR, February 1, 2016, http://bit.ly/2pGn5Jd.
[347] Robert Bloink, and William H. Byrnes, *After the DOL Fiduciary Rule, Enter the Fee-Based Variable Annuity,* July 4, 2016, THINKADVISOR, http://bit.ly/29xyBnk.
[348] Michael Kitces, *Why DOL Fiduciary Won't Kill Annuities, It Will Make Them Stronger!*, NERD'S EYE VIEW, April 21, 2016, http://bit.ly/22THLKe.

anybody doing fiduciary due diligence is going to be looking for." Overall, he said, "I think what we're going to see is a huge wave of innovation for annuities."[349]

Leaders within the industry made similar predictions in an *Insurancenews.net* article on how the rule will lead to simplification of many retirement products.[350] "On the product side, gimmicks will fall away and you're going to see more and more focus on client value," David Rauch, chief operating officer and general counsel for the insurance marketing organization Annexus, told the publication. Companies want to simplify their products and return to basics instead of overwhelming advisers with product features, said Paula Nelson, head of annuity distribution, retirement, with Global Atlantic Financial Group.

As discussed above, some of these changes are already evident in the rapid development of fee-based variable and fixed-indexed annuities. These new products generally appear to have lower costs and shorter surrender periods than earlier commission alternatives. But pro-investor innovations have also occurred among commission-based products, and more are expected. "Some insurers feel confident they can sell through commission but, for some, things might change a little," variable annuity expert Steven McDonnell, said in an interview with *ThinkAdvisor*.[351] Greg Cicotte, executive vice president and chief distribution officer for Jackson, agreed. "At Jackson, we have always believed commissions and fees can coexist in this space," he said.[352] Transamerica senior vice president Joe Boan said, "Transamerica sees the DOL Rule and the requirement to do what is in the best interest of the client as an opportunity to introduce solutions to financial advisors who haven't considered these products in the past. The need for lifetime income is as strong as it has ever been."[353] He added that Transamerica "is committed to making our annuities as simple to understand as possible, because we believe that advisors and clients both want and need this type of structure when planning for retirement income." And Brian Kroll, senior vice president and head of Annuity Solutions for Lincoln Financial Group, said that Lincoln remains committed "to providing transparent and flexible options that fit the need for guaranteed lifetime income in today's marketplace – within both commission- and fee-based arrangements...We believe in choice, and in allowing advisors and consumers to decide which model is best for their retirement income objectives. Commissions and fees can *both* be in the best interest of clients."[354]

It has also been reported that the fiduciary rule is hastening death of L-share variable annuities, as they are replaced with versions that have more favorable options.[355] "Certainly with the DOL fiduciary rule now in play, they just won't stand the test of time," Bernard Gacona, senior vice president and director of annuities at Wells Fargo Advisors, told

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[349] *Id.*
[350] Cyril Tuohy, *DOL Rule Will Lead To Simplification Of Many Retirement Products,* INSURANCENEWSNET, September 27, 2016, http://bit.ly/2p60Ikv.
[351] Cyril Tuohy, *VA Product Lines See A Wave Of Changes*, INSURANCENEWSNET, February 16, 2017, http://bit.ly/2oEgEbX.
[352] Press Release, Jackson, "Jackson Launches Elite Access Advisory," January 23, 2017, http://bit.ly/2mdi7S1.
[353] Joe Boan, Senior vice president, Transamerica's statement on its new no-commission VA with income benefits, Retirement Income Journal, January 20, 2017, http://bit.ly/2oCw68M.
[354] Press Release, Lincoln Financial Group, "Lincoln Financial Group Broadens Its Suite of Guaranteed Lifetime Income Solutions with New Fee-Based Options," February 13, 2017, http://bit.ly/2nPGSJT.
[355] Greg Iacurci, *DOL fiduciary rule hastening death of L-share variable annuities,* INVESTMENTNEWS, January 11, 2017, http://bit.ly/2oyQgyu.

InvestmentNews. He said Wells Fargo, which eliminated L shares from its platform around 2011, now offers variable annuities with a "liquidity rider," which carries a similar cost to an L share for the first four years of the contract, but then automatically drops to B-share pricing afterward if an investor doesn't exchange the annuity for a new one. Securities America is reportedly considering a similar approach to help comply with the DOL rule, since such a feature would prevent clients from paying a higher ongoing cost if they were to decide to remain in the annuity.

Meanwhile, on the fixed-indexed annuity side of the market, Lincoln announced that it plans to develop a DOL-friendly product "specifically for the broker-dealer channel."[356] And Symetra has created a fixed-indexed annuity that appears to be generally comparable in structure to mutual fund clean shares. As the company wrote in a response to Sen. Warren,"Symetra is developing an annuity contract, the design of which is such that it does not support the payment of commissions to distributors or sales agents. In other words, the parties that distribute and sell the contract intend to obtain compensation for the sale directly from the contract owner and not from Symetra. We are developing this contract at the request of several of our distributors whom we believe will find it very helpful in complying with the DOL Rule."[357]

Annexus' Rauch predicted that the rule would also lead to improvements "on the distribution side," by helping to "impose a more consistent and repeatable way for an agent and a financial institution to review products that might meet the needs of retirement investors."[358] That, in turn, will lend itself to electronic documentation, he said. "That's the beauty of the rule. It will force and accelerate change and compel agents to adapt. The initial learning curve may be steeper than what agents are used to," he added. "But over the long run, the changes will make it easier and more efficient for agents and insurers as compensation and product platforms become more consistent."[359]

E. The rule is discouraging the sale of harmful investment products.

In addition to encouraging the development of more investor-friendly investment products, the rule also appears to be discouraging the sale of harmful products, including those with excessive costs or that expose retirement investors to unwarranted risks or substandard performance. As noted above, a CoreData survey of financial advisers found that 60 percent plan to decrease allocations to non-traded REITs in response to the rule, and 57 percent say they will limit offering variable annuities in retirement accounts.[360] On the other hand, six in ten (62 percent) say they will increase ETF recommendations in their retirement accounts due to the rule. This suggests that a beneficial shift away from high-cost products and toward

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[356] Rachel Summit, *Four Fee-Based Fixed Indexed Annuities Coming Soon*, ANNUITYFYI, July 2016, http://bit.ly/2pGB7L3.
[357] Letter from Thomas Marra, Symetra Life Insurance Company, to Senator Elizabeth Warren, January 31, 2017, http://bit.ly/2ogT7eF.
[358] Cyril Tuohy, *DOL Rule Will Lead To Simplification Of Many Retirement Products,* INSURANCENEWSNET, September 27, 2016, http://bit.ly/2p60Ikv.
[359] *Id*.
[360] Press Release, CoreData Research, "Fiduciary Rule To Leave Us Mass-market Investors Stranded, Study Shows," November 2016, Value Walk, http://bit.ly/2oBDxuU.

lower-cost alternatives is underway. In its study on the impact of the rule, A.T. Kearney predicted that such a shift would occur.

The statement from LPL's Casady quoted above suggests that this is attributable, at least in part, to the fact that firms are evaluating their investment offerings not just in light of their compensation conflicts but also to assess the appropriateness of the products under a best interest standard. This likely explains the recent drop in sales of non-traded REITs and high-cost variable annuities inside IRAs that some have sought to paint as a harmful consequence of the rule.[361] It also helps to explain the shift away from variable annuity L shares and toward more investor-friendly share classes. If industry can figure out a way to design non-traded REITs that deliver value to investors, reduce conflicts, pay a premium for their illiquidity, and reduce exorbitant costs, there's no way they couldn't meet the rule's conditions. Only time will tell whether the REIT community will respond, as annuity producers appear to have done, to develop a more investor-friendly product to comply with the rule. If they don't, that reflects a business choice on their part, not a flaw in the rule.

Ultimately, of course, while the rule may change (for the better) the products that are recommended by conflicted advisers, it will place no limits whatsoever on the investment products that investors themselves can choose to invest in either within, or outside, retirement accounts. Investors who prefer the investment world's equivalent of "junk food" will remain free to indulge, but the financial advisers they turn to for expert advice will no longer be able to peddle it as a healthy option.

IX. Industry Claims that the Rule will Lead to Increased Litigation are Baseless

The Department invites comments on "whether or to what degree the final rule and PTEs are likely to cause an increase in litigation, and how any such increase in litigation might affect the prices that investors and retirees must pay to gain access to retirement services." This is another area where evidence since the rule was adopted clearly shows that industry fear-mongering about the harmful impact of the rule's liability provisions was entirely unfounded.

A favorite stalking horse of industry rule opponents in their endless battle to render the fiduciary rule toothless is the claim that it exposes them to out-sized liability risks that will either drive firms out of the market or drive up the costs of retirement investment advice. Evidence discussed elsewhere in this letter conclusively shows that neither prediction is supported by firms' response to the rule since it was finalized. Not only have firms overwhelmingly decided to continue to offer retirement investment advice, but many, if not most, have decided to do so in reliance on the BIC. A large number of firms have signaled their continued willingness to serve small accounts and small plans under a fiduciary standard. And total costs for those services, including costs for the advice as well as the investments to implement the advice, have been going down, not up since the rule was finalized. While no one doubts that firms would prefer to avoid legal accountability for acting in customers' best interests, the argument that any increased risk of liability will harm investors is entirely

[361] *See*, for example, Letter from Kent A. Mason, Davis & Harmon, on behalf of a group of unnamed clients, to the Department of Labor, March 16, 2017, http://bit.ly/2nLi44l.

baseless. On the contrary, the BIC exemption's contract requirement, as well as the required warranties and prohibition on class action waivers, are essential to ensure that the rule provides the intended benefits.

We discussed at length in our July 21, 2015 comment why a legal enforcement mechanism is absolutely critical to the rule's effectiveness and why there is simply no basis for the claim that the rule would lead to an upsurge in harmful or frivolous litigation. To suggest that it would ignores not only the high cost of pursuing claims, and the particular difficulty of pursuing class action lawsuits, but also the plain language of the rule itself. It also ignores the incentive attorneys have to avoid taking cases that they are unlikely to win, as they typically get paid only if they are successful. The risk that attorneys will pursue baseless or frivolous claims, therefore, is miniscule when compared to the risk, indeed the certainty, that all too many financial advisers would flout the rule's requirements to reduce conflicts and act in customers' best interests absent an effective mechanism to hold them accountable for compliance.

A. The Department has already carefully weighed arguments about the liability provisions.

The Department already thoroughly considered all of these questions before finalizing the rule. It carefully analyzed industry rule opponents' claims with regard to the costs and harmful consequences of increased liability and appropriately concluded that both were greatly exaggerated. The preamble of the rule responds at length to industry claims in this regard. It thoroughly addressed claims that certain conditions of the exemption were ambiguous or subjective and would form the basis of class action lawsuits by disappointed investors, as well as claims that firms would not risk the anticipated legal liability in order to serve retirement investors, particularly with respect to small accounts. The Department cannot now simply do an about-face and repudiate its earlier findings and conclusions without providing strong evidence for why such a reversal is appropriate. To do so would be arbitrary and capricious and expose the Department to legal challenge.

A key target in rule opponents' efforts to render the fiduciary rule toothless is certain to be its requirement that firms and financial advisers that receive conflicted compensation enter into a written contract in which they acknowledge their obligations as fiduciaries. Before adopting this approach, the Department concluded that the enforceable contract and its attendant rights serve a critical function for IRA owners and participants and beneficiaries of non-ERISA plans.[362] The Department found, furthermore, that the contractual commitment "provides an administrable means of ensuring fiduciary conduct, eliminating ambiguity about the fiduciary nature of the relationship, and enforcing the exemption's conditions, thereby assuring compliance. The existence of enforceable rights and remedies gives Financial Institutions and Advisers a powerful incentive to comply with the exemption's standards, implement effective anti-conflict policies and procedures, and carefully police conflicts of interest. The enforceable contract gives clarity to the fiduciary nature of the undertaking, and ensures that Advisers and Financial Institutions do not subordinate the interests of the Retirement Investor to their own competing financial interests. The contract effectively aligns

[362] BICE at 21022.

the interests of Retirement Investor, Advisers, and the Financial Institution, and gives the Retirement Investor the means to redress injury when violations occur."[363]

In analyzing the contract requirement, the Department further reasoned that, without a contract, there would be an inadequate incentive to ensure compliance with the exemption's standards-based approach. This is particularly true, the Department found, because the only other penalty for violations in the IRA market would be imposition of an excise tax. However, as the Department noted, "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."[364] Having reached the entirely valid conclusion, based on this analysis, that the contract requirement is essential to ensure that the BIC adequately protects plans, plan participants and IRA investors, the Department cannot simply abandon that approach without showing on what basis it has determined that its earlier conclusions were invalid.

Industry rule opponents have also targeted the BIC's warranty requirements, particularly with regard to the requirement to adopt policies and procedures to rein in harmful conflicts. Here again, however, the Department has already weighed these arguments and concluded that the requirement is necessary, "because it gives the Financial Institution a powerful incentive to ensure advice is provided in accordance with fiduciary norms, rather than risk litigation, including class litigation and liability."[365] The Department focused particularly on the importance of the enforceable obligation to maintain and comply with the policies and procedures, as that requirement should create a powerful incentive for financial institutions to carefully police conflicts of interest, reducing the risk that advisers will give advice that does not meet the best interest standard and thereby reducing the likelihood that disputes will arise. The Department could not have been any clearer about the vital importance of this provision, stating: "The policies and procedures requirement is a critical part of the exemption's protections."[366] It cannot reverse course now without first showing on what basis it has reasonably concluded that the requirement to minimize incentives to act against customers' best interest is not necessary to ensure compliance with the best interest standard.

Rule opponents have reserved particular venom for the rule's ban on including class action waivers in written contracts required under the BIC. This argument has come both from firms with too few clients to support a class and from firms that readily abide by the exact same rules with regard to class action waivers under FINRA rules. In fact, as the Department made clear in its extensive discussion of industry comments on this topic, it took a number of steps to ease firms' concerns on this front. First, it made clear that compliance with the impartial conduct standards is measured based on the circumstances existing at the time of the recommendation, not on the ultimate performance of the investment with the benefit of hindsight. Second, it added several provisions enabling advisers and financial institutions to correct good faith errors in disclosure, without facing loss of the exemption. Third, it permitted

[363] *Id*.
[364] *Id*.
[365] *Id*. at 21034.
[366] *Id*. at 21041.

firms to include waivers of the right to obtain punitive damages or rescission based on violation of the contract. And, fourth, it permitted advisers and financial institutions to require mandatory arbitration of individual claims, so that claims that do not involve systemic abuse or entire classes of participants can be resolved outside of court.

Having taken these steps to minimize the liability risk, the Department nonetheless concluded that it was necessary to the rule's effectiveness "to provide an option to pursue class actions in court for systemic violations affecting many different investors."[367] The Department reasoned that availability of a class action remedy provides an important enforcement mechanism for retirement investors. It also reasoned that exposure to class claims creates a powerful incentive for financial institutions to carefully supervise individual advisers and ensure their adherence to the impartial conduct standards. This incentive is enhanced by the transparent and public nature of class proceedings and judicial opinions, as opposed to arbitration decisions, which are less visible and pose less reputational risk to firms or advisers found to have violated their obligations. The Department expressed the concern that the ability to bar investors from bringing or participating in such claims would undermine important investor rights and incentives for advisers to act in accordance with the best interest standard.

In defending its decision to include a ban on class action waivers, the Department noted that courts impose significant hurdles for bringing class actions.[368] And it explained that, because communications by an adviser require a certain degree of specificity in order to constitute fiduciary advice, it would typically be extraordinarily difficult for a class of investors to satisfy the procedural requirements of commonality, typicality and numerosity. Where investors can surmount these hurdles, however, it concluded that class actions are particularly well suited for addressing systemic breaches. Finally, it highlighted the fact that its chosen regulatory approach is consistent with FINRA's rules, adopted by its predecessor NASD in 1992 and approved by the SEC. And it concluded, like the SEC and FINRA before it, that courts are generally better equipped to handle class claims than arbitration procedures. Having reached the conclusion that the threat of class litigation provides a necessary incentive for compliance, and that the threat of frivolous or excessive litigation is remote, the Department cannot reasonably reverse course without first showing the reasonable basis on which it determined that its earlier conclusions were erroneous.

Industry rule opponents can be expected to argue that liability costs of the rule are far higher than those estimated by the Department. While the precise costs of litigation based on the rule are unknowable, the DOL carefully considered the impact that an increase in exposure to litigation might cause as part of the RIA and adopted a reasonable approach. Specifically, it examined the increased insurance premiums for Errors and Omissions (E&O) Insurance that firms may incur as a result of increased potential for liability.[369] E&O insurance helps protect advisers from financial exposure for liability and litigation costs based on claims made by clients alleging negligence, errors, or fiduciary breaches resulting from rendered services. In providing those estimates, the Department acknowledged that there are some situations in which the cost from claims is not fully captured by the increased cost of the insurance

[367] *Id*. at 21043.
[368] *Id*.
[369] RIA at 239 (E&O insurance: 5.4.1 Increased Insurance Premiums/Litigation).

premiums, including when an adviser loses a case or when penalties are assessed. If an adviser losses a case, however, it is entirely reasonable that both the adviser and the firm shoulder some of the costs to make the investor whole.

In its analysis of E&O insurance increases, the Department correctly drew a distinction between transfers to investors in order make them whole from violations of the rule and true additional costs to firms and advisers. The Department explained that part of E&O insurance premiums will pay for expenses and profits of insurance carriers and agents who sell the policies. The Department considered these true costs to industry. In contrast, the Department explained that part of E&O insurance premiums will go to paying recoveries to investors to compensate them for losses they suffer from violations of the rule. The Department properly did not consider these true costs of the rule, but transfers. The Department explained that, particularly in the IRA context, it is not appropriate to consider such transfers a "cost" because these investors, who have not typically been able to recover when harmed as a result of conflicted advice, will now be compensated, which is a just outcome. Based on conversations with industry consultants, the Department used $3,000 as the cost for an insurance policy, 10 percent as the increase in premiums due to the rulemaking (resulting in a $300 increase per adviser), and a 50-50 split of the premium increase between insurer profits ($150) and a transfer ($150). The Department explained that it arrived at this split because it was not able to estimate the fraction of profits that could be transferred, due to limitations of the literature and available evidence.

In seeking to rebut the Department's estimates of liability costs, some have pointed to a report by Morningstar securities analyst Michael Wong which analyzes the potential costs of litigation to financial services firms.[370] Owing in large part to its nature as a securities analyst's report -- designed to inform wealth management firms' strategic business model decisions and to determine the valuation impact on publicly traded financial institutions -- the report adopts the view that anything that reduces firms' valuations should be considered "costs." This is very different from the approach to costs demanded by appropriate regulatory economic analysis, where true costs are distinguished from transfers. Based on this securities analysis approach, Morningstar's cost analysis includes a variety of elements that, from the financial sector's business perspective, could be viewed as costs that reduce company profits, but that, from a policy perspective, should properly be viewed as transfers.

Morningstar acknowledges this distinction when it states, for example, that "the litigation and restitution costs can either be viewed as an expense for the financial sector or as a justified transfer of profits from the financial institutions to the harmed retirement investors."[371] But treating the estimated cost of restitution and disgorgement of profits as costs makes no sense. Under this approach, returning money to investors that never should have flowed to industry is treated as a cost to industry. Using a prominent example to illustrate the absurdity of this logic, the money Bernie Madoff had to return to defrauded investors would be treated as a cost to Madoff under this perverse approach to cost calculations.

[370] Michael M. Wong, CFA, CPA, Weighing the Strategic Tradeoffs of the U.S. Department of Labor's Fiduciary Rule, Morningstar, Financial Services Observer, February 2017.
[371] *Id*. at 25.

For the purposes of conducting its economic analysis of the rule, including any resulting increase in liability costs, the Department must retain an appropriate distinction between true costs, such as compliance costs and costs to society, and "costs" to private parties that result from not complying with a law, losing an unfair advantage they shouldn't have had, or having to return money after getting caught unjustly taking what was not theirs in the first place. In other words, it cannot reasonably treat damage payments to investors in class-action suits as liability "costs." Rather, these payments should appropriately be treated as transfers in the form of reimbursements to harmed investors for unfair treatment.

The Morningstar report does raise what appears to be a legitimate issue with the Department's RIA on one point, namely the appropriate scaling estimates for large broker-dealer firms, based on the number of affected advisers. This boils down to a scaling issue based on the cost of E&O insurance multiplied by the number of financial advisers at the largest broker-dealer wealth management firms, which the Department did not estimate. Morningstar estimated that just the cost of E&O insurance could consume all of the department's $1.8 million in estimated ongoing compliance costs for large broker-dealers, suggesting that total ongoing compliance costs for these firms are likely to be higher than the Department has estimated.

On the other hand, Morningstar appears to accept as reasonable the Department's estimate that annual premiums per adviser are likely to increase by roughly $300. Leaving aside the question of what portion of that amount should be treated as a cost and what portion should be treated as a transfer, this added cost simply isn't meaningful relative to other costs that firms and advisers readily accept. It is an amount that an adviser or its firm could easily pay for out of pocket -- less than they are likely to pay for a new suit, or phone, or office equipment. Even looking at aggregate costs, Morningstar's revised estimate for large firms would still be a drop in the bucket when compared with other relevant measures, such as revenue. For example:

- Stifel's Wealth Management brought in approximately $670 million last year in non-institutional brokerage revenue (defined as commissions and principal transactions) alone, and their net revenue for the entire company was $2.6 billion.[372]
- LPL reported over $1.7 billion in commission revenue last year and $300 billion in brokerage assets.[373]
- Raymond James reported $5.4 billion in net revenue, including $630 million from mutual fund commissions, another $377 million from insurance and annuity commission revenue, plus another $255 million from "mutual fund and annuity service fees."[374]

[372] Press Release, Stifel, "Stifel Reports Fourth Quarter and Full-Year 2016 Financial Results," January 31, 2017, http://bit.ly/2ogy6Ro.
[373] Press Release, LPL Financial, LPL Financial Announces Fourth Quarter and Full Year 2016 Results, February 9, 2017, http://bit.ly/2oNvy02.
[374] Raymond James, 2016 Annual Report, http://bit.ly/2jy40J2.

- Morgan Stanley's Wealth Management business earned commission and fee revenue of more than $1.7 billion, which doesn't include the $8.5 billion it earned related to asset management, distribution and administration fees.[375]

An added cost of $1.8 million is simply not going to break the bank. Nor is it going to prompt these firms to abandon the market or even dramatically restructure their business or increase their costs. On the other hand, it just might be enough to make them take their compliance obligations seriously.

The Morningstar report makes several other points that are unlikely to find their way into the comment letters of industry rule opponents. It includes a number of statements that directly rebut industry claims that heightened liability concerns will cause firms either to abandon the retirement market, shift exclusively to fee accounts, or stop serving small accounts. The following are among the most pertinent quotes from the Morningstar report rebutting these arguments:

- "Some financial industry participants have argued that wealth managers will just step away from serving retirement investors because of the impact from the Department of Labor fiduciary rule. We don't think that's possible."[376]
- "In regards to IRA assets, almost no firm can afford to neglect this slice of the market….Following the fiduciary rule, wealth management firms can't turn their backs on IRAs, as some in the industry have suggested, or they would significantly reduce their profitability."[377]
- "The major benefit of giving clients and advisors the option of having commission-based retirement accounts is that this is the status quo and is the least disruptive to existing relationships. Not only do firms choosing this route lessen the potential of client and advisor attrition, but also these firms may be able to gain assets from firms that decided to move to all fee-based."[378]
- "Generally speaking, we see using the full BICE and maintaining commissions as the safer strategy. Arguably the most important asset of wealth management firms is its relationships with advisors and clients, so keeping them is paramount. Commissions is the less disruptive of the business model choices, and still has the option of transitioning to all fee-based later. On balance, our assessment is that the potential cost of class-action litigation with using the full BICE is lower than the cost of losing advisors and clients by moving to all fee-based."[379]

Also contrary to industry criticisms, the Morningstar report says that the RIA is "well-founded, thoughtful, and responsive to private industry input."[380] It states, for example, that the RIA's "overall cost estimate of $5 billion of startup costs and $1.5 billion of ongoing costs for

[375] Morgan Stanley, Form 10-Q, Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934, For the Quarterly Period Ended December 31, 2016, http://mgstn.ly/2okzEJf.
[376] Michael M. Wong, CFA, CPA, Weighing the Strategic Tradeoffs of the U.S. Department of Labor's Fiduciary Rule, Morningstar, Financial Services Observer, at 3, February 2017.
[377] *Id*. at 14.
[378] *Id*. at 20.
[379] *Id*. at 22.
[380] *Id*. at 36.

the financial sector is also likely in the right range."[381] As discussed above, Morningstar's one dispute is with the cost estimate for individual large financial firms, which Morningstar says "is likely off by a multiple or, at a minimum, not representative of the largest wealth management firms."[382]

Again at odds with industry rule opponents, the Morningstar report acknowledges benefits of class action litigation as an enforcement tool. It states, for example, that, "Class-action lawsuits serve a constructive purpose distinct from individual arbitration, as they fill in a remedial hole for systemic issues."[383] Morningstar cites the recent Wells Fargo phony account scandal as a prime illustration of an instance in which a class action could be particularly beneficial. "A recent example of a systemic, conflict of interest that might expose a firm to a class-action lawsuit is Wells Fargo's fraudulent account openings. Arguably, Wells Fargo had a system in place that encouraged employees to open accounts for clients without their permission, so that they or their managers could meet cross-selling quotas. The class-action lawsuit isn't about penalizing firms for a rogue trader or bad apple financial advisor, but preventing corporate policies from spoiling otherwise well-intentioned advisors."[384] This is a particularly apt analogy in the context of a rule that is designed to rein in conflicts of interest that encourage retirement investment advice that is profitable for the adviser, but not in the best interests of the customer.

The Morningstar report also bolsters the Department's analysis that firms can limit their liability exposure through strong conflict mitigation. It states, for example, that "an ounce of compliance system prevention is worth a pound of class-action settlement cure."[385] It adds: "Well-supported prudent policies and procedures are especially necessary when using the full BICE, as the class-action lawsuits should only be for more systemic breaches of prudent policies and procedures that seem to encourage behavior that isn't in the best interest of clients...Prudent policies and procedures when coupled with monitoring should help prevent a strong claim for breach of the best interest contract, or at least stop the imprudent activity early before the potential damages accumulate."[386] In short, just as the Department itself concludes, Morningstar finds that well designed policies to reduce conflicts could reduce liability.

Even with its increased estimate of ongoing costs for the largest firms, Morningstar finds these costs, including settlement costs, to be "manageable."[387] It states: "We believe that the normalized class-action litigation expenses stemming from the Department of Labor's new fiduciary rule will be manageable for the wealth management industry...Our long-term range for class-action lawsuit settlements is approximately $70 million–$150 million annually."[388] This figure represents its estimated total for the entire industry, not any one firm. Compared with the level of retirement assets managed by these firms, and divided among the many firms

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381 *Id*.
382 *Id*.
383 *Id*. at 5.
384 *Id*. at 21.
385 *Id*. at 34.
386 *Id*. at 21.
387 *Id*. at 34.
388 *Id*.

and advisers serving this market, that is a modest amount to pay to provide an incentive for compliance and a means of redress for harmed retirement investors.

In short, the Morningstar report underscores the point that industry claims about liability risks are drastically overblown. The facts do not support the claim that retirement investors will be harmed by increased litigation. Instead, they reinforce the conclusion, reached by the Department in crafting the rule, that the liability provisions, including the class action ban, benefit retirement investors by providing an incentive for compliance that would otherwise be missing.

B. Class action lawsuits provide benefits that greatly outweigh their costs.

A favorite rhetorical flourish of rule opponents is that the sole purpose of the rule is to enrich plaintiffs' lawyers. This reckless and unfounded claim ignores the very real social benefits that class action litigation can promote. The availability of a legal enforcement mechanism, including the ability to bring a class action based on systemic misconduct doesn't just exist for its own sake. As we and others argued in an earlier court case: "Aggregate litigation levels the playing field in disputes between businesses (which automatically aggregate the costs and benefits of a practice affecting consumers) and individual consumers (who can do so only by joining a class)."[389] Class actions can serve as a powerful deterrent against wrongful business practices and as a necessary mechanism to compensate those who are wronged.

Moreover, empirical evidence confirms that class-action lawsuits can be effective in shaping corporate conduct. In a Rand study on class actions, for example, corporate representatives interviewed by researchers acknowledged that class actions had "played a regulatory role by causing them to review their financial and employment practices. Likewise, some manufacturer representatives noted that heightened concerns about potential class action suits have had a positive influence on product design decisions."[390] These are more than empty platitudes. In all six consumer cases studied by Rand, the litigation was associated with changes in practice, and in four of the six, "the evidence strongly suggest[ed] that the litigation, directly or indirectly, produced the change in practice."[391]

A prime illustration of how class actions can cause ground-breaking improvements for consumers can be seen in the context of lawsuits challenging racial discrimination in auto financing.[392] Between 1993 and 1994, auto dealers were found to be engaging in subjective and racially discriminatory dealer markups for auto financing rates. These subjective dealer markups caused African-American buyers to pay between $347 and $508 more in markups on average than whites. In the late 1990s, class actions were brought against virtually all the major

[389] Brief of the Legal Aid Society of the District of Columbia and National Consumer Advocacy Organizations (including CFA) as Amici Curiae in Support of Respondents, AT&T Mobility v. Concepcion, On Writ of Certiori to the United States Court of Appeals for the Ninth Circuit, October 6, 2010, http://bit.ly/2nSCwl2.
[390] Deborah H. Hensler et al., Class Action Dilemmas: Pursuing Public Goals for Private Gain Rand Inst. For Civil Justice 2000, at 9, 119.
[391] *Id*. at 431.
[392] *See* Ian Ayres, Market Power and Inequality: A Competitive Conduct Standard for Assessing When Disparate Impacts Are Unjustified, 95 Cal. L. Rev. 669, 693-94 (2007).

automotive lenders for engaging in these wrongful practices. Settlements of these class actions achieved significant equitable relief, and "reshaped loan pricing throughout the industry."[393] Such fundamental reforms of an entire industry could not have occurred without class-wide proceedings. And it occurred without reducing the availability or driving up the cost of auto financing.

But the Department need not look so far afield to see the beneficial effects from class action lawsuits. On the contrary, many experts point to a decade of lawsuits against 401(k) plans as an important cause of declining fees and improving plan design. When *Bloomberg BNA* recently asked employee benefits attorneys how this litigation is reshaping the 401(k) industry, they pointed to lower industry-wide fees as one significant result.[394] That view was shared both by plaintiffs' attorneys and by those representing 401(k) plans and employers. *Bloomberg BNA* quoted Allison Wilkerson, a partner with McDermott Will & Emery in Dallas who advises 401(k) plans, as agreeing "that we're seeing a 'general move toward lower fees' in the wake of this litigation effort." Wilkerson reportedly indicated that "plan sponsors are also responding by looking into flat, per-participant fees that are easier to understand and explain."

Groom Law Group attorney David N. Levine was the most skeptical, among those interviewed, regarding the beneficial effect of the lawsuits. Levine reportedly "expressed concerns about how the litigation has focused on plan fees at the expense of other important considerations." In contrast, Carl Engstrom, a Minneapolis-based attorney with Nichols Kaster who represents 401(k) investors in lawsuits against companies, argued that, "The effect has been enormously positive overall ... It's had a tremendous effect on improving fiduciary practices among large plans." Engstrom reportedly predicted that the continuing threat of fee litigation would encourage more and smaller companies to consider fiduciary liability insurance policies for their 401(k) plans, which he praised for being relatively inexpensive and for their potential to "really improve fiduciary practices." Fiduciary insurers can help retirement savers indirectly, Engstrom told Bloomberg BNA, "by pressuring plan fiduciaries to adopt best practices and by increasing premiums on plans that fail to do so."

Class action lawsuits have focused not just on excessive fees, but also on poor plan design and conflicts of interest.[395] "The focus has always been on practices of some plan sponsors that harm workers and retirees and limit their ability to build meaningful retirement wealth," attorney Jerome Schlichter, whose St. Louis-based law firm represents many plaintiffs in these suits, told CNBC. The lawsuits have brought down fees beyond companies that are immediately affected by the suits, according to Schlichter. "What you have is attorneys that are advising small companies telling them, 'You'd better get your act together because there is the threat of litigation.'" Schlichter said. "We've seen small- and medium-sized plans [lowering their fees]."

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[393] *Id*. at 714-715.
[394] Jacklyn Wille, *Uptick in Fee Litigation Reshaping 401(k) Industry*, BLOOMBERG BNA, June 8, 2016, http://bit.ly/2pn2tt9.
[395] Ilana Polyak, *Lousy 401(k) plans may spark more lawsuits,* CNBC, May 1, 2016, http://cnb.cx/1Ut3SqJ.

Although there have been more than 75 lawsuits claiming excessive fees over the past decade, according to Groom Law Group,[396] and large settlements in some of those cases,[397] there's no evidence that the threat of litigation has caused employers to drop their plans or service providers to flee the market. Instead, as we discuss elsewhere in this letter, there is lively competition underway among service providers to serve this market, including the market for very small plans, and to do so under a fiduciary standard of care.

U.S. Supreme Court Justice William O. Douglas, stated: "The class action is one of the few legal remedies the small claimant has against those who command the status quo."[398] Far from harming retirement savers, the liability provisions in the rule help to put teeth into rule requirements that will benefit retirement investors. The Department reached precisely that conclusion when it carefully analyzed the impact of the rule prior to its adoption. Nothing in the record since has provided the basis for changing that conclusion. On the contrary, the recent Morningstar analysis similarly concludes that the liability costs are manageable and will not cause firms to abandon either the retirement market or commission accounts. Evidence from the 401(k) excessive fee cases suggests the effects on retirement plan cost and design will be beneficial. The only reasonable conclusion for the Department to reach based on the available evidence is that any increased liability that may result from the rule will benefit, rather than harm, retirement investors.

X. The Rule is Not Causing Harmful Disruptions to the Retirement Advice Market

Echoing industry rule opponents' propaganda that the rule is too burdensome and that the timeline for implementation is too ambitious, the Presidential Memorandum directs the Department to examine whether the "anticipated applicability" of the rule "has resulted in dislocations or disruptions within the retirement services industry that may adversely affect investors or retirees." In response, the Department invites comment on whether particular rule provisions could be revised to minimize "disruptions while still accomplishing the regulatory objective of establishing an enforceable best interest conduct standard for retirement investment advice." Moreover, the Department used this concern over potential disruption to justify its 60-day implementation delay, despite clear evidence that the harm to retirement investors from that delay greatly outweighed any benefits to industry. There is no justification for further delay, or for revising the rule, based on the unsupported claim that it is causing harmful disruptions in the retirement advice market.

It is important for the Department to acknowledge at the outset that a change of the magnitude anticipated by this rule simply cannot be achieved without some temporary disruptions. After all, the goal of the rule is to transform the self-interested sales recommendations that pass muster under a suitability standard into the best interest advice that retirement savers expect and deserve. Because of the deeply entrenched conflicts that pervade the industry, achieving that goal requires sweeping changes in how commission-based financial professionals approach advisory relationships and in how financial firms pay and reward these

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[396] Groom Law Group, "Excessive Fee Litigation," October 2016, http://bit.ly/2f4s6YG
[397] Ilana Polyak, *Lousy 401(k) plans may spark more lawsuits*, CNBC, May 1, 2016, http://cnb.cx/1Ut3SqJ.
[398] Eisen v. Carlisle and Jacquelin, 417 U.S. 156, 186 (1974).

financial advisers. And that, in turn, requires changes to the investment products they sell to implement their recommendations. In other words, the scope of the changes required by the rule are the direct result of the magnitude of the conflicts that have for too long been allowed to taint retirement investment advice, to the detriment of working families and retirees.

It is unreasonable to expect that changes of this scope could be achieved without some temporary disruptions and dislocations. The relevant question is whether any such "disruptions" are temporary, whether appropriate steps have been taken to minimize those disruptions, and whether the benefits to retirement investors justify any such resulting inconvenience. The answer to all three questions is an unequivocal "yes." As we discuss above, all the early evidence suggests that retirement savers, including those with only modest savings, will retain access to affordable advice after the rule is implemented, even if some few have to change firms to receive it. Indeed, because services that once consisted of mere sales recommendations will be transformed into true fiduciary advice, access to advice will be significantly expanded under the rule. A wide variety of investment options will remain available to retirement investors, products are being improved in response to the rule, and recommendations of harmful products are diminishing. Their total costs of investing -- the cost of the advice plus the cost of investments to implement the advice -- is likely to come down.

Meanwhile, the Department has taken steps to minimize disruptions in the interim. First, the Department has provided an additional two months for firms to come into compliance. The Department indicated in the final delay rule that they do not plan to bring enforcement actions during the reconsideration, and likely for a period thereafter, for violations of the rule.[399] Their focus during that period, they've said, will be on assisting firms to come into compliance rather than enforcement for non-compliance. And because the requirement to sign a written best interest contract does not take effect until January 2018 at the earliest, firms have limited exposure to liability during the interim. The one exception is with regard to rollovers, where ERISA's liability provisions will apply. But firms have access to compliance systems specifically designed to determine and document whether a rollover is in customers' best interests. And a variety of share classes will be available to implement recommendations. Given the limited liability during the reconsideration, a firm that can make a reasonable case that a particular mutual fund A share is better for a retirement advice customer than available T or clean shares, for example, need have little concern that their recommendation would be second-guessed, even if the adviser receives higher compensation as a result. Indeed, there is far greater concern that inadequate incentives for compliance will exist during the period when the rule is under reconsideration for possible revision.

A. *Companies' tempered statements to their investors re: the effect of the rule are in stark contrast to the sky-is-falling claims they're making for advocacy purposes.*

Individual firms have generally expressed great confidence that they are prepared to implement the rule without significant disruptions. Their statements make clear both that retirement investors will continue to have access to advice, including for small accounts, and that they will continue to have access to a full menu of investment products. Moreover, these

[399] Definition of the Term ''Fiduciary''; Conflict of Interest Rule—Retirement Investment Advice Final rule; extension of applicability date, 82 FR 16902, at 16906, http://bit.ly/2nxCXBv.

industry leaders provide a wealth of examples of beneficial changes that are being adopted as a direct response to the rule.

The following is a sampling of statements from recent earnings calls and media reports regarding firms' level of preparation of implementation.

American Financial Group Co-CEO Craig Lindner said in a third quarter earnings call last November that the annuity company continues "to make product and process changes needed to comply with the Department of Labor fiduciary rule adopted earlier this year. Our goal was to minimize disruption resulting from the implementation of the rule in April of 2017."[400] He added that, "Most of our largest independent marketing organizations are making adjustments to their operations to provide a long-term solution to their need to have a financial institution sign the best interest agreements, and a number of these entities have made application to the DOL to serve as a financial institution. AFG believes the biggest impact of the new rule will be on insurance only licensed agents whose sales represented less than 10% of our third quarter premiums. While we continue to believe the adjustments required of us and our distribution partners to comply with the new DOL rule will have a negative impact on premiums next year, we do not believe the implementation of the DOL rule will have a material impact on AFG's business.[401]

Asked about the ability of IMOs to operate under the rule, Lindner said, "We happen to have a meeting with our large IMOs last week and got their opinions as to the impact and how they're dealing with things. And I will say the tone was quite a bit more positive. We deal with principally the very large IMOs, but they generally think that they are going to have a solution to the rules that are going to be implemented. I'm sure you know many of the large IMOs are filing to become financial institutions...The Department of Labor needs to be more clear on exactly what is going to be required, but they were really very optimistic about their ability to deal with the new rules.[402]

Asked about the effect of the rule on commission levels, Lindner said: "I think the result of the rule will be lower commissions without a doubt. We're kind of looking to our distribution partners to guide us, as to what kind of commission levels will be acceptable and what they think they need to do to comply with the new rules. So we're going to, at this stage, receiving a lot of input from our distribution partners and trying to respond to that. I do believe that the net result will be a meaningful reduction in commissions….Frankly, we've always been a low commission company, different than many that we compete with. **Our model fits actually very well with the new rules. I think if you pay a lower commissions, everything else being equal, what you can do is pass on more value to the customer and I think that's going to be the net result of the rule**."[403] (bold added for emphasis)

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[400] American Financial Group's (AFG) CEO Carl Lindner III on Q3 2016 Results - Earnings Call Transcript, SEEKING ALPHA, November 2, 2016, http://bit.ly/2oBw3YV.
[401] *Id*.
[402] *Id*.
[403] *Id*.

Ameriprise CEO and chairman Jim Cracchiolo --"**I believe Ameriprise is well positioned to handle the changes required to respond to the rule, and to help advisors do the same**...We're dedicating significant resources and leadership time to manage it in a regimented way…Ameriprise is one of the largest providers of fee-based investment advice, and we already operate as a fiduciary under a very high standard of care. **In terms of our product offerings, we're focused on minimizing disruption to our clients and ensuring our advisors continue to have a broad suite of solutions to help meet client needs, grow and protect their assets and achieve their goals.** We continue to believe providing investor choice is important and therefore, we've been hard at work to enable both advisory and brokerage options for clients and advisors. Ameriprise has a very strong compliance foundation and conducts robust due diligence on the products and platforms we offer. We have always been able to operate in a heavily regulated environment and comply with the requirements."[404] (bold added for emphasis)

In addition to describing plans that are well underway for implementing the rule in advisory accounts, for commission-based recommendations using the BIC, and for rollovers, Cracchiolo said the firm is also working "to bring this to life for advisors and support them to comply with the new rule" through training webcasts and in-person training sessions. "We continue to review the regulation and all of its intricacies to ensure we can meet all of the requirements of the new fiduciary standards and minimize potential exposure to the firm and our advisors by having the right due diligence, analysis and documentation as well as the appropriate supervision necessary. Given what we know, **we feel comfortable that we can effectively navigate through it...Again, we feel comfortable that we will continue to offer a broad suite of products with the necessary oversight**." (bold added for emphasis)

While acknowledging the challenges, Cracchiolo indicated the rule also offers a growth opportunity for his firm. "In this regulatory environment, the importance of delivering advice is even more significant than ever. We know clients and consumers are looking for us to serve them holistically. The growth opportunity we have is compelling…To summarize, we're delivering nice growth and profitability in Advice & Wealth Management. We're working closely and comprehensively with advisors to manage the DOL change ahead, and **we feel good about our near and long-term opportunity to serve even more consumers with advice**." (bold added for emphasis)

BlackRock discussed in a third quarter 2016 earnings call how cutting investors' costs in response to the DOL rule may decrease the firm's profitability in the short term, but leave the firm better off in the long term.[405] CFO Gary Shedlin stated: "In line with that commitment earlier this month, we reviewed prices on 15 U.S. iShares for ETFs and several actively managed U.S. bond funds. We chose to use our scale and leadership position to invest on behalf of clients and financial advisors as they adapt to the DOL's new fiduciary rule. In isolation, these price reductions will result in an estimated $85 million annualized revenue reduction for BlackRock, representing less than 1% of our total base fees. However over the

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[404] Ameriprise Financial (AMP) Q3 2016 Results - Earnings Call Transcript, SEEKING ALPHA, October 26, 2016 http://bit.ly/2pnqNuU.

[405] BlackRock's (BLK) CEO Laurence Fink on Q3 2016 Results - Earnings Call Transcript, SEEKING ALPHA, October 18, 2016, http://bit.ly/2pngzLa.

mid-to-long term, we expect this investment to be accretive to organic growth and additive to overall shareholder value."

Shedlin said BlackRock has "been working closely with our distribution partners in the U.S. in advance of the Department of Labor rule implementation. Aladdin for Wealth, our technology and risk management system designed specifically for wealth managers, will be a key differentiator for BlackRock in helping our clients adapt, as financial advisors sharpen their focus on the quality and cost efficiencies of funds." He added that the firm is in a "**great position to navigate.** I should add, I don't think any other organization has those capabilities and so it puts us in a great position. By having that position it allows us to have more dialog, not just more dialog for passive strategies but more dialog in portfolio construction and models and active strategies. So having this opportunity to be working with these institutions, on the navigation of risk management on behalf of all their individual clients, gives us -- will give us a unique opportunity to be working with these institutions in a way that we never had been able to before." (bold added for emphasis)

Cambridge President Amy Webber reported in November that Cambridge was in "the final stages of building out the processes and tools" its advisers would need to customize their practices and comply with the rule.[406] Cambridge will continue to pay commissions on IRAs under DOL fiduciary rule. "This is the biggest change our industry has gone through in 40 years so we took a step back and tried to go forward without a knee-jerk reaction," Ms. Webber said. "We want to be compliant and follow the rules, walking the path in the middle with four different channels we've developed." Regarding their decision to retain customer choice with regard to type of account, Webber told *Investment News*, "What is best for the client can be presented in different manners. We're not ready to give up on that flexibility and open architecture." Cambridge has added two business models for advisers as part of its ramping up for the DOL: a small, managed account for clients with $25,000 or less and a commission account under the BICE. Pursuant to the BICE, commissions will be level by investment category so that all similar investment options have the same compensation structure. Cambridge is also offering a level fee fiduciary account. "To maintain the flexibility for advisers is the reason why we came up with the four paths," said Colleen Bell, first vice president of fiduciary services at Cambridge.

Cetera Financial, which is comprised of seven firms and approximately 9,000 reps and advisers, said in a memo from individual broker-dealer presidents to advisers last November that the Cetera firms have "**every intention of continuing to offer commissions-based products, including mutual funds, in retirement accounts.**"[407] "It should be noted...that many of these products require a level of remediation by the sponsors in order to facilitate sales practices that meet the requirement of the fiduciary rule," the memo said. "We remain confident that most sponsors are working diligently to facilitate such changes in time to meet the April deadline." (bold added for emphasis)

[406] Bruce Kelly, *Cambridge, Cetera will continue to pay commissions on IRAs under DOL fiduciary rule*, INVESTMENTNEWS, November 1, 2016, http://bit.ly/2oNAPF5.
[407] *Id*.

<u>CNO Financial</u> President Gary Bhojwani stated in a third quarter 2016 earnings call: "We continue to build the material components into our business model, and we'll meet the April 2017 and January 2018 compliance deadlines. It is important to understand how the Rule will impact our segments: namely, that Colonial Penn will not be impacted. Washington National will be immaterially impacted due to the low volume of products that are subject to the Rule. This segment has only sold a handful of annuities during 2016. The bulk of the impact will be in Bankers Life. However, **we do not anticipate any material adverse impacts to our business at Bankers Life or our recently launched broker dealer product portfolios. Bankers Life will be utilizing the BIC exemption**. Transaction-based compensation will continue to be paid for covered products, and additional compensation impacts are under review. We anticipate implementation expenses to be in the $8 million to $10 million range. As previously discussed, **the diversity of our distribution channels and products and our robust compliance culture have lessened any meaningful disruption to our business model as a result of adopting the Rule**."[408] (bold added for emphasis)

<u>Cohen and Steers</u> indicated on a third quarter earnings call last year that it anticipates "that the implementation of the DOL fiduciary rule will accelerate the move to model-based delivery of advised and more open architectures in the retirement channel. **This represents one of the most important opportunities for us to gain share of asset allocations**, which increasingly favor our core real asset strategies. Going forward, we're convinced that success will depend more on unique and innovative investment strategies, consistently superior performance and brand, rather than supermarket-like product arrays and distribution."[409] (bold added for emphasis)

<u>FBL Financial</u> CFO Ray Wasilewski discussed the impact of the rule on annuities in a third quarter earnings call last year: "**[W]e are confident in where we are sitting at this point.** We do continue to get external expertise to go over our conclusions, and we get that from a couple different perspectives just to make sure because as you know, there is some ambiguity in this rule and so we are looking to make sure that our conclusions have found this and are in line with where the rest of the industry is going; so **our position remains we don't have to make substantial changes. We will have a small product tweak or two**. We have an annuity that has very low sales that we are looking at whether we can align compensation with that to meet the differential rules. That's the one that sticks out."[410] (bold added for emphasis)

Wasilewski said that the company was making "**some minor tweaks on what we will pay on some of our brokered compensation, but no major changes there.** Our portfolio, being some proprietary products, we have gone through that analysis, are creating that proprietary disclosure, have **no major concerns** there. We used to manufacture variable products, and with that came an infrastructure that allowed us, that's a compliance infrastructure and we have a broker-dealer; that gives us a big leg up. We have exclusive agents, as you know, and with that compliance infrastructure in place, that makes it **not a big**

[408] CNO Financial's (CNO) CEO Ed Bonach on Q3 2016 Results - Earnings Call Transcript, SEEKING ALPHA, November 02, 2016, http://bit.ly/2p8sdtI.
[409] Cohen & Steers' (CNS) CEO Robert Steers on Q3 2016 Results - Earnings Call Transcript, SEEKING ALPHA, October 20, 2016, http://bit.ly/2pGCMAj.
[410] FBL Financial's (FFG) CEO Jim Brannen on Q3 2016 Results - Earnings Call Transcript, SEEKING ALPHA, November 04, 2016, http://bit.ly/2oBDT4J.

stretch to get the processes in place that we need to monitor what's going on under that best interest contract." He said that the firm had chosen to sell all its annuities, "**both indexed and fixed, on those qualified plans under that Best Interest Contract Exemption.** We're not using PTE 84-24. That is our intention. That allows one process for the agent. That smooths that sales process out for them so that it does not become overly complex." (bold added for emphasis)

On a fourth quarter earnings call, CEO James Brannan noted that, "There is a lot of speculation that the Department of Labor Fiduciary Rule will be delayed. However, we are preparing for the first compliance date in April. Our current proprietary product offerings and agent compensation models will not change substantially, and **we plan to sell under the Best Interest Contract Exemption, or BICE**."[411] (bold added for emphasis)

Federated Investors CEO and President Chris Donohue said during a third quarter earnings call last year that the firm is "in active dialogue with our intermediary distribution clients" in advance of the April implementation deadline.[412] "**We're working towards a solution that would enable brokers to use our funds** and add their make [sic] desired commission structure," Donohue said. "**In this model each broker could construct its own commission structure and overlay it to all of the funds it sells across multiple fund families in order to achieve level pricing.** This would avoid the necessity of sponsors to create many multiple share classes to reflect different choices brokers are making with regard to their commission structures...We are taking steps to address our product line in advance of the new rules." (bold added for emphasis)

Donohue indicated the firm had expanded the number of funds with no 12b-1, shareholder service, or sub-TA fees to 19 this year and plans to increase it to 23 funds in early 2017. "Our $23 billion SMA business is well suited to the DOL fiduciary rule," he added. "We offer 14 equity SMA strategies and 8 fixed income SMA strategies. SMAs work well in a level-fee, wrapped-account structure and provide transparency and potential tax advantages. Finally, as it goes to fiduciary duties in general, **we believe that Federated will have a competitive advantage in working with intermediaries to help them navigate these challenges.** Our long history with bank trust departments, our extensive resources, both in-house and with leading industry experts, represents an opportunity to add significant value for our clients." (bold added for emphasis)

Noting that most advisers' businesses are about 40 percent retirement-related, whether it is IRA rollovers or the 401(k) themselves, Donohue indicated that "a lot of firms are going to look at it and think that they want to have one overall methodology and pricing structure for their clients. And so **this could impact the business even broader than simply in the retirement world**. So to me the poetry is in using the R-6 share class, which is stripped-down, and enable the brokers with any fund group to put the commissions on and the charges that they

[411] FBL Financial's (FFG) CEO James Brannen On Q4 2016 Results - Earnings Call Transcript, SEEKING ALPHA, February 10, 2017, http://bit.ly/2pnq7FO.
[412] Federated Investors' (FII) CEO Chris Donahue on Q3 2016 Results - Earnings Call Transcript, SEEKING ALPHA, October 28, 2016, http://bit.ly/2pGBvch.

have determined themselves to be reasonable, which is the standard under the DOL rule." (bold added for emphasis)

<u>Invesco</u> President and CEO Marty Flanagan said during a third quarter 2016 earnings call that, "It is clear each distributor has a different business mix, and we will implement the rule in a manner that will meet its client needs. **Based on the discussions we are having with clients we continue to believe that our comprehensive range of capabilities, our distribution expertise, our market leadership all position us extremely well to help our clients** [indiscernible]. If the shift is towards passive as some believe, a decade of ETF experience, our comprehensive range of factors and smart data capabilities, our scale, our significant track record of innovation all **put us in a very competitive position**."[413] (bold added for emphasis)

<u>Jackson National Life</u> Senior Vice President Rob Dearman said, in response to a question on levelizing compensation, during a recent DTCC webinar: "We have worked with our firms, our own BDs, as well as other firms, who have gone through that process to identify the neutral factors and determine at what levels they want to levelize. In some cases, you see a stylistically pure approach where they say all commissions across all product types are going to be levelized. In other cases they've gotten comfortable with those neutral factors and some cases, even within a product type, they may have identified two commission options, where they might use a neutral factor."[414]

<u>Legg Mason</u> Chairman and CEO Joseph Sullivan offered five key reasons why Legg Mason is "**well-positioned to win in this new post-DOL world**," on last year's second quarter earnings call.[415] "Specifically, we have a deep roster of products well placed across the platforms of our distribution partners that have strong performance and investment objectives that solve retirement needs," he said. "Secondly, we have an ability to utilize our leading position in the SMA market, our multi-asset class capabilities and our efforts to expand our Retail investment capabilities in ETF vehicles to meet the needs of the retirement market. Third, we have a wide range of competitively priced investment vehicles and pricing structures, including I and iShares that can be converted to meet fee level requirements. Fourth, we have a distribution sales team of more than 250 professionals who work with home offices and in the field with advisors at our partner firms as they adapt to this new environment. And finally, **we now have a digital capability and Financial Guard, through which our partner firms can leverage the technology to serve smaller portfolios efficiently and deliver solutions that meet the fiduciary standard**. Again, scale and diversification matters even more in a post-DOL world." (bold added for emphasis)

Sullivan predicted that the DOL rule would cause distribution platforms "to consolidate their product lineups. Like most everyone, we do expect to lose some products in AUM on these platforms that haven't really gained traction or have under-performed, but at the same

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413 Invesco's (IVZ) CEO Marty Flanagan on Q3 2016 Results - Earnings Call Transcript, SEEKING ALPHA, October 27, 2016, http://bit.ly/2nSvsoG.
414 DTCC, The DOL Fiduciary Rule: Insight Into An Insurance Industry Solution, Recorded on Wednesday, January 18, 2017, http://bit.ly/2okqGvG.
415 Legg Mason (LM) Q2 2017 Results - Earnings Call Transcript, SEEKING ALPHA, October 28, 2016, http://bit.ly/2p5EVcr.

time, we see a great opportunity to become a net flow winner from these platform reallocations with, by some estimates, as much as $3 trillion of money being in motion." He also predicted that "**the effect of the DOL rule will be broader than just on retirement accounts. Some firms may choose to follow comparable standards with respect to non-retirement accounts.**" (bold added for emphasis)

Lincoln Financial president of Distributors and Lincoln Financial Network, as well as Lincoln National's annuity solutions team, Will Fuller, indicated in an investor call last summer that Lincoln plans to offer commission IRAs in reliance on the BIC.[416] In Lincoln Financial Group's June earnings call,[417] CEO Dennis Glass stated: "[W]e will have to respond in some ways, but **we don't see this as a huge impediment as we go forward**." He said that "**the final rules put us in a pretty good position**," and expressed pride "that Lincoln not only embraces these challenges, but we take a leadership position." (bold added for emphasis)

On the same call, Fuller said that the firm is "generally encouraged with the adjustments that were made to the final rule, in particular on the priorities that were most important to Lincoln." These included the rule's "recognition and the specific inclusion of lifetime income guarantees that are fundamentally different than traditional investment and the ability to offer a very clear and straightforward approach to how to use this inside of the BIC: recognize that different benefit profile; recognize the differences in how the advisor and client interact; recognize the differences in cost -- costs for guarantees different than costs for investment management; recognize the differences in compensation. Very important point, our most important priority. Second, the recognition that there can be value in commissions. Now I want to go further in this. I don't want you to walk away and say that it's just about commissions. It's not. It's about having all forms of compensation held to the same standard. Our issue was that there was consumer value in commissions; there's consumer value in fees. Hold them to the same standard. And that was an important reflection in the rule. **I think it's likely the most significant reason why most distributors intend to use the BIC, because every method of compensation is held to the same standard**." (bold added for emphasis)

Fuller added that the rule's grandfather provision "**definitely avoids a very disruptive backward application.** Any time you have a regulation that's this comprehensive, there's going to be some level of disruption as you shift to it, some level of disruption to advisor productivity. But a backward application, having to avoid that, that was very, very significant." He said the firm had "been working with most distribution partners" and **"virtually everyone" intends to use the BIC**. "So I think what you're largely going to see is an industry that says: Yes, we have to continue to serve retirement savers if we're going to be competitive. Keep in mind the point, how many people are going to be in retirement, how much of investable assets are going to be in the hands of retirement savers; and if you're going to serve that market, you have to be in the qualified retirement plan business, you're going to operate towards the BIC. **So I think you'll see the industry largely move in that direction, and I'd be surprised if you don't have anything other than just a few stragglers**." (bold added for emphasis)

[416] Greg Iacurci, *Insurance-based broker-dealers plan to use BICE under DOL fiduciary rule,* INVESTMENTNEWS, July 7, 2016, http://bit.ly/2nSN83s.
[417] Lincoln National Corp Investor Day Edited Transcript, THOMSON REUTERS, June 09, 2016, http://bit.ly/2okHMt8.

Fuller continued: "[W]hile there may be some near-term disruption with this rule, **we do believe fundamentally, longer term, that this is a strong value proposition**. And we are well positioned to take and have future growth from that. So in closing, I sit back and I think that, on one hand, we've got this very powerful distribution network: worksite, retail, wholesale -- 800-plus wholesalers offering specialist expertise, proven ability to pivot, very experienced. We've got this large advisor base of producers, and as I've shown you we have room to grow and capabilities to help do that." (bold added for emphasis)

In addition to discussing the rule's impact on distribution, Fuller also discussed opportunities in product space as a result of the rule. "We have almost 50,000 producers working with us on a regular basis with our annuity products in the marketplace. It's a very sizable group of producers. That broad product portfolio, it's broad within core VA [variable annuities], it's broad within fixed, and we've not been standing still. **We're constantly in the product lab looking for new solutions that will meet new customers and help to grow and diversify our sales**." Among other things, the firm has been "looking at the fee-based versions of our products for some time. I told you we were ready; ready to get those available to shelf space. **We've expanded the fixed-indexed portfolio**. **But we see opportunities to do more**. In particular, there is a very attractive segment of advisors in the industry: those that have traditionally not used variable annuities. They have a tendency to use and steer towards lower-cost passive investments; tend to be more oriented towards registered investment advising and fee-based. We are in the process of developing a very compelling solution that would marry low-cost passive investments with a simple, broad, innovative lifetime income to reach that segment, which would be a new segment for our industry, one that's been very difficult to crack. It's something that we plan to have out and in the market this time next year, ideally before the first leg of the DOL rule is implemented." (bold added for emphasis)

Also in that call Mark Konen, President Insurance and Retirement Solutions, said that the rule's impact on projected sales "**is manageable**." The ERISA rule is "not new to this industry," he said. "The sales that we get are covered by the BIC, level-fee or seller's exemption, all of which **we are well positioned with our product portfolio**." "Because of some of the changes that were made in the final rule and the expansion of the definition of education, our value proposition is in fact intact," he added. "So bottom line, **while there is work required around the edges, we are well positioned to comply and to continue that growth I was just talking about**...On the product front, we have enhanced our Lincoln Director product. **We've expanded investment options in there. But importantly, we've designed it with simple, transparent flexible fee structure -- right at the bull's-eye and well positioned for the new DOL rule**." (bold added for emphasis)

<u>**LPL Financial**</u> President Dan Arnold said, "**We believe the impact from the rule will be very manageable for our business**," according to an article in *Financial Planning*.[418] Arnold reportedly acknowledged that LPL faces some challenges on gross profits as it implements the rule, but said there will also be "growth opportunities" and that the "cost trajectory" of implementing the rule "improves over time." Sales commissions may decrease as

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[418] Charles Paikert, *How LPL is implementing the fiduciary rule*, FINANCIAL PLANNING, May 25, 2016, http://bit.ly/2oNFjeL.

a result of the rule, and commission structure is likely to shift from upfront to trailing payments, Arnold said. The industry is likely to see a "simplification of products," he predicted, with "reasonable compensation" based on benchmarking. But advisers should not expect a "disruption" in their existing trail structure, Arnold maintained. "There may be headwinds at the start of the process," he said, "but we'll see more tailwinds as we proceed." Arnold also said: "The good news is that, because of the grandfather provisions, we do not have to pivot overnight."

As for the costs, Arnold said higher expenses would be split about evenly between technology and operational upgrades over a two-year period, with the "majority" to be completed this year. Core general and administrative costs have already been included in the firm's 2016 financial outlook, Arnold said, while implementation costs for 2017 will likely be lower than this year. Ongoing costs, driven by compliance oversight and the cost of insurance, are expected to be manageable and less than implementation costs, he noted. In the long term, added Michelle Oroschakoff, LPL's chief risk officer, "**We believe our investments in compliance and risk management will reduce our regulatory expenses**."[419] (bold added for emphasis)

LPL was one of the first firms to indicate it would implement the rule using the BIC in order to offer both fee- and commission-based options for customers. Toward that end, it indicated it would utilize new share classes decided to standardize commissions and share classes it pays brokers on investment products they recommend.[420] As reported by *Investment News*, the standardized commissions will apply to all accounts, not just retirement accounts affected by the DOL rule. *Investment News* also reported that LPL had made other cuts in fees in anticipation of the DOL fiduciary rule; in March, the firm said it was cutting prices and easing minimums on some of its internally managed model wealth portfolios. According to Mark Casady, LPL's chairman and CEO, "**If you standardize the pricing, it becomes much easier to defend the adviser's decision as it relates to compensation structures**." And Dan Arnold, LPL's president, stated, "We wanted to make this as easy as possible for an adviser to do his business and make clear to the consumer what the pricing is by product line, because there is a difference between what an adviser has to do with a VA sale versus a mutual fund sale or other products." (bold added for emphasis)

On a third quarter earnings call last November, Casady said, "We have been working hard for over a year on the DOL issues, and I think the ...work is starting to pay off in terms of **showing our existing advisors how we can help them, how we can drive down costs for investors, and how we can help potential advisors come and grow their businesses with us.**[421] And that, I know, is resonating based on the prospective advisors I've been talking to as part of this process. So I think that is a number of things coming together that have been part of our plan for pivoting this regulatory opportunity into a growth opportunity for the business for us in a meaningful way. So we are trying to signal more optimism in the growth of the pipeline

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[419] *Id.*
[420] Bruce Kelly, *DOL fiduciary rule sparks LPL to standardize fees on mutual funds: CEO,* INVESTMENTNEWS, August 24, 2016, http://bit.ly/2pnvZ1W.
[421] LPL Financial Holdings (LPLA) Q3 2016 Results - Earnings Call Transcript, SEEKING ALPHA, November 02, 2016, http://bit.ly/2oigXG7.

and more optimism about our ability to win larger share that's profitable." (bold added for emphasis)

Asked about the narrowing of investment menus, Casady predicted it would not result in harm to investors: "We have 130 fund families today in brokerage. We are going to have fewer in the new world because we have to standardize commissions, and that won't work for all of the mutual fund companies. And there will be some that, **as we curate the shelf and think about it in context of the DOL and just in general making sure we're doing the right job by investors, as you would expect that number to come down** … Our mutual fund direct account will have somewhere around 15 mutual fund families in it as opposed to the 130 that are available today. And that, obviously, is a significant narrowing, but the good news is that represents by far almost 100% of the assets ... So we do see the shelf space narrowing. We do see the number of relationships narrowing, and **we see that creating a better ecosystem for the investor, the end client for the advisor, for the money manager, and, of course, for LPL**." (bold added for emphasis)

By March 2017, LPL announced that it had put the final touches on product lineups and standardization in preparation for the rule, including mutual funds, variable and fixed and indexed annuities.[422] The firm worked directly with product manufacturers to develop products that met LPL's specifications, according to a *Bank Investment Consultant* article.

ManuLife Financial Senior Vice President and General Manager of the U.S. Division Craig Bromley discussed the rule during a first quarter earnings call last year: "**I think the industry in general was pretty pleased with how the final rules came out. There are some parties in the industry that would prefer not to have the rules at all. But in terms of the DOL consulting with industry and formulating their final opinion based on that consultation, I think there was certainly some easing up of some of the most onerous provisions and timelines.** That having been said, the spirit of the regulation has been very consistent from the beginning. It's been consistent with the position of the DOL for some time, really trying to stress transparency of fees and fairness and customer centricity. I don't think that changed. I would say I actually [sic] it kind of went a little bit full circle with a real emphasis on rollovers and making sure that, when people are leaving pension plans, they are leaving to as good or better situation than they are leaving. And that's sort of what we expected; that's what it was intended to do in the first place and that's where they landed. So I don't think there's big surprises there."[423] (bold added for emphasis)

In response to a follow-up question about the impacts on John Hancock, Bromley said he believed they and others would easily adjust, stating: "This is a regulation that is primarily focused at distributors. And a lot of our businesses obviously in the U.S., our big businesses, are manufacturing businesses, so I guess I would answer it in two ways. To the extent that we have distribution businesses, so we have a fairly significant broker-dealer, they will need to take some steps from a compliance perspective, from an IT perspective to implement the BIC

[422] Margarida Correia, *LPL puts final touches on product lineups in preparation for fiduciary rule,* BANK INVESTMENT CONSULTANT, March 09, 2017, http://bit.ly/2oNIdA0.
[423] Manulife Financial's (MFC) CEO Donald Guloien on Q1 2016 Results - Earnings Call Transcript, SEEKING ALPHA, May 05, 2016, http://bit.ly/2pGDq0N.

exemption. And that's the same as any other broker-dealer [in] the industry. I think the good thing with them is that they already have a full array of products and are pretty product-agnostic and quite independent already, so they are probably less impacted than some other broker-dealers. But there will be some costs and some adjustments to make. The same would go with our rollover business which is sort of a direct-to-consumer distribution business. **You will need to make some adjustments, but from what we have seen, there are ways to continue on business just being compliant and should not have a major disruption to the sales levels.** The manufacturing businesses are a little bit different. They are more dependent on other distributors and how they react to changes in the regulation and what the impacts are on them. Right now, we think that the **distributors, just like ourselves, will adjust to the new rules and there will be a somewhat muted impact**, but we need to wait and see as to exactly what they actually do to react to the regulations. **Overall, not a big impact on us, at least in the short term**. How the industry then adjusts may have impacts in the medium term." (bold added for emphasis)

Morgan Stanley co-heads of wealth management Shelley O'Connor and Andy Saperstein sent a memo to employees in January indicating the firm intends to move ahead with changes designed to comply with the rule, according to an article in *InvestmentNews*.[424] Regarding their decision to offer both fee and commission IRAs, O'Connor and Saperstein said, "We believe our advisers can most effectively uphold a fiduciary standard of care and work in clients' best interests by continuing to offer choice." Morgan Stanley announced that clients who prefer transaction-based pricing will continue to have access to retirement brokerage accounts while receiving financial advice that complies with the DOL fiduciary rule and best interest contract exemption. "**Delivering a retirement account platform based on fiduciary principles that provides the widest possible capabilities and preserves client choice is our vote of confidence in our advisers' continuing commitment to placing client interests first,**" Ms. O'Connor and Mr. Saperstein said in a statement.

In addition, Morgan Stanley has published a page on its website entitled, "Morgan Stanley Preserves Client Choice Choice in Response to DOL Rule."[425] It states: "Morgan Stanley Financial Advisors have always believed that the key to successful retirement planning is to start with you. Your individual situation, goals and aspirations have always been our starting point for creating your retirement framework. We also believe that offering you a variety of investment products and platforms is the best way to increase your chances of comfortably retiring the way you envision. In our view, maintaining client choice—in both the services provided and how they are paid for—should remain a critical goal of how we respond to the new rules. That is why **our Financial Advisors will continue to offer you a choice on how you invest for your retirement goals and how you choose to pay for those services**." Not only will the firm offer commission accounts, but these accounts "**will continue to offer a broad array of investment products, including mutual funds and exchange traded products (such as ETFs)**," according to the website. (bold added for emphasis)

[424] Bloomberg News, *Morgan Stanley to move ahead with changes despite uncertainty around DOL fiduciary rule*, INVESTMENTNEWS, Jan. 27, 2017 http://bit.ly/2k9Q4DG.
[425] Morgan Stanley, Morgan Stanley Preserves Client Choice, March 28, 2017, http://mgstn.ly/2pGMdja. (*See* Appendix D)

<u>Northern Trust</u> President Bill Bowman said during the firm's third quarter earnings call last year that the firm expects "that **any changes to our business model and product offerings will be limited. And the cost associated with the design implementation and ongoing monitoring of compliance will be moderate**."[426] (bold added for emphasis)

<u>Primerica</u> CEO Glenn Williams announced in a second quarter conference call last year that the firm had decided to use the BIC to implement the rule.[427] "After extensive analysis of the various alternatives, we have concluded that **we will use the best interest contract exemption in our brokerage business**. The changes made in the final rule to the disclosure, administrative and grandfathering provisions have made this exemption more workable than the previous proposal." He added that the firm's "ongoing communications about the rule, including the potential changes to our U.S. retirement business, have been well received" by their representatives. "Our mission remains the same," he added. "**We're committed to serving middle income families and we're confident that our simple business model will give us the flexibility to adapt to the new rule**." (bold added for emphasis)

In an earnings call after the election, Williams acknowledged that the election had "introduced some new uncertainties regarding the rule," but indicated the firm was continuing the plan for the rule as "currently written."[428] He added, "Our management team along with the help of industry leading consultants and service providers is diligently working through changes we would need to make to comply with the rule. While a numbers of firms, which serve mostly affluent clients are considering only offering IRAs in advisory programs and eliminating any IRA brokerage options," Williams said Primerica plans to continue to offer mutual funds with front-end loads since these "can be the most appropriate way for clients to invest and save toward their long-term retirement goals. **We plan to continue to offering these products on a brokerage platform to the markets we serve**," he said. "**We, along with the industry are mindful of potential legal exposure and our implementation effort is being thoughtfully undertaken to minimize this exposure, while bringing us into compliance ahead of the deadlines**." (bold added for emphasis)

Williams said the firm had developed enhanced point-of-sale technology to help with compliance of the rule. It had also analyzed all of its operational processes and was making the necessary adjustments, including enhancements to its policies, procedures, training and supervision. He said the firm expected to be in compliance with the rule by the April deadline. "Throughout this rulemaking process, we have kept our top ISP [Investment and Savings Products] licensed representatives informed about the DOL developments. We are in ongoing communications about the rule and working with them to deliver the support ISP representatives will need to adapt the new landscape," he said.

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[426] Northern Trust (NTRS) Q3 2016 Results - Earnings Call Transcript, SEEKING ALPHA, http://bit.ly/2okqxZ0.
[427] Primerica's (PRI) CEO Glenn Williams on Q2 2016 Results - Earnings Call Transcript, SEEKING ALPHA, August 09, 2016, http://bit.ly/2nSKsD5.
[428] Primerica's (PRI) CEO Glenn Williams on Q3 2016 Results - Earnings Call Transcript, SEEKING ALPHA, November 10, 2016, http://bit.ly/2nSOVFI.

<u>Principal Financial</u> CEO Dan Houston said in a third quarter earnings call last year that Principal is continuing "to strengthen relationships by helping our distributors work through implementation" of the rule.[429] Asked about FAQs on the rule that had just been released, Deanna Strable President of Insurance Solutions responded that "what was clarified in that FAQ was actually very consistent with how we had set up our plan forward with our advisers. Again, I think we had anticipated the clarification would have been there, and **we feel good relative to how we were planning to comply and compete going forward**. You know, I think as Dan mentioned, we have actually made announcements relative to our internal sales force, and we have moved from decision making into implementation, but I think **those FAQs that came out really aligned with how we were targeting our implementation pact going forward**."[430] (bold added for emphasis)

<u>Prudential</u> Executive Vice President & COO-US Business Unit Stephen P. Pelletier discussed how the final rule had been improved in ways that benefit their business during a first quarter earnings call last year, shortly after the rule was finalized.[431] "If you look at our three businesses most impacted on Prudential Advisors – and here I'm more talking about the differences between the original regulation and the final one – if you look at Prudential Advisors, the final rule did make the process for obtaining the required contract under the BIC exemption less onerous than it originally was. And it also permits us to deal on a negative consent basis with clients who had accounts established prior to the beginning of 2018. So that's helpful. Final rule also clarified how proprietary products can be sold to IRA owners, providing we address some significant new requirements. Again, that's useful. So, for Prudential Advisors, c**ompliance and business processes will change, and we'll be ready for those changes. And we fully expect that unit to continue to play an important role in our distribution strategy**." (bold added for emphasis)

For annuities, Pelletier added, "the DoL did attempt to clarify the circumstances under which higher compensation for the sale of more complex products requiring more upfront time by the advisor is permissible, so long as that compensation is reasonable. And what that means will play out over time. The final rule did not include an exemption that would have favored lower cost products, such as index funds over higher cost, higher value products. And so, while these changes could help mitigate adverse impact on the VA sales, we do want to emphasize, we think it's really still premature to offer any predictions as to what that impact will be. That's going to play out over multiple years through the lens of advisor behavior and firm behavior. So we'll see what that proves out to be. For Prudential Retirement, the third business I'd mention," Pelletier said, **"the final regulation does contain meaningfully clearer delineation between investment advice and investment education, and we think that delineation will allow us to continue to offer our asset allocation services to DC plans**."[432] In response to a question about liability under the BIC for the sale of VAs, Pelletier stated: **"**I would point out that manufacturers will have a responsibility to perform certain processes and provide certain

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[429] Principal Financial Group's (PFG) CEO Dan Houston on Q3 2016 Results - Earnings Call Transcript, SEEKING ALPHA, October 28, 2016, http://bit.ly/2ogNnBC.
[430] *Id*.
[431] Prudential Financial (PRU) John Robert Strangfeld on Q1 2016 Results - Earnings Call Transcript, SEEKING ALPHA, May 05, 2016, http://bit.ly/2pr91El.
[432] *Id*.

information to distributors so that they can fulfill their obligations under the contract. And we are making the necessary preparations to do exactly that." (bold added for emphasis)

Raymond James CEO Paul Reilly told analysts during an earnings call last October that the firm will offer clients commission-based retirement accounts under the BIC in order to preserve client choice.[433] "**We fully expect to offer a range of options to help our clients**," he said. Reilly emphasized that Raymond James didn't want to pressure its advisers or clients into moving into fee-based accounts. "Right now, our plans aren't to push people or heavily influence people onto different platforms," he said, adding, "When you do that, you get some misallocations." (bold added for emphasis)

Schwab, during its fall business update, indicated that the rule "**involves modifications -- not significant overhauls -- to processes, systems, training, staffing, and oversight**" and will "**play to Schwab's strengths in the future.**" The firm indicated it isn't "anticipating dramatic changes to our business model or client experience."[434] (bold added for emphasis)

Stifel Nicolaus Chairman and CEO Ronald Kruszewski said in a third quarter 2016 earnings call: "At Stifel, **we are taking a balanced approach which preserves choice while recognizing the new fiduciary requirements**. Over the last several months, we have communicated plans for our platform and timetable to all of our advisors. With respect to choice, we have supplemented our advisory platforms with new capabilities programmed, and importantly **have reduced minimums**." He said that, in contrast to some firms, Stifel has "**lowered many of our minimums and welcome the opportunity to provide early savers with professional advice**."[435] (bold added for emphasis)

SunTrust states on its website that the firm "supports the Department of Labor's Fiduciary Rule and its goal to help provide information that will allow you to make informed decisions about your financial future. **The spirit of the Rule embodies our purpose, to help move Americans from financial stress to confidence**."[436] (bold added for emphasis)

TD Ameritrade President and CEO Tim Hockey said in a fourth quarter 2016 earnings call that the firm has "approached this opportunity with a client-first focus. **While we will be making some adjustments, we have tried to do so in a way that minimizes the impact on the client. That's important to us. In fact, given our plans for advice and guidance solutions, our client will have even more options to choose from than they had in a pre-DoL world**."[437] Hockey said that, "While other financial services firms are making major changes to the fees, commissions, service and product offerings as a result of the fiduciary rule, TD Ameritrade has not … **We've been well positioned to comply with the rule from the start and the vast majority of our Retail retirement clients won't see any significant**

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[433] Andrew Welsch, *Raymond James follows Morgan's lead in keeping commissions under fiduciary*, ON WALL STREET, October 27, 2016, http://bit.ly/2okEWEB.
[434] Schwab Fall Business Update, Slide 24.
[435] Stifel Financial's (SF) CEO Ronald Kruszewski on Q3 2016 Results - Earnings Call Transcript, *SEEKING ALPHA*, November 2, 2016, http://bit.ly/2prgV0g.
[436] SunTrust, Department of Labor Fiduciary Rule, http://bit.ly/2nSyzNo.
[437] TD Ameritrade Holding (AMTD) Q4 2016 Results - Earnings Call Transcript, SEEKING ALPHA, October 24, 2016, http://bit.ly/2prrvoi.

changes in how they work with us. In fact, rather than take away services from our clients, we plan to give them more tools and education and shift our model a bit to provide more guidance and advice."[438] (bold added for emphasis)

Waddell & Reed indicated on a fourth quarter earnings call that it was making strong progress toward implementing the rule. "With respect to the DOL fiduciary rule, we have completed the evaluation of our business model and are implementing changes as needed in order to comply with the new regulations. For the asset management side of our business, we are evaluating the share class and fee structures of our mutual fund families in order to ensure proper alignment with our broker-dealer partners. **Regarding our broker-dealer, we have identified conflicts inherent in our distribution channel and are in the process of either eliminating or mitigating these conflicts.**" The firm indicated that rollout of its updated adviser platform is scheduled for this spring, which it said "will significantly enhance the competitive position of Waddell & Reed financial advisors. **The end result will be more investment options, greater program flexibility and increased efficiencies in managing client portfolios**."[439] (bold added for emphasis)

Wells Fargo plans to "**keep commission retirement accounts under DOL fiduciary rule**" as a way to preserve customer choice, according to a recent *InvestmentNews* article.[440] The article cites to a memo from company leaders to advisors entitled, FIDUCIARY ROADMAP/Leading the way forward.[441] "**Fortunately, our firm is already in a strong position to succeed in the evolving regulatory environment because of our commitment to advisor best practices and investments in technology**, such as Envision®, Plan to PieSM, and Client Financial Review," the memo states. It says two additional "focus areas will allow the firm to **not only comply with the DOL rule, but also to continue growing our retirement business, gain significant market share, and improve the consistency of the client experience**." These are: 1) continuing to offer a choice of retirement account types and 2) making enhancements to retirement account standards and services. "**WFA strongly believes that our clients deserve options when making their investment decisions. Therefore, we will continue to offer traditional commission-based retirement accounts leveraging the Best Interest Contract (BIC) Exemption, as well as Advisory solutions**," the memo states. (bold added for emphasis)

In addition, the firm is "implementing several enhancements to help ensure we are meeting the DOL's best interest standard when advising and servicing our clients' retirement accounts," the memo states. The new retirement account standards include frequent client contact, advice that aligns with a client's verified investment objective and risk tolerance (or documentation if the investments aren't aligned), and a documented annual review. Under the enhanced retirement account policy statement, all retirement clients "will be mailed a Retirement Account Policy Statement outlining the account's purpose, time horizon, liquidity

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[438] Press Release, TD Ameritrade, "TD Ameritrade Introduces DOL Fiduciary Rule Resource Center to Educate and Empower Retirement Investors," December 8, 2016, http://bit.ly/2oE0UpA.
[439] Waddell & Reed Financial's (WDR) CEO Phil Sanders on Q4 2016 Results - Earnings Call Transcript, SEEKING ALPHA, January 31, 2017, http://bit.ly/2oNPxMi.
[440] Greg IacurcI, *Wells Fargo to keep commission retirement accounts under DOL fiduciary rule*, INVESTMENTNEWS, December 2, 2016, http://bit.ly/2oNL6kt.
[441] Wells Fargo, Fiduciary Roadmap, Leading the Way Forward, http://bit.ly/2ogWvGk. (*See* Appendix D)

needs, investment objective, risk tolerance, and the current vs. recommended investment allocation." In addition, WFA is developing a standardized process to document and help demonstrate when 401K-to-IRA rollovers and IRA-to-IRA transfers are in the client's best interest." And, to "provide increased discipline for investment selection, allocation decisions, and rebalancing, WFA has developed a firm-approved list of available investments for retirement accounts, backed by research from Wells Fargo Investment Institute and other research providers."

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In short, firms operating under a variety of business models, including some that have been strong opponents of the rule, have found the rule to be workable and are prepared to move forward with implementation. This directly rebuts the claim made by industry rule opponents that the rule will is causing disruptions and dislocations that are harmful to retirement investors. A number of firms have even embraced the rule as offering new opportunities for growth of their business. This is consistent with findings of a 2017 Executive Outlook Survey recently released by the Investment Adviser Association and Cerulli Associates, which found that industry are significantly more likely to view the rule as a boon to business than they are to see it as a threat.[442] This is not to suggest that many of those quoted here wouldn't like to see the rule significantly revised. But that is not the question the Department is being asked to consider. With regard to the question of whether the rule will cause harmful disruptions to retirement investors, the message from industry leaders when speaking to securities analysts and shareholders is that it will not. (Their statements in this context are particularly meaningful, since they would be liable under securities laws for misrepresentations.) Companies operating in all sectors of the retirement market maintain, moreover, that they are well positioned to implement the rule on time and in a manner that will benefit their customers. This stands in sharp and welcome contrast to the often heated rhetoric of industry lobbyists intent on getting the rule weakened or even revoked.

XI. Technological Innovation Will Ease Compliance with the Rule, Benefitting Firms and Retirement Savers

In inviting comments on "the emerging and expected effects of the final rule and exemptions on retirement investors' access to quality, affordable investment advice," the Department specifically references its previous conclusion that "innovation trends in markets for investment advice" have "the potential to deliver affordable, quality advisory services ... to all retirement investors, including small investors." Developments of new technology-based compliance services since the rule was finalized have served to validate the Department's prediction that technology would play an important role in preserving affordable access to advice, particularly for small accounts. Specifically, in its Regulatory Impact Analysis, the Department accurately predicted that technological innovation would ease compliance with the

[442] Melanie Waddell, *Talent Development, Cybersecurity Are Top Advisor Concerns: IAA/Cerulli Poll*, THINKADVISOR, March 9, 2017 http://bit.ly/2odLp5O (Among survey respondents, 38 percent called the rule "the single biggest opportunity for increasing business over the next 12 months," compared with 21 percent who cited the rule as a significant threat to business.")

rule, lower costs for firms and investors, reduce conflicts, increase transparency and, as a result, improve the quality of advice, particularly to small investors.

For example, the RIA predicted that: "Technological innovation likely will be harnessed to ease compliance with the Best Interest Contract Exemption. Possible applications include automated monitoring of trades for patterns of inappropriate recommendations, and automated generation of sound, impartial recommendations for consideration by consumer-facing advisers. Equally important, technology can directly lower the cost to deliver beneficial advice. The market is already beginning to serve small accounts with quality, impartial, affordable advice or other effective support for sound saving and investing decisions. The final rule and exemptions are likely to promote healthier development of emerging business models that rely heavily on technology to generate and deliver advice and/or that build advice into financial products themselves, as is the case with target date funds. Such new technologies and innovations in financial products already appear to be making advice and other potentially effective investment support more affordable and available to many consumers."[443] Others shared the Department's optimism. An *Investment News* editorial published following the adoption of the rule highlighted how the rule was "likely to unleash a wave of software upgrades and business relationships that will result in greater efficiencies for advisory practices."[444]

Just as predicted, the rule has accelerated positive innovations in the market, as a variety of firms have introduced cost-effective solutions to ease compliance with all aspects of the rule. According to one industry analyst, "The DOL rule has set off a veritable cottage industry of tools to help advisors and financial planners cope with the additional analysis and reporting requirements."[445] A report by the market research firm Cerulli issued just before the rule was finalized provides further evidence that the rule is spurring technology adoption and innovation, allowing firms to serve small accounts, mitigate regulatory risk and grow their revenue.[446] According to Cerulli's managing director of research and the author of the report, Bing Waldert, the alternative of not serving small investors is "fairly unappealing and non-consumer friendly."[447]

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[443] RIA at 319; *see also* RIA at 18, 178, 305 ("Innovation in new advice business models, including technology-driven models, may be beneficially accelerated, and nudged away from conflicts and toward transparency, thereby promoting healthy competition in the fiduciary advice market."); RIA at 318 ("The Department is confident that the final rule and exemptions will accelerate positive innovations in the market that will serve small savers particularly well. Enabled by new technologies, new business models already are delivering inexpensive, quality advice to small investors. The final rule and exemptions will promote the availability of such advisory services, because the business models' technologies can help efficiently ensure the impartiality they demand and because increased price transparency will favor such cost-saving innovations. The Department believes the final rule and exemptions will promote healthy competition in the market for advice on the investment of IRA assets, to the advantage of IRA investors.")

[444] Editorial, *Bright side of the new DOL fiduciary rule: Tech and efficiency*, INVESTMENTNEWS, April 24, 2016, http://bit.ly/23j4tvB.

[445] Bob Veres, *New Tools to Prove You Acted as a Fiduciary*, ADVISOR PERSPECTIVES, http://bit.ly/2okO2kB; *See also* Bob Veres, *DOL Fiduiary Compliance Part II: The Most Comprehensive Solutions for RIA Firms,* ADVISOR PERSPECTIVES, http://bit.ly/2oky7mr.

[446] Alessandra Malito, *DOL fiduciary rule is spurring technology adoption and innovation: Cerulli report*, INVESTMENTNEWS, March 16, 2016, http://bit.ly/1Pmd1d6.

[447] *Id*.

Revising or repealing the rule could cause enormous harm to these compliance companies, many of which are small businesses that have invested significant time and money into developing these new compliance tools. It would also stifle innovation that is making the retirement advice market more efficient and profitable in the long-term and allowing advisers to focus on the aspects of the advisory relationship in which they can have the most beneficial impact on investors.

A. A non-exhaustive discussion of DOL fiduciary-related compliance tools.

The following section of our letter provides brief descriptions of some of the vast array of compliance tools and services that have been developed to support compliance with the rule. These services overwhelmingly prove that compliance with the rule is workable and affordable and will enable firms to continue to serve accounts of all sizes under a fiduciary standard. They include:

- helping support firms' due diligence and data gathering capabilities so as to ensure they undertake a prudent process;
- providing workflow assistance and Client Relationship Management (CRM) software;
- undertaking quantitative analyses, assessments, and comparisons of various products and their attendant costs and features to help advisors justify their recommendations under the best interest standard and evaluate the reasonableness of the fees they are charging;
- providing sophisticated investment management and portfolio optimization;
- creating streamlined document management, including the preparation and implementation of BICs and the provision of required disclosures; and
- managing document retention and account audit trails to help firms monitor investment recommendations and ensure advisors' compliance with the rule's requirements, as well as to aid with the rule's recordkeeping requirements.

Below is a non-exhaustive list of some of the firms offering such services and a description of some of the services they are providing. (Descriptions are based on materials produced by the companies themselves and have not been independently verified by CFA.) As it reconsiders the rule, the Department must consider not only the evidence they provide that compliance is affordable, but also the impact any revision or revocation of the rule would have on these market participants.

PIEtech℠, the developer of the financial planning software MoneyGuidePro, recently introduced Best Interest Scout, a client-facing discovery tool that provides a standardized and efficient process for advisors to get client data in order to better understand the client's full financial situation, needs, and expectations, and determine whether clients are invested in their best interests.[448] Best Interest Scout is especially designed to help wirehouses, banks, insurance companies, mutual fund companies, RIAs, regional broker-dealers, and credit unions, according to the firm. It is available to firms whether they use MoneyGuidePro or not. It is also

[448] MoneyGuidePro, Your Firm's DOL Solution, Best Interest Scout, http://bit.ly/2p8E4YE; Alessandra Malito, *MoneyGuidePro creator releases DOL fiduciary-focused software,* INVESTMENTNEWS, July 21, 2016, http://bit.ly/2pGyV6c.

customizable so firms can determine what features they need to assess whether a client is invested in their best interests, and the tool can be configured to alert a firm if that information is not entered.[449] Once the client contributes more information, Best Interest Scout will send the data to a client relationship management (CRM) system, financial planning software or other system.[450] In addition, PIEtech℠ has developed a full workflow program to help firms define a path to comply with the DOL requirements.[451] According to Kevin Knull, president of PIEtech℠, "Best Interest Scout provides firms the ability to meet the discovery requirements of the DOL regulation, while giving them additional time to train their advisers on financial planning and implement a financial planning infrastructure."[452]

Accenture has introduced a new cloud-based solution, Accenture Wealth Management Compliance Solution for Salesforce, designed to help wealth management firms comply with the rule.[453] Wealth Management Compliance Solution for Salesforce facilitates client onboarding by allowing advisors to capture client data such as investing experience, risk tolerance, and investment goals to be used to support rule compliance. Additionally, the solution's decisioning tool guides advisors through the product selection process, which can be used for a wide array of retirement and insurance products, and helps ensure that investment rationale, suitability and client best interest are considered, captured and stored for audit purposes. The solution also automates the process of determining whether a Best Interest Contract is required and if so, automatically generates the contract for electronic signature by the client, according to the company.

Fi360 Fiduciary Focus developed its Fiduciary Focus Toolkit™ to help advisors "Organize, Formalize, Implement, and Monitor a prudent fiduciary process."[454] Specifically, it: provides automation of investment policy statement (IPS) creation and plan/account monitoring, ultimately allowing advisors and associated support staff to manage more business with the same headcount, according to the firm. It also mitigates liability via defined workflows, standardized IPSs/watchlists, and documentation of activities and decisions. In addition, the Toolkit helps those in oversight roles ensure through automation that advisor activities comply with the company's prudent practice policies. The use of automation will significantly reduce manual compliance tasks under the rule.

Riskalyze launched a comprehensive DOL compliance solution for advisors shortly after the rule was finalized.[455] This includes software that allows advisors to showcase and quantify alignment between portfolio construction and investor risk tolerance, according to the firm. Riskalyze's risk-alignment platform will calculate how much risk a client wants, how

[449] *Id*.
[450] *Id*.
[451] PIEech, DOL Best Interest Workflow, http://bit.ly/2nSC7z3. (*See* Appendix D)
[452] Alessandra Malito, *MoneyGuidePro creator releases DOL fiduciary-focused software*, INVESTMENTNEWS, July 21, 2016, http://bit.ly/2pGyV6c.
[453] Press Release, Accenture, "Accenture Launches New Cloud-Based Solution to Help Wealth Managers Comply with U.S. Department of Labor Fiduciary Rule," September 21, 2016, https://accntu.re/2dHuMNh.
[454] Press Release, Fi360, "Fi360 Unveils the Fiduciary Focus Toolkit," October 20, 2016, http://bit.ly/2p8wFIF.
[455] Blog, Riskalyze, "Riskalyze Launches Comprehensive DOL Compliance Solutions for Advisors," April 26, 2016, http://bit.ly/2okK4Zx; Riskalyze, DOL Compliance Solutions: Turning an Industry Challenge Into an Opportunity, http://bit.ly/2oBxoit.

much risk a client needs to take to reach their goals, and how much risk they currently have in their portfolio. Riskalyze's compliance solution also includes software that automates the documentation of a point-of-contact audit trail at each stage in the client relationship -- from initiating the client relationship, to education, to investment recommendations, to client reviews, according to the company. It also includes software that manages the procurement of each adviser's BICE contract forms in one location. This software allows advisers to easily deliver documents to clients for e-signature and documentation prior to the presentation of investment recommendations. In addition:

- Riskalyze has provided updates to its Compliance Cloud, which will empower firms' supervisory and operations teams to search across accounts and zero in on problems such as missing BICE documentation, mismatched risk objectives, high-risk positions, a high rate of 401(k) rollovers, or hyperactive accounts that may be abusing commission-based compensation.
- It has also formed a partnership with AmeriLife® to bring DOL compliance technology to the annuity market.[456] According to Nathan Hightower, president of AmeriLife, "The Riskalyze platform is a great tool our annuity producers will be able to use to assist in making a DOL compliant sale, and also provide an effective way to communicate the insurance need for a fixed annuity in an easy to understand presentation."[457]
- Its Autopilot platform has been integrated with TD Ameritrade's iRebal automated portfolio rebalancing tool.[458] This will allow advisers to spend less time on manual paperwork and trading tasks and, instead, focus on their role as a fiduciary -- making sure the client is making investment choices that best fit their long-term goals and providing the behavioral coaching, financial planning and tax assistance that clients need, according to Riskalyze and TD Ameritrade.
- Most recently, Riskalyze unveiled a lineup of new products and services aimed at revolutionizing client engagement, portfolio construction, and account automation and practice efficiency for advisers, according to the firm.[459] This includes their Autopilot Partner Store, which will provide advisers with a wide variety of third party research, portfolio strategies, and asset allocation models. Advisers can choose the asset management partners that best fit their clients and provide unique value propositions for the advisers, and all models will instantly update when those partners publish changes. For example, one of the asset management partners, Morningstar, will offer Morningstar® Managed Portfolios℠ on the Riskalyze Autopilot Partner Store. "Our managed portfolio services offer advisors access to institutionally managed investments that employ our valuation-driven, contrarian approach to asset allocation, as well as manager and investment research by our global team," according to Matthew Radgowski, Chief Operating Officer at Morningstar Investment Management LLC.

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[456] Blog, Riskalyze, "Riskalyze and AmeriLife Form Partnership Bringing DOL Compliant Technology to Annuity Producers," October 20, 2016, http://bit.ly/2nSSH1V.
[457] *Id*.
[458] Blog, Riskalyze, "Riskalyze's Roboadvisor Platform Autopilot to Be Integrated With TD Ameritrade's iRebal," September 29, 2016, http://bit.ly/2ogCgbQ.
[459] Blog, Riskalyze, "Riskalyze Announces the Next-Generation Autopilot Platform, Autopilot Partner Store, Risk Number Models and Riskalyze Premier," February 15, 2017, http://bit.ly/2nSTdwO.

According to Riskalyze, firms can leverage digital advice platforms to profitably and effectively serve smaller accounts. "Perhaps the greatest opportunity for advisors lies with the small accounts that will slip through the cracks," said Aaron Klein, CEO at Riskalyze, adding that "firms who can transition these smaller accounts onto a next-generation, fee-based digital advice platform will be able to take advantage of a unique opportunity."[460]

PreciseFP, a provider of financial planning software, is offering a client data-gathering solution that is customizable so it can be used by all firms, not just those that provide financial planning services, according to the firm.[461] It comes with an extensive forms library, which can be prefilled, for adviser ease. It also comes with automated client discovery workflows. The reporting features included in the software allow for firm-wide oversight over the quality and adequacy of data being collected, help to ensure data is up-to-date, and can further provide insight into client opportunities and potential pitfalls.

Nationwide Retirement Institute published a DOL Practice Management Guide on "Making Prudent Recommendations."[462] It states, "Using a consistent, deliberate process with clients can help advisors make prudent recommendations with confidence." It advertises several assessment tools to help firms and advisors quantify clients' needs and provide individualized reports that document clients' financial circumstances. One such tool includes RetireSense®, a comprehensive, retirement income, draw-down strategy tool that helps advisors to prudently evaluate and restructure portfolios to plan for their clients' needs in retirement, according to the firm. The guide concludes by stating, "You don't need to overhaul your business to incorporate a prudent process for fiduciary responsibility. All it may take is the right partner. Nationwide can help you make necessary changes today that can give you confidence in the new fiduciary environment."

Envestnet Retirement Solutions provides its enterprise and financial advisor clients with an "integrated offering of automated data aggregation, goals-based planning, data analytics, and advisor-centric wealth management technology in order to leverage better intelligence and deliver better outcomes in support of their clients' best interest," according to the firm.[463] Specifically, the aggregation of client data is designed to enable a holistic view of a client's financial situation and accelerate client on-boarding. In addition, the firm recently acquired a wealth management analytics firm, which will allow advisers and institutions to glean more insight into client portfolios, investment strategies and products, fees, performance and other information.[464] These analytics will allow firms to benchmark their client accounts against what others are doing with similar types of clients, and how they might be charging for those accounts among different asset class, according to the firm.[465] The tools could help advisers see, for example, whether parts of their portfolios are lagging their peers and then determine

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[460] Blog, Riskalyze, "Riskalyze Launches Comprehensive DOL Compliance Solutions for Advisors," April 26, 2016, http://bit.ly/2okK4Zx.
[461] PreciseFP, Your Compliance & DOL Solution, http://bit.ly/2p8x0eG.
[462] Nationwide Retirement Institute, "Making Prudent Recommendations" White Paper.
[463] Envestnet (ENV) Q3 2016 Results - Earnings Call Transcript, SEEKING ALPHA, November 07, 2016, http://bit.ly/2ogCGyW.
[464] Liz Skinner, *Envestnet buys analytics firm with eye toward DOL fiduciary rule compliance*, INVESTMENTNEWS, October 10, 2016, http://bit.ly/2oEaB7x.
[465] *Id*.

which investment strategies within their clients' accounts are underperforming, according to the firm. "It's like an x-ray into how an adviser is managing assets," Envestnet's President Bill Crager said. "It creates a lot of transparency that regulators are looking for." The tools will be available for all types of investment accounts and will generate the type of information firms need to ensure compliance with the rule, according to the firm.

In a recent earnings call, Envestnet's Chairman and CEO Judson T. Bergman highlighted the value they are providing financial services firms with these compliance solutions. He stated, "[L]arge enterprises...see the value of our unique integrated offering. Some of our largest opportunities result from the fiduciary rule recently adopted by the Department of Labor….We are uniquely positioned to help advisors and enterprises manage the transition of their businesses in a post-DOL world."[466] Bergman also stressed the fact that their offering is flexible to accommodate various approaches to compliance. He stated, "So, there are a number of responses [regarding firm's implementation of the rule] that are happening. Given the flexibility and the configurability of our platform, we expect that we're going to be able to accommodate a high degree of the numbers of permutations we expect from this."[467]

MassMutual is advertising its Fiduciary Assure program, in which Envestnet Retirement Solutions will help plan sponsors with their fiduciary obligation.[468] With this program, Envestnet will act as co-fiduciary with the plan sponsor, thereby better aligning their interests and help[ing] insulate [the plan sponsor] against legal claims that can result from offering inadequate or inappropriate investments." Envestnet will also recommend "a broad range of investment options" in core asset classes and monitor plan performance and report back to the plan sponsor on how plan investments are doing. A pamphlet describing the program to employers states, "Fiduciary Assure gives you objective guidance from Envestnet Retirement Solutions, LLC (ERS) — an independent third party — when making investment selections for your plan. You don't have to be an investment expert. You don't have to shoulder all the responsibility yourself for investment selection. Working with a financial professional, you can select the program that best suits your plan's needs."

Broadridge has created a Fiduciary Resource Center that features a suite of technology driven tools and solutions to help firms and advisers comply with the rule.[469] "Whether you require a full-service solution or standalone capabilities, we can offer you proven ways to simplify compliance, reduce costs and strengthen relationships," according to the firm. The new offerings – DOL Fiduciary Solutions, DOL Customer Communications, and DOL Compliance Reporting – are designed to help firms validate, communicate and comply with the new rules, according to the firm.[470]

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[466] Envestnet (ENV) Q3 2016 Results - Earnings Call Transcript, SEEKING ALPHA, November 07, 2016, http://bit.ly/2ogCGyW.
[467] *Id.*
[468] MassMutual, Fiduciary Assure®, http://bit.ly/2oE2Vlo. (See Appendix D)
[469] Broadridge, Broadridge, Fiduciary Resource Center, Turn Compliance Challenges into Competitive Advantages, http://bit.ly/2pnJv5I; *See also* Broadridge DOL fiduciary solutions PDF in Appendix D
[470] Press Release, Broadridge, "Broadridge Launches Suite of Solutions for DOL Conflict of Interest Regulations," November 3, 2016, http://bit.ly/2nSLGOx.

- Broadridge's DOL Fiduciary Solutions, built on Broadridge's FundPOINT data, can help financial advisers and firms make investment recommendations that meet fiduciary standards, according to the firm.
- Broadridge's DOL Customer Communications solution leverages Broadridge's existing communications connectivity across the breadth of the financial services industry to easily allow for composition, multi-channel print or digital delivery, as well as tracking and archival capabilities for compliance. This will facilitate the production, distribution, and archiving of all disclosures, transaction documents, regulatory documents, and adviser recommendations, such as the Best Interest Contract (BIC), Fiduciary Acknowledgement Letter, pre-transaction disclosures, and numerous other disclosures, according to the firm.
- Broadridge's DOL Compliance Reporting solution, built on Broadridge's scalable RevPort revenue management engine, can help firms maintain compliance and manage risk by minimizing conflicts of interest with third-party compensation/payments and aggregating account level data for monitoring and reporting, according to the firm.

Broadridge also expanded its DOL fiduciary compliance capabilities with the acquisition of M&O Systems, Inc., a leading provider of adviser compensation management solutions for broker-dealers and wealth management firms.[471] With this acquisition, Broadridge expanded its offerings to include adviser compensation and incentive management, an adviser commission portal, and account opening and client books and records solutions, according to the firm. These solutions offer an integrated approach to compensation across asset classes, including assets held-away, facilitating commission-based, asset-based and other innovative and compliant compensation approaches. "These capabilities complement Broadridge's overall DOL Fiduciary Rule strategy by allowing us to provide a timely solution to help facilitate clients' compliance with the Rule by calculating, monitoring, and reporting on compensation and tracking of Best Interest Contract Exceptions (BICE) and grandfathered accounts," Charlie Marchesani, President, Global Technology and Operations at Broadridge said.

Betterment for Advisors, a leading digital, wealth management platform for advisers, is designed to streamline the investment process and accelerate an adviser's ability to serve its clientele.[472] The platform requires no minimums and charges no upfront or transaction costs.[473] Betterment for Advisors provides flexibility to advisers to customize fees for individual clients. The Betterment for Advisors platform costs 25 basis points. The adviser can set his or her fee on top of the platform fee (up to 125 basis points total). The expenses for the underlying ETFs are paid out of dividends.

FolioDynamix, a leading provider of wealth management technology and advisory services, is particularly focused on helping advisers manage smaller accounts under the rule. According to FolioDynamix's website, they can support accounts as small as $5,000 using VisX Gateway solutions. This solution "offer[s] a way for advisors to help investors who might

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471 Press Release, Broadridge, "Broadridge Expands its Wealth Management Capabilities Through Acquisition of M&O Systems, Inc.," November 4, 2016, http://bit.ly/2gg4KyF.

472 Betterment For Advisors, Support, What is Betterment for Advisors?, December 13, 2016, http://bit.ly/2oNUKDM.

473 Betterment For Advisors, Support, What does Betterment for Advisors cost?, December 13, 2016 , http://bit.ly/2prqJax.

otherwise turn to robo-advisors," according to the company.[474] The company is also offering a "DOL Risk Exposure Assessment," in which analysts will assess a firm's retirement business process and suggest ways in which it can comply with the new regulation by deadline.[475]

FolioDynamix recently announced several strategic partnerships to help firms grow, automate key functions, and comply with the rule. For example, it announced a partnership with Scivantage to "deliver an enterprise-grade digital advice solution allowing advisers to collaborate with clients of all account sizes," according to the firm.[476] It announced a partnership with PIEtech, the creator of MoneyGuidePro, discussed above.[477] FolioDynamix expects this partnership will allow for the successful integration of MoneyGuidePro's robust client discovery tools with FolioDynamix's custom wealth management platforms.

FolioDynamix also recently announced a partnership with Blucora, which recently acquired HD Vest, to offer solutions to HD Vest Advisors.[478] According to Blucora President and Chief Executive Officer, John Clendening, this partnership will upgrade HD Vest's advisory platform so they can more efficiently create and manage investment portfolios, efficiently trade more security types, and rebalance when appropriate. "This is an important investment in our capabilities, and the new platform will provide our team with enhanced insight into client portfolios and the ability to better monitor for compliance with the DOL best interest standard," Clendening said. FolioDynamix also expressed optimism about this partnership, particularly as it relates to helping advisers successfully serve small savers under the DOL rule. "The HD Vest team has been very proactive in working to stay ahead of the upcoming DOL Fiduciary Rule deadlines," said Joe Mrak, CEO of FolioDynamix. "Advisors will be able to meet regulations through leveraging our enterprise-class technology and advisory solutions that include even low-minimum managed account options."

BlackRock recently published a document entitled "Building better portfolios after the DoL fiduciary rule."[479] In it, it advertised portfolio construction tools and insights to help advisers better understand risks, manage overall portfolio costs and build portfolios that may help bring their clients closer to their investment goals, according to the firm. Specifically, Blackrock advertised their technology platform, Aladdin®, which integrates risk analytics, portfolio management, and trading and operations. They also advertised their Portfolio Consulting Services, which allow advisers to quantify a portfolio's current risk exposures and performance drivers in real-time; assess how a portfolio may behave in different market scenarios, how each component may contribute to the overall picture, and how to find the critical balance between return, risk and cost; and implement portfolio enhancements, understand their impact, and update clients to reinforce the rigor with which advisers are

[474] FolioDynamix, VisXGateway Asset Allocation Model, http://bit.ly/2pnxGwi. (See Appendix D)
[475] Alessandra Malito, *DOL fiduciary rule is spurring technology adoption and innovation: Cerulli report*, INVESTMENTNEWS, March 16, 2016, http://bit.ly/1Pmd1d6.
[476] Press Release, FolioDynamix, "FolioDynamix and Scivantage Partner To Deliver Enterprise-Grade Digital Advice Robo Solution," September 22, 2016, http://bit.ly/2o5Qih2.
[477] Press Release, FolioDynamix, "FolioDynamix Announces Collaborative Partnership with PIEtech Enhancing Comprehensive DOL Solution," November 16, 2016, http://bit.ly/2oKwbaC.
[478] Press Release, FolioDynamix, "Blucora and FolioDynamix Partner to Offer Account Management Solution for HD Vest Advisors," November 7, 2016, http://bit.ly/2fwgFsi.
[479] BlackRock, Building better portfolios after the DoL fiduciary rule, http://bit.ly/2p8zoSD.

pursuing their goals. These Portfolio Consulting Services, according to BlackRock, will address a critical client need, as 75 percent of advisers say that their clients' top need is "help constructing a portfolio that will get them to their goal," according to BlackRock's 2014 Investor Pulse Survey. BlackRock says that financial advisers equipped with BlackRock's tools, technology, and resources are well positioned to embrace this evolving environment.

LPL Financial published a white paper on the rule entitled "Communicating Change."[480] In a section entitled: "Leading the Way During Times of Change" it describes how LPL is helping its advisers to comply with the rule: "At LPL Financial, we help advisors like you navigate through change and find new opportunities while managing disruption to their practices. Since the first mention of the Department of Labor (DOL) fiduciary rule, LPL has been preparing solutions from all angles of our business for any potential outcome. The full resources of our firm are at work to provide advisors the tools they need, the knowledge they crave, and the support they deserve."

The section lists some of the things LPL is doing for its current advisers and clients relating to implementation and compliance, including: maintaining an online DOL information center, updated frequently with the latest news and developments; supporting a specialized DOL Service Center team, available to answer questions on all things DOL; hosting weekly DOL forum calls with LPL leadership to provide updates on our solutions and interpretation of the rule; lowering advisory fees and minimums across several platforms and streamlining the process to move accounts from brokerage to advisory, where appropriate for the client; introducing a robo-inspired, low-cost advisory solution that couples a digital investment platform with adviser review and advice, allowing advisers to compete in the space while maintaining the human component; and developing a mutual fund brokerage account that will replicate the cost of direct business while offering the efficiency of a single custodial platform." As referenced above, LPL has integrated the robo-adviser FutureAdvisor[481] on its custodial dashboard, providing access to the firm's model investment portfolios as well as data aggregation, portfolio management and a client portal.[482]

Cetera announced in October its iAnalyze practice management analytics tool designed to provide Cetera financial advisers with a comprehensive, fully-integrated dashboard that brings together account information, asset levels, and other key data for each client.[483] According to the firm, iAnalyze will allow financial advisers to gauge the adjustments needed for each client account in order to bring them into compliance with the new rule. The firm's launch of its iAnalyze tool followed the launch in May of iQuantify, which helps advisers gauge their overall preparedness to comply with the rule and provides them with educational resources to understand its effects. Both tools are components of the firm's DOL DynamIQs platform, which aims to help advisers understand what it will mean to be an independent adviser in the post-DOL world, as well as how to deliver best interest

[480] LPL Financial, "Communicating Change" White Paper. (*See* Appendix D)
[481] FutureAdvisor has also partnered with BBVA, RBC, and US Bank.
[482] Alessandra Malito, *LPL partners with BlackRock's FutureAdvisor, paving way for robo-pilot program*, INVESTMENTNEWS, April 13, 2016, http://bit.ly/2pGOGdf.
[483] Press Release, Cetera, "Cetera Financial Group® Launches iAnalyze Tool as Next Crucial Element of DOL DynamIQsTM Platform," October 27, 2016, http://bit.ly/2prnct0.

advice within the new rule's requirements and how to position their practices to thrive in the reshaped regulatory environment that will result once the rule is implemented.

Adam Antoniades, President of Cetera Financial Group, said that these tools will help their advisers "bring each of their client accounts and products into compliance with the rule smoothly and seamlessly." Antoniades continued, stating, "With iAnalyze, Cetera Financial Group is building on the success and momentum we have experienced to date with the rollout of our DOL DynamIQs platform to demonstrate, once again, our ability to leverage our industry-leading scale, resources, and thought leadership to provide our advisors with the tools and support they need to achieve DOL compliance with confidence. Our strong technology offerings, coupled with the multitude of educational resources and in-house consulting expertise we offer, have positioned Cetera as a true partner focused on helping our advisors and their clients thrive in the years ahead."

SEI has partnered with Redtail, a provider of Client Relationship Management software, to help advisers plan, execute, and comply with the rule.[484] Pursuant to this partnership, the companies have created an Action Plan Template of various implementation workflows as well as instructional videos to prepare advisers for implementation. The SEI template recommends that commission-compensated advisers segment their consumers for purposes of the rule. "For certain accounts, we believe it might make sense to obtain a BIC exemption, and continue to serve those clients on a commission basis," says Raef Lee, managing director at SEI, Inc. "With others, you'll want to move to a level-fee relationship, changing the compensation from commissions to a level-fee arrangement. And the third option – and the more we get into this, the more we believe this is not going to happen very often – is the concept of orphaning."[485]

Docusign recently published a white paper entitled, "Get Compliant and Stay Compliant with Department of Labor (DOL) 'Final Rule' Fiduciary Regulations."[486] In it, Docusign offers its platform to help financial firms digitize and manage customer contracts and disclosures under the BIC, as well as to help firms record and retain this information for audit and compliance purposes. As stated in the paper, "The DocuSign platform is capable now of meeting all of the requirements for getting compliant and staying compliant with the DOL's final rule. And when you automate business processes, like those related to disclosures, you simplify cumbersome workflows and operate with solutions that can run automatically, without human intervention. Your customers can access, view, download, print, sign, and send documents quickly and easily, while the platform records all of the actions they take for an audit trail in compliance with the DOL rule."

FIS published a white paper entitled, "Solutions for Meeting DOL Fiduciary Rule Requirements," advertising a suite of tools that can help with client discovery, product selection and best interest checks, investment proposal and management, BIC disclosures, and

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[484] Press Release, SEI, "Industry Leaders SEI and Redtail Form Strategic Partnership to Help Advisors Plan, Execute, and Comply with the DOL Rule," October 26, 2016, http://bit.ly/2p8sI6W.
[485] Bob Veres, New Tools to Prove You Acted as a Fiduciary, ADVISOR PERSPECTIVES, http://bit.ly/2okO2kB.
[486] Docusign, "Get Compliant and Stay Compliant with Department of Labor (DOL) 'Final Rule' Fiduciary Regulations" White Paper. (*See* Appendix D)

supervisory capabilities so that firms have greater visibility into potential risk factors and increased operational efficiency and regulatory transparency.[487]

Morningstar has announced several tools that will help firms and advisers comply with the rule, including its Best Interest Scorecard and annuity workflow.[488] These tools will make it easier for advisers to analyze the cost and quality of a client's 401(k) portfolio and compare it with 1) superior alternatives that are available in the plan and that the investor could be placed in 2) an IRA portfolio and 3) any additional services that the adviser proposes. According to Amy Ost, the Morningstar senior project manager handling the DOL rule tool's development, this tool will allow the adviser "to show that the proposed IRA portfolio is not only superior to the funds the client has selected, but is also superior to potentially better portfolios that are available if the client had the advice of an advisor." Morningstar recently purchased the data analytics firm, Right Pond, which will provide the necessary plan fund data for Morningstar to conduct this type of analysis.[489] In addition, the scorecards and analysis can be monitored by a firm's compliance personnel to ensure that recommendations are in the client's best interest. Morningstar has announced that it has built a proprietary process to help advisers determine how to recommend a fixed-annuity product that's in a client's best interest.[490] This annuity workflow will enable advisers to easily compare the best fitting annuity options and assess the extent to which alternative annuity allocations can fill an investor's retirement income gap.[491]

FeeX was launched in 2012 to bring transparency to the retirement market and has spent the last five years developing the technology, systems and algorithms necessary to capture, normalize, analyze and compare various financial products including 401k, 403b, 401a, 457, PSP, IRA's and brokerage accounts. FeeX has been and is currently analyzing 404(a)(5) participant fee disclosures along with aggregated account data, public fund data, and 5500 forms. It serves multiple facets of the financial industry, including broker-dealers, insurance companies, RIA's and online brokerages as they look to comply with the DOL fiduciary rule. The FeeX For Advisors™ SaaS platform enables an in-depth, personalized analysis and side-by-side comparison of retirement and investment accounts. The platform extracts plan level fees and services, fund fees for both public funds and private funds, adviser fees, past returns, asset allocation, benchmarks, brokerage window availability and fees and the full list of available investment options within that plan. Because it analyzes plan documents, FeeX is able to analyze private funds, such as Collective Investment Trusts, that are found in roughly 50 percent of plans and for which no public information is available. Using information in the plan documents, FeeX analyzes these funds and presents the relevant data, including expense ratios, past returns, benchmark, and fund category.[492]

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[487] FIS, "Solutions for Meeting DOL Fiduciary Rule Requirements" White Paper. (*See* Appendix D)

[488] Bob Veres, New Tools to Prove You Acted as a Fiduciary, ADVISOR PERSPECTIVES, http://bit.ly/2okO2kB.

[489] Alessandra Malito, *Morningstar acquires RightPond, data analytics provider on defined contribution and defined benefit plans*, INVESTMENTNEWS, March 31, 2016, http://bit.ly/2prwBk5.

[490] Morningstar, "Avoid These 7 Fiduciary Rule Mistakes." (*See* Appendix D)

[491] Will Parton, *New Proposal Annuity Workflow & Best Interest Scorecard*, MEDIUM, February 7, 2017, http://bit.ly/2oBxB5u.

[492] Description on record with authors

RiXtrema has announced several offerings that will help firms and advisers justify recommendations based on investment fees and performance. These include their 401kFiduciaryOptimizer, IRAFiduciaryOptimizer, and AnnuityOptimizer.

- RiXtrema's 401kFiduciaryOptimizer analyzes investment fees of funds offered in plans and identifies very similar alternative investments in terms of risk/return profile to the assets in the plan that could save the plan participants significant amounts of money. Advisers can use this sophisticated quantitative analysis to create proposals that offer significant savings to plan sponsors. And, in an effort to further augment this technology, RiXtrema recently announced a partnership with Brightscope to integrate BrightScope's Plan Data Network into the FiduciaryOptimizer suite of products.[493] This partnership will allow RiXtrema users to seamlessly obtain plan-level details about services, investment products, and fee details from any 404(a)(5) document.Gathering and processing details from 404(a)(5) disclosures will provide firms with the most accurate and complete data for conducting best interest analyses. BrightScope's Plan Data Network provides RiXtrema FiduciaryOptimizer users with access to plan details from disclosure documents uploaded by other members of the network, while also loading their own disclosures for others to use.
- RiXtrema's IRAFiduciaryOptimizer allows an adviser to compare an investor's current portfolio with the adviser's recommended portfolio on a range of metrics, such as total fees, returns, risk, Sharpe ratio and fiduciary best practices. This software then produces a report summarizing why a rollover is in the best interest of the client based on these metrics. Reports can be generated by individual advisers, or by a home office compliance team. IRAFiduciaryOptimizer can support such compliance work both at the individual adviser level and for an entire firm or broker/dealer.
- RiXtrema's AnnuitiyOptimizer analyzes and compares annuity investments with available alternatives. This software allows advisers to model annuity fees, surrender charges, affect on cash flows, and it can compare the results of switching from inferior annuities to more optimal solutions, including based on projected savings over the long term.

Orion fee benchmarker enables firms to compare an investor's account fees with over a million other managed accounts.[494] This quantitative information will allow firms to prove the reasonableness of their fees and demonstrate the value of the services they provide. This new fee-benchmarking tool will allow advisers to filter the advisory fee benchmark comparison by: type of firm, services provided, account type, and account size.

McKinsey & Co. recently bought PriceMetrix, which provides benchmarking data and analytical tools, including CommissionCheck and FeeCheck, that also allow firms to prove the reasonableness of their fees.[495] PriceMetrix maintains a database representing 500 million retail transactions and 10 million investors with more than $5 trillion of investment assets. This can

[493] Press Release, RiXtrema, "RiXtrema Partners With BrightScope to Create Seamless Workflow for Fiduciary Analytics," March 21, 2017, http://prn.to/2prJsmn.
[494] Press Release, Orion Advisor Services, "Orion Advisor Services Launches Industry's First Fee-Benchmarking Tool," December 22, 2016, http://prn.to/2hLhL6Q.
[495] McKinsey Buys PriceMetrix, Advisor to Firms on Pricing Strategies, AdvisorHub, September 7, 2016, http://bit.ly/2oh1Ope.

provide the necessary data for firms and advisers to make informed and justifiable decisions when pricing products and services and making investment recommendations of those products and services. Large brokerage firms that have subscribed of PriceMetrix's CommisionCheck include D.A. Davidson,[496] Robert W. Baird,[497] and Hilliard Lyons.[498]

Fiduciary Benchmarks (FBi), a leading defined contribution plan benchmarking firm, has leveraged its existing technology to bring a robust and easy-to-use solution to the IRA marketplace.[499] "The system we built for DC Plan Benchmarking was quickly and easily modified to meet the Fiduciary Rule's requirements for the IRA marketplace. The fact that we had so many of the components built enabled us to have a production beta running on July 22, 2016," said Matt Golda, SVP of Tech and Operations. FBi's Fiduciary Rule Solution for IRA's includes tools that enable clients to determine fee reasonableness, identify best interest approaches for rollovers, and provide full compliance reporting and workflow oversight. "We know that we can provide an independent and cost effective solution that not only protects our clients but also highlights the value that they provide," said, Craig Rosenthal SVP, Sales and Service.

Shortly after announcing their Fiduciary Rule Solution for IRAs, FBi and IRI announced a tool for financial advisers to gather and evaluate client information to recommend retirement products and services that are in the client's best interest.[500] The tool will enable advisers to determine fee reasonableness, given their clients' needs and the value of the products and services offered. This includes evaluating rollover recommendations and assessing the merits of level fees versus commissions. The tool also offers full compliance reporting and workflow oversight. Cathy Weatherford, IRI's President and CEO, praised the utility of this new tool in helping IRI member companies and financial advisers comply with the rule. She stated, "By working with leading solution providers, such as FBi, we are able to support the development of innovative tools that fulfill a need in today's marketplace. Our members have already begun to participate in focus groups and are providing valuable insights on including lifetime income products and services into FBi's process and methodology." FBi stated that this tool would be available well in advance of the rule's compliance deadline.

Professional Capital Services (PCS), a 401(k) record keeper that currently services $4.5 billion in qualified plan assets across 150,000 participant accounts, recently expanded its AdvisorPlan software by adding a tool that will help advisers benchmark their fees for managing IRAs, comparing those fees with 401(k) fees, and justifying rollover recommendations based on the fees being charged and services being provided.[501] AdvisorPlan

[496] Press Release, PriceMetrix, "D.A. Davidson Commits to Multi-Year Subscription of PriceMetrix' CommissionCheck Pricing Intelligence Solution," March 3, 2016, http://bit.ly/2ogWx0Q.
[497] Press Release, PriceMetrix, "Robert W. Baird & Co Renews PriceMetrix' CommissionCheck Pricing Intelligence Solution, Adds FeeCheck," September 4, 2015, http://bit.ly/2nSQ683.
[498] Press Release, PriceMetrix, "Hilliard Lyons Renews PriceMetrix' CommissionCheck and ValueOne, Signs Contract for FeeCheck 2.0," October 21, 2015, http://bit.ly/2okAtlu.
[499] Press Release, Fiduciary Benchmarks, "Fiduciary Benchmarks (FBi) announces the availability of its Fiduciary Rule Solution for IRAs," November 9, 2016, http://bit.ly/2okQFTs.
[500] Press Release, Fiduciary Benchmarks, "IRI and Fiduciary Benchmarks Announce New Tool to Evaluate Benefits and Fees for IRA," December 19, 2016, http://bit.ly/2oEgtxn.
[501] Bob Veres, *DOL Fiduciary Compliance Part II: The most comprehensive solutions for RIA firms,* ADVISOR PERSPECTIVES, January 23, 2017, http://bit.ly/2oBVXf4 http://bit.ly/2prpPLo

then generates a document that includes a side-by-side comparison of the results, which can automatically be saved in a master compliance file.[502]

DST Systems recently announced a Surveillance Module for DOL Fiduciary Rule Compliance Support. DST's Risk and Compliance Intelligence (RCI) offers a suite of tools that provide a comprehensive set of surveillance solutions that help advisory firms conduct, manage, and provide evidence of supervision. It contains a library of tests that have been specifically designed to help financial services firms analyze transactions and investor account holdings. These preconfigured, customizable tests can assist compliance officers in identifying investor retirement accounts that may need further review, such as those that are overly concentrated in high fee securities, invested in unsuitable ETFs, undermanaged or being churned. DST's DOL Fiduciary Rule Surveillance Module can facilitate more efficient and effective oversight activities and help firms mitigate risk, according to the firm.[503]

Seismic, a marketing and sales enablement platform, is advertising tools that help firms comply with the rule by automating and tracking all phases of client interactions.[504] For example, it uses a predictive content feature that automatically shows product offerings, supporting materials, and other content that is tailored to the client's situation. This feature helps advisers to easily align products to a client's financial goals. In addition, it provides tracking and analytics capabilities that allow firms to document every interaction with a client.

Advicent has created "The Compliance Blueprint" in response to the rule. It consists of a three-part offering that includes DOL-ready financial planning software functionalities, a DOL Education Center, and consultant partnership services.[505] As part of this suite of compliance offerings, the company provides data gathering tools that allow advisers to collect more thorough and in-depth information pertinent to their client's holistic financial situation, which then allows them to make more optimal recommendations based on the client's best interest. The company also provides tools that allow for detailed client reporting, which creates transparency around data and recommendations from the adviser. In addition, the company provides tools that strengthen organizational oversight by empowering home offices with firm-level compliance management to leverage predefined workflows. Advicent is also offering its clients the ability to leverage Advicent's partnership with North Highland Worldwide Consulting to utilize their DOL Fiduciary Foundations Playbook.[506] This Playbook includes a risk assessment, DOL readiness assessment, and adviser training. This holistic and structured approach will assist firms in quickly implementing changes that may be necessary under the new rule.

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[502] John Manganaro, *PCS Reveals 'Advisor Lab' Fiduciary Toolkit,* PlanAdviser, September 29, 2016, http://bit.ly/2pnCJwT, PCS, About PCS website, http://bit.ly/2prpPLo.
[503] Jim Mock, "Surveillance Tool Supports DOL Fiduciary Rule Compliance," DST Risk and Compliance Intelligence (2017) http://bit.ly/2p8B7XS.
[504] Seismic White Paper, "The Advisor's Guide to the New DOL Fiduciary Rule - What it means, why it matters, and how it will affect your firm," http://bit.ly/1W9PzsP.
[505] Advicent, "The Compliance Blueprint," http://bit.ly/2pnD8PA; *See also* Press Release, Advicent, "Advicent is providing tools to arm advisors for success as financial planning becomes a larger focus among financial services organizations," Advicent website, June 28, 2016, http://bit.ly/2nSJfLY.
[506] *Id.*

DTCC has worked with clients and the rest of the insurance industry to develop an initiative to provide a centralized, automated, and standardized solution to facilitate the satisfaction of the rule's disclosure requirements, both under the BIC and 84-24. In July 2016, it published a concept paper discussing how the insurance industry could comply with these requirements.[507] In the paper, DTCC expressed its intent to facilitate the disclosure of direct and indirect expenses and an initial general transaction disclosure for upfront fees and expenses. The direct expenses include, but are not limited to, Management Fees (Mortality and Expense; Annual Contract, Fund Management and Rider/Feature fees), Surrender Charge Rates & Schedules and Commission Schedules. The indirect compensation may include various expenses such as revenue sharing, entertainment, and marketing allowances. In addition, it expressed its intent to support the exchange of data between the insurance carriers and distributors for reporting ongoing fees and expenses for on-demand disclosure and website disclosure. DTCC explained that its Fee & Expense Disclosure Transmittal would include details of fees and expenses at the product level, feature/rider level, and fund (subaccount) level.

DTCC clients would receive considerable benefits from this initiative, according to the concept paper. Leveraging a central data source of comprehensive and standardized annuity information would greatly facilitate access to data critical to the management of and adherence to the Department of Labor's fiduciary disclosure rules. Key benefits, according to the paper, include:

- greater transparency into annuity expenses, both direct and indirect, and commission schedules;
- streamlined data process with robust data validation, increased data conformity and accuracy based on a defined, standardized data dictionary;
- a standard data format;
- reduced costs, risks and errors associated with manual processing;
- improved efficiency;
- elimination of support and maintenance associated with proprietary feeds or product databases;
- simplified web access; and
- timely updates to distribution partners.

In January 2017, DTCC held a webinar, entitled "The DOL Fiduciary Rule: Insight Into An Insurance Industry Solution."[508] DTCC confirmed that the solution was already in testing and was on target for launch by April 10th. DTCC also stated that, in addition to offering this solution for insurance/annuities, it will offer a similar service for mutual funds and other pooled investments. Both services would be available to DTCC clients on a subscription or per transaction basis.

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[507] DTCC, "DTCC Initiative Supporting the Department of Labor (DOL) Fiduciary Rule - Concept Paper, July 8, 2016.

[508] DTCC, The DOL Fiduciary Rule: Insight Into An Insurance Industry Solution, Recorded on Wednesday, January 18, 2017, http://bit.ly/2okqGvG.

SalesForce, a client relationship management software company, issued a white paper entitled "A System of Engagement to Navigate the DoL Fiduciary Rule."[509] In it, SalesForce explained why their Financial Services Cloud could "make the impending shift to the Fiduciary Rule manageable by helping advisers achieve fiduciary responsibility and ease regulatory compliance obligations, while continuing to deepen client relationships and grow the business." This tool will allow firms to implement standardized and repeatable processes for engaging with clients and collecting information relating to client engagements, including the advice that has been given, who was involved, how the advice was conveyed, and what actions were taken. SalesForce has also added a DOL fiduciary compliance feature to its Financial Services Cloud, known as Salesforce Shield for Financial Services Cloud, which "gives firms the ability to gain 360-degree views of clients, stay on top of due-diligence reviews, create and record communications, protect records and supervise fiduciary activity."[510]

Other financial industry client relationship management (CRM) providers, including Wealthbox and Redtail, have expanded their tools to help advisers and firms comply with the rule.[511] "CRM by its very nature allows advisers to record information with transactions with clients, so on the face of it, CRM is good for the mandates of the DOL law," said John Rourke, chief executive of Starburst Labs, the creator of Wealthbox CRM.[512] "The heart of this is recording and compliance."[513] Wealthbox enhanced its archiving and editing tools in anticipation of the regulation, Mr. Rourke said. Advisers who use the software can see an audit trail of notes, which can be edited and color-coded. Documentation and workflows are going to be key to comply with the rule, according to David Mehlhorn, director of sales at Redtail. Redtail added a tool that lets advisers track when a best interest contract agreement was signed, or search for which clients have and do not have the contract signed. He said advisers' interest in workflows has skyrocketed in the last six months.

eMoney Advisor announced its Fiduciary Framework, which provides scalable DOL compliance solutions for all aspects of the adviser/client lifecycle, from creating complete client profiles through online account aggregation and automated client discovery workflows to archiving evidence of best interest and reviewing recommendations for compliance.[514] In March, eMoney Advisor announced eMoney for Enterprise, a new division dedicated to assisting financial institutions looking to implement eMoney's technology across the financial institution's entire user-base.[515] "[W]e are committed to delivering solutions that support a wide range of advisers and firms with diverse needs," said Ed O'Brien, CEO of eMoney. These solutions will include providing institutions with robust analytics capabilities as well as the abilities to document and archive key adviser-client interactions.

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[509] Rohit Mahna, *3 Ways Salesforce Can Help Advisors Meet the Department of Labor's Proposed Fiduciary Rule*, SALESFORCEBLOG, March 31, 2016, http://sforce.co/1ZPlkG3.
[510] Alessandra Malito, *Salesforce adds compliance features to financial services CRM for DOL fiduciary rule*, INVESTMENTNEWS, July 25, 2016, http://bit.ly/2a5jIFB
[511] *Id.*
[512] *Id.*
[513] *Id.*
[514] eMoney Advisor, "Taking FinTech to FiduciaryTech," http://bit.ly/2nSWufF (*See* Appendix D); eMoney Advisor webinar, "Taking FinTech to FiduciaryTech," http://bit.ly/2nSUt39.
[515] Press Release, "eMoney Advisor Launches Enterprise Division to Support the Wealth Management Needs of Firms at Scale," eMoney Advisor Blog, March 23, 2017, http://bit.ly/2oNPgJa.

NRS is offering its DOL Fiduciary Rule Consulting Services to help firms prepare for implementation of the rule.[516] It is also advertising its ComplianceGuardian DOL Module, which, according to the firm, combines the best of NRS technology, education, and consulting into a convenient one-stop compliance solution. This new DOL module will provide the materials firms need to adapt their processes to meet the new rule. Components include:

- model documents and contracts;
- policies and procedures;
- fiduciary client notification letter templates;
- website disclosure templates; and
- supervisory and representative training modules.

NRS is also provide training and education to help firms prepare staff for compliance with the rule.

AKA is advertising its DOL Fiduciary Rule Compliance Management solution which, according to the firm, "gives financial advisors everything they need to meet the requirements with minimal effort or disruption…and without the hefty price tag."[517] The tool provides a 360-degree view of customers as well as detailed tracking of events and interactions, which can provide advisers a deeper understanding of their customers, as well as the information they need to justify and document their recommendations, according to the firm.

Trizic, a provider of enterprise class (non-direct to consumer) digital advice technology, recently announced that John Hancock Financial has deployed Trizic's automated digital wealth platform, which will deliver a competitively priced digital advice program for all account sizes, while allowing John Hancock to more efficiently add new clients to the service.[518] Trizic's Investor Portal provides a number of digital advice features, including risk profiling, client onboarding and account opening. John Hancock's proprietary models will drive the advice provided through the Trizic platform, and John Hancock will retain control over rebalancing, trading, investment recommendations, and other feature.[519]

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Technical solutions are also available to ensure that services will continue to be available to small 401(k) plans under the rule. While opponents have suggested that the rule will make serving this market less attractive, a number of firms indicated that they see it as a business opportunity. Matt Head, director of micro and small-business retirement products at Bank of America Merrill Lynch, notes, for example, that there are an estimated 20 million small businesses, and though estimates vary, most experts think that only about 50 percent have a retirement plan.[520] "You're looking at a huge opportunity there with the remaining

[516] NRS, "DOL Fiduciary Rule Consulting Services," http://bit.ly/2ogTXIc.
[517] AKA Enterprise Solutions, "DOL Fiduciary Rule Compliance Management," http://bit.ly/2p8y0PJ.
[518] T3NewsADM, "John Hancock Financial to Deploy Trizic's Digital Advice Platform," T3, March 8, 2017, http://bit.ly/2ogqD4U.
[519] *Id.*
[520] Ed McCarthy, "The Small Biz 401(k) Challenge," WEALTH MANAGEMENT, Dec. 23, 2015 http://bit.ly/2o9lV9D.

population," he said. Tom Murphy, the head of delegated investments for consulting firm Mercer, says his firm views the small-business 401(k) market as a large opportunity because it's "pretty poorly served" by high-cost providers, which often lack transparency and are saddled with poor options and disclosures.[521]

B. Technology makes fiduciary services to even very small plans affordable.

A number of technology-based businesses have come to market in recent years specifically to provide more affordable services to the small plan market. These include Betterment for Business, Employee Fiduciary, Ubiquity Retirement + Savings and Vestwell.[522] All include fiduciary advice to help plan sponsors establish appropriate plan menus, generally at much lower cost than non-fiduciary providers have charged in the small plan market. They provide clear evidence that the rule will not cause a harmful disruption in services to 401(k) plans. On the contrary, as we discuss above, the rule will help to bring down costs to these plans.

Betterment for Business offers a full-service platform providing record-keeping and personalized investment advice for all plan participants. "For plan sponsors, it will save them time because they get everything in one place and the system is easy to use," according to founder Jon Stein. "For participants, they will have lower costs and better outcomes, because they will have more efficient investments as well as holistic advice about how much to save and invest."[523] Participants enrolled on the Betterment platform receive a diversified portfolio of index-tracking exchange-traded funds (ETFs), with all-in costs ranging from 10 basis points for large plans to 60 basis points for the smallest plans.

Employee Fiduciary serves very small plans (usually up to 50 participants) as record keeper and third-party administrator. It also provides custody, as well as investment selection help, through its RIA subsidiary, Frugal Financial.[524] While Employee Fiduciary does not provide individual participant advice, if does offer tools participants can use to help figure out how much to save. Employee Fiduciary has an open architecture platform that allows plan sponsors to use whatever investments they want for their investment menus. It charges a flat fee of $1,500 per year for up to 30 eligible employees, and $30 for each additional employee. The firm also charges an 8 bps fee on assets—which does not increase as assets grow—for custody expenses. Employee Fiduciary also partners with fiduciary advisers that provide investment advice to small plans, as discussed above.

Ubiquity Retirement + Savings provides bundled services to small plans. It can work with plan sponsors' existing advisers or, where the plan does not get investment selection help from an adviser, Ubiquity has partnered with robo advisers such as Direct 401k, as well Morningstar for outsourced investment management.[525] Ubiquity creates custom target-date fund portfolios for plan sponsors and uses ETFs as underlying investment options, but clients

[521] *Id.*
[522] Rebecca Moore, *401(k) Solutions for Micro Plans,* PLANSPONSOR, Sept. 21, 2015 http://bit.ly/2oc2UoS.
[523] *Id.*
[524] *Id.*
[525] *Id.*

can also select other investments. Ubiquity charges an asset-based fee, averaging 25 bps, which includes 3(38) investment management, as well as trust and custody services.

Vestwell "offers financial advisors a turnkey solution to deliver retirement investing services to companies and their employees while meeting all requirements" of the DOL fiduciary rule.[526] Designed to partner with individual investment advisers, Vestwell's technology platform provides onboarding, administration, recordkeeping, investment management, and compliance services,[527] while the adviser offers personalized advice to plans and plan participants. As one writer describes it, "Vestwell has taken the best parts of the robo platforms, such as intuitive user interface and paperless onboarding and applied them to the opaque and complex 401(k) enrollment process. A new plan is created in a sequence of 10 steps, with the platform logic guiding the advisor through key decision points to shape the optimal offering."[528] Because some of the more technical aspects of the plan setup may still require expert advice, "Vestwell has partnered with a CPA firm that handles tax-related questions and is well-versed in the granular details of 401(k) plan design."[529] By partnering with a third party administrator, an ETF strategist and a record-keeper, Vestwell is able to offer all the four key services plans typically require -- custody, record-keeping, third party administration and investment selection. By assuming both 3(38) investment fiduciary and 3(16) administrative service functions, Vestwell alleviates liability concerns for employers. In contrast to robo advisers, which may cut human advisers out of the process entirely, "Vestwell is positioned to give advisors a tool that will help them deliver the service in a way that is regulation-compliant, cost-effective and scalable."

The technological solutions to the DOL rule discussed above are only a sampling of the many firms creating and marketing solutions to ease compliance with the rule. For more examples of firms that are deploying innovative technological solutions in this space, please see Bill Winterberg's Financial Advisor Technology Landscape[530] as well as Michael Kitces' monthly discussion on The Latest in Financial Advisor #FinTech.[531]

The above listing of technological tools is significant for two reasons. 1) It shows that a vast array of tools are available to help financial firms and their advisers with all aspects of the rule's implementation, contradicting claims that the rule will cut off access to advice. And, 2) it shows that companies have made a huge investment of time and money developing these tools in reasonable expectation that the rule would go forward. These technological tools have the potential to make compliance, not only manageable, but also affordable. As Fidelity Clearing and Custody Solutions' Chief Operating Officer Tom Corra recently stated, "The best firms are going to utilize the coming of this rule both to comply and to potentially adapt their business to

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[526] Craig Iskowitz, *Can This 401(k) Robo-Platform Defeat the Dark Side of Retirement?*, WEALTH MANAGEMENT TODAY, Dec. 18, 2016 http://bit.ly/2pd7iBC.
[527] Vestwell, Retirement Made Simple, http://bit.ly/2oiWiW1.
[528] Craig Iskowitz, *Can This 401(k) Robo-Platform Defeat the Dark Side of Retirement?*, WEALTH MANAGEMENT TODAY, Dec. 18, 2016 http://bit.ly/2pd7iBC.
[529] *Id*.
[530] Bill Winterberg, "Financial Advisor Technology Landscape," FpPad.com, http://bit.ly/2prxcCG (*See* Appendix D)
[531] Michael Kitces, *The Latest In Financial Advisor #FinTech (April 2017)*, NERD'S EYE VIEW AT KITCES.COM, April 3, 2017, http://bit.ly/2nVCCoT.

compete in what may be a much different environment moving forward…they're going to find a combination of processes and technology that will ensure that compliance doesn't add a tremendous amount of cost to the way they do business today."[532]

Meanwhile, the entrepreneurs who have developed these tools have turned the challenges of complying with the rule into a business opportunity. They shouldn't have the rug pulled out from under them just because financial firms don't want to be legally accountable for acting in their customers' best interests. Make no mistake, any decision to rescind or significantly revise the rule would do just that. For the smallest companies, which are counting on income from the compliance tools they've poured money into developing, significant changes to the rule could threaten their very livelihood. Others would likely survive, but suffer painful, even devastating financial losses.

As it reconsiders the rule, the Department must carefully and thoroughly weigh the costs that any changes to the rule would impose on these firms. Indeed, because the cost could be significant and the damage extensive, the Department has an obligation to go far beyond the cursory evidence presented here to better understand this developing market. It must carefully evaluate the effect of any rule change it may consider on the various providers of these fiduciary compliance services and tools, the specific solutions they are providing, and how they would be affected by the Department's actions, before taking any action that would affect them or the beneficiaries of the services they provide. Failure to do so would be arbitrary and capricious and would expose the Department to legal challenge.

C. Technology tools will make firms more efficient and profitable in the long-term.

Rule opponents will doubtless identify the cost of these technological tools as a cost of the rule. But it is a cost with attendant benefits that go beyond cost-effective compliance that reduces firms' regulatory risk. Using these tools has the potential to make firms more efficient and profitable in the long-term and to allow advisers to focus on the aspects of the advisory relationship in which they can have the most beneficial impact on investors. The Department must consider these benefits when weighing the economic impact of the rule. For example, the same technological capabilities that help firms address regulatory mandates can also improve business outcomes from a cost or revenue perspective, according to a recent white paper from CEB.[533] Similarly, an *Investment News* editorial published shortly after the rule was finalized predicted that it would "unleash a wave of software upgrades and business relationships that will result in greater efficiencies for advisory practices."[534]

Envestnet commissioned a report by Aite Group analyzing the impact that advanced technology integration, of the type incorporated in many compliance tools, can have on a

[532] Webinar: The DOL Fiduciary Rule – Comply, Compete and Pave the Way, Compliance Week, February 2017, http://bit.ly/2oBLAIg.
[533] A CEB Insight Brief Commissioned by FIS (See Figure 3: Adding and Regulatory Value Through Technology
[534] Editorial, "Bright side of the new DOL fiduciary rule: Tech and efficiency," INVESTMENTNEWS, April 24, 2016, http://bit.ly/23j4tvB.

financial adviser's practice.[535] According to the report's findings, advisers benefit from advanced technology integration in a number of ways. For example, financial advisers utilizing advanced technology integration allocate more time to client investment management than their peers with basic or no integration -- an increase of 19 percent for independent registered investment advisers (RIAs), 28 percent for independent broker-dealer practices, and 62 percent for bank/trust advisers. That can help to deepen the relationship with existing clients or increase the practice's client and asset base. They found, for example, that independent RIAs with advanced technology integration generate around 50 percent more financial plans and investment proposals than their peers that don't benefit from advanced integration. This increased advice activity translates into a greater number of clients served by the practices (57 percent more), larger books of business (78 percent larger), and greater practice revenue/production (46 percent greater). Independent broker-dealers benefiting from advanced technology integration dedicate an additional 11 percent of their time to client investment management and serve a greater number of clients (44 percent greater), according to the study, enabling them to double their books of business, and increase practice revenue/production by 73 percent, compared to their peers that do not have advanced technology integration.

Others who have explored the issue have reached similar conclusions about the benefits of incorporating technology into advisory practices. According to research by Fidelity, for example, overall so-called e-advisers -- those who have embraced technology -- have 42 percent higher assets under management than those who have not embraced technology, 34 percent higher assets under management per client, and earn 23 percent more.[536] Similarly, survey research conducted by eMoney Advisor finds that advisers who have integrated technology within their businesses typically achieve a 20 percent higher income, spent 32 percent less time on operational processes and 29 percent more time on client management as well as serving 15 percent more clients overall.[537] In addition, according to survey research of eMoney Advisor's clients: 93 percent of advisers say that eMoney's tools have helped them grow their business; 79 percent of advisers reported a 10-40 percent growth in revenue and profits with eMoney; 83 percent of advisers polled indicated that eMoney has helped increase prospecting and new business generation; 87 percent of users cited that eMoney has helped reduce business costs.[538]

A study by InvestmentNews Research in collaboration with SS&C Advent similarly found that financial advisory firms that invest strategically in technology, and make the most use of it, tend to outperform other firms significantly on a number of financial and productivity measures.[539] It found that tech-focused firms achieve 25 percent more assets per professional, 18 percent more revenue per professional, and 45 percent more profit per professional than non-tech-focused firms. The study also measured productivity per professional, finding that

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[535] Aite Group, Technology Integration Turbocharges Advisor Productivity: Making Time for Clients, commissioned by Envestnet, September 2016, http://bit.ly/2prj38b; *See also* James Lumberg, *Advisers must seize opportunity to deliver best-interest advice to clients*, InvestmentNews, April 3, 2017, http://bit.ly/2nSOHhY.

[536] Ian McKenna, Stunned, amazed and in awe - a day of exceptional revelations at T3, DIGITAL WEALTH INSIGHTS.COM, February 17, 2017, http://bit.ly/2kwjBeh.

[537] *Id*.

[538] eMoneyAdvisor website, http://www.emoneyadvisor.com/.

[539] SS&C Advent and InvestmentNews Research, Elevating the Client Experience: Leveraging Technology to Drive Profitability, Scale, and Growth, 2016, http://bit.ly/2nSRoQG.

tech-focused advisers managed 113 relations versus 69 for the study participants who weren't tech-focused, a massive 64 percent improvement. Putting this figure in perspective, the study concluded that technology use is adding 25 extra adviser hours for every 40-hour work week, or three full extra days per week, and that advisers who haven't invested in technology to support their interactions with clients on average can't manage the same number of clients effectively.

Among financial services firms, broker-dealer and insurance industries have apparently been particularly resistant to technology. To the extent that the rule forces these firms to adapt to the modern marketplace, that transformation has the potential to benefit their business significantly by making them more efficient, helping to alleviate any reduction in revenue that results from a shift away from sale of high-cost investment. By taking advantage of technology, they could focus more of their time on the the aspects of the adviser-client relationship where they can add value, to the benefit of both the adviser and their customers.

XII. Harms from Conflicted Advice Will Persist Without the Rule

In its request for comment, the Department asks whether "if the rule were rescinded, the regulated community, or a subset of it, would continue to abide by the rule's standards." Certainly, there are those who have suggested that firms have gone so far in adapting to comply with the rule that its benefits can be realized regardless of the ultimate fate of the rule itself.[540] In part, this reflects wishful thinking among those who poured their heart and soul into getting the rule adopted and hope that effort will not prove to have been in vain.[541] In part, it reflects an attempt by groups like ours to remind industry rule opponents that there's likely to be a price to be paid in the market if they succeed in rolling back the fiduciary rule. After all, it is certainly true that investors today are more aware of the importance of hiring a fiduciary adviser than they were before the Department launched its rulemaking.[542] And groups like ours will unquestionably undertake efforts to build on that awareness if the rule is eventually overturned. If it is watered down to allow conflicted advisers to retain their conflicts or evade legal accountability, we will adjust our messaging accordingly to sell investors on the importance of avoiding conflicted "advisers" rather than simply focusing on the need to hire a fiduciary. And by arguing in court that they are salespeople "merely selling a product" while marketing themselves as trusted advisers, financial firms seem to have set themselves up for deceptive trade practices claims to be brought against them. The Department should include the risk that such claims would be brought, including potentially through class action litigation, in its assessment of the costs of a decision to revoke or water down the rule.

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[540] See, e.g., Peter Scheve, "DOL Fiduciary Standard ─ We Have Crossed the Rubicon," Accenture Capital Markets Blog, Feb. 7, 2017 https://accntu.re/2nTfSW1 ("Make no mistake: if the ruling is repealed, potential legal hazards to the industry could diminish. If this occurs, the shift to low fee products as well as more transparency and investor protection could persist. The rulemaking and thought process behind it have gone too far to walk it back. It crossed the Rubicon.")

[541] Nick Thornton, *No matter its fate, fiduciary rule will define Labor, EBSA legacy*, BENEFITS PRO, Jan. 20, 2017, http://bit.ly/2oKxqHW.

[542] Anne Tergesen, *The 'F-Word' Never Sounded So Sweet*, WALL STREET JOURNAL, Dec. 13, 2016, http://on.wsj.com/2oh9uuq.

But experience has taught us the limitations of remedies that depend on investor education for their effectiveness. The more sophisticated investors will get the message and protect their interests by choosing a fiduciary adviser, just as they do today. But, absent a legally enforceable fiduciary duty, the least sophisticated investors -- those who are most in need of fiduciary advice -- will continue to be duped into following the recommendations of slick salespeople masquerading as advisers in order to sell high-cost investments that are profitable for the seller but harmful to the financial well-being of the trusting investor. Relying on financial firms to give up practices that have proven so profitable in the past is hopelessly naive. While some may buck the trend and embrace a fiduciary standard, it is impossible to predict how many would stick with this course. After all, financial firms haven't directed their lobbyists to spend millions to try to kill this rule in court, in Congress, and through the regulatory process just to turn around and voluntarily adopt the key changes that are central to the rule's effectiveness, particularly with regard to elimination of conflicts. And new products that are being brought to market to ease compliance with the rule, in part by reducing high fees, are unlikely to be broadly embraced by firms absent a requirement to minimize conflicts. Only those changes that are either revenue neutral or where there is a benefit to firms' bottom line, like moving investors into fee accounts, are likely to be retained in the absence of the rule. And, without the rule, provisions designed to discipline excess costs will be sorely missed.

Indeed, we have already seen evidence of backsliding after plans to delay the rule were announced. In a March letter to customers, for example, J.P. Morgan noted that any delay in the implementation of the rule would put a hold on a planned shift to fee accounts.[543] A group of analysts with Keefe, Bruyette & Woods cited that move as one indication of how a delay in the rule "telegraphs a potential strategic change if the rule is watered-down or scrapped, in our view."[544] In keeping with that assessment, UBS Chief Financial Officer Kirt Garder indicated in a recent earnings call that the firm is in "a wait-and-see mode. Because of that, we actually delayed our announcement of our approach to the DOL, and I think that's proved to be fairly effective, given the commitment that some of our competitors have made."[545] And firms that have planned to implement the rule using T shares recently reported that the release of the proposal to delay the rule had disrupted efforts to roll out the new share class.[546] The *Journal* reported that "brokerages that were going to offer the new shares are being forced to re-evaluate their plans as fund companies halt their efforts to develop them."[547]

This evidence of backsliding in response to the Presidential Memorandum supports the conclusion the Department reached that strict limits on conflicts were necessary to encourage best interest advice and that a strong enforcement mechanism was needed to buttress these reforms. Inclusion of the specific requirements of the Impartial Conduct Standards, including the limits on harmful incentives, was "critical" to the Secretary of Labor's ability to make the required findings that the BIC was "in the interests of plans, participants, beneficiaries, and

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543 Janet Levaux, *DOL Delay Leads to Some Regrouping at BDs*, THINKADVISOR, April 3, 2017, http://bit.ly/2ob0s1T.
544 *Id*.
545 UBS Group's (UBS) CEO Sergio Ermotti on Q4 2016 Results - Earnings Call Transcript, SEEKING ALPHA, Feb. 1, 2017 http://bit.ly/2okJ1J3.
546 Michael Wursthorn and Sarah Krouse, *New Class of Mutual Fund Shares in Limbo as 'Fiduciary' Rule Is Delayed*, WALL STREET JOURNAL, March 5, 2017 http://on.wsj.com/2mUDBaL.
547 *Id*.

IRA owners and protective of their interests," according to the RIA.[548] In analyzing alternative approaches to a "best interest" standard proposed by opponents of the rule, the Department stated, for example, "the Department does not believe that these alternatives will adequately protect retirement investors, particularly those in the IRA market, from harmful conflicts of interest, or that financial institutions and their advisers will be properly incentivized to comply with a best interest standard, if there is no enforceable mechanism for retirement investors to enforce adherence to that standard or to obtain redress when they've been injured by violation of the standards. From the perspective of retirement investors, a right without a remedy is scarcely a right at all."[549] Yet these are the provisions of the rule most likely to be lost if it were rescinded or revised.

The result of the SEC's mid-1990s experiment with reining in conflicts of interest offers support for this view -- and a cautionary warning to those who, despite the evidence, hold on to the belief that the benefits of the rule will be retained even if the rule itself is watered down or rescinded. In a report that was broadly embraced by industry groups, the Tully Commission identified a series of "best practices" around compensation that firms were encouraged to adopt in order to better align the interests of customers, registered representatives, and brokerage firms.[550] Among the suggested reforms were elimination of up-front signing bonuses, sales contests, and differential compensation to push the sale of certain products, including proprietary mutual funds.

A few years later, the *Wall Street Journal* was reporting that relying on firms to police themselves had been a failure.[551] "Initially, some firms cut back. More recently, however, intense competitive pressures to build client assets have led PaineWebber, Salomon Smith Barney, Prudential Securities and even Merrill to ratchet up efforts to pay upfront bonuses and provide other perks to brokers," the paper reported. "At Morgan Stanley Dean Witter, some brokers say they are under constant pressure to sell in-house, or 'proprietary,' mutual funds, despite past assurances by Dean Witter and other firms that they would abide by the Tully Commission's recommendations in this area." The *Journal* added that Chairman Levitt, "once a leading proponent of self-regulation," had concluded that rulemaking was likely to be necessary to achieve the desired results and supported a rule to ban sales contests based on single securities.

Nearly two decades later, signing bonuses that create major conflicts of interest remain an issue, firms still impose quotas to encourage the sale of proprietary products, and sales contests are a common feature in the insurance segment of the market. In the wake of the Tully Commission experience, Kurt Cerulli, founder of financial consulting firm Cerulli Associates, explained backsliding among firms this way: "Marketplace forces are stronger than self-regulatory forces … I think the Tully Commission has been almost irrelevant."[552] If changes that industry largely embraces prove transitory in the face of market forces, how much more likely is that to be the case for changes that industry has been willing to spend millions to

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[548] RIA at 289.
[549] *Id*.
[550] Tully Commission Report
[551] Charles Gasparino and Pui-Wing Tam, *Wall Street Seems to Backslide On Pay and Bonus Practices*, WALL STREET JOURNAL, March 28, 2000, http://on.wsj.com/2nOBTHK.
[552] *Id*.

oppose? The Department cannot reasonably assume there will be wide adoption of fiduciary practices if the rule is rescinded or weakened.

The inescapable fact is that conflicted advice may be a bad deal for investors, but it is hugely profitable for financial firms. It took a herculean effort on the part of the Department to adopt a rule to rein in those practices. Industry has been successful at fending off similar efforts at the SEC for decades. And they have shown that there is no limit to the money they are willing to spend to overturn this regulation. In light of the vehemence of those efforts, the Department cannot reasonably assume that investors will receive the benefits of the rule, or even a significant portion of those benefits, if it is ultimately rescinded or watered down. On the contrary, all the evidence suggests that it will require tough enforcement and the threat of legal accountability to ensure that the rule delivers on its promise to reduce conflicts and improve the quality of retirement investment advice.

XIII. Conclusion

The Administration has identified as priorities: 1) empowering Americans to make their own financial decisions and 2) facilitating 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. These are commendable priorities that CFA shares, and they are appropriate principles against which to measure the fiduciary rule. A fair and open-minded evaluation of the rule will certainly show that, not only is the rule consistent with these principles, it is essential to their achievement.

The rule supports the goal of facilitating Americans' ability to save for retirement by ensuring that the advice they receive is designed to serve their best interests and isn't unduly influenced by conflicts of interest. When investors get best interest advice, more of their money will actually go toward retirement savings, instead of being siphoned off to line the pockets of financial professionals. Importantly, the rule will help to ensure that investors who prefer to pay for advice through commissions will get advice, and not just a sales pitch dressed up as advice. And it will help workers indirectly by making sure their employers get fiduciary advice when they set up workplace retirement plans. Without the rule, the conflicts that bias retirement advice will go unabated, and Americans' ability to save for retirement will be placed at unnecessary risk.

Indeed, if it is truly committed to improving Americans' ability to save for retirement, the Administration should be looking to expand on the reforms in the rule, not roll them back. And it should be looking to ensure tough enforcement of the rule, not weaken the compliance incentive provided by the availability of class action litigation to remedy systemic violations. The reason for that is simple: financial services firms have over the years demonstrated an infinite capacity to exploit loopholes, evade regulations, and game the system in order to preserve their ability to profit at customers' expense. Even before the rule has been fully implemented, articles are already being written describing how some financial "advisers" are finding workarounds that enable them to keep peddling high-cost products and services to vulnerable investors.

One recent article describes how firms that are developing lower cost investments for use in retirement accounts are still "loading the non-qualified parts of their clients' account portfolios … with high-fee and high-cost investment vehicles, because those accounts aren't covered by the fiduciary rule."[553] The writer, himself an investment adviser, describes how some firms are moving as much money as possible into variable annuities outside the retirement account in "an attempt to put as much of the assets under management into the highest expense vehicle possible." Some advisers are charging sky-high wrap fees inside retirement accounts, which may comply with the letter of the fiduciary rule, depending on how you interpret the reasonable fee requirement, but certainly doesn't comply with its spirit. Others have recommended low-cost mutual fund shares inside the retirement accounts but C shares outside those accounts. Noting that C shares typically have higher expenses than other alternatives, he concludes that "it's pretty obvious that these 'advisers' are complying with the intent of the DOL's version of the fiduciary rule when required to do so, and doing the exact opposite inside the non-qualified accounts. Because, frankly, they can."

This dispiriting account demonstrates not that the rules have "backfired," as the headline suggests, but that conflicts of interest in the financial services industry are insidious and harmful. It demonstrates, moreover, that serious, comprehensive action will be needed if firms are finally to be forced to act in their customers' best interests. Many firms and advisers certainly won't do so voluntarily, without the goad of the rule. In short, the real message of this article, and others like it, is that further action is needed to cement the reforms promised by the rule.

- First, the Department must do everything in its power to ensure that the rule is effectively enforced, including by preserving the strong incentive for compliance that legal exposure provides. As we discussed above, the liability threat in this rule is not excessive. There is far less risk that it will result in frivolous or meritless litigation than there is that, absent that legal accountability, conflicted advisers will flout the requirement to act in customers' best interests and instead continue to engage in practices that allow them to profit at customers' expense.
- Second, the Administration should look to extend the protections in the DOL's fiduciary rule to non-retirement accounts through rulemaking at the SEC, and it should use its bully pulpit to encourage state insurance departments to do the same. As we have discussed at length elsewhere, an SEC rule is not broader than the DOL rule or otherwise superior to the DOL rule (since, among other shortcomings, it doesn't yet exist and wouldn't apply to advice about non-securities or advice to retirement plans). But it is a necessary supplement to the DOL rule. The Trump Administration could greatly benefit retirement and non-retirement investors alike if it would motivate the SEC to finally act to address the harmful effects of conflicts of interest it has been talking about to little effect for more than two decades.

If the Administration were to take these two actions, it would advance its priorities of helping Americans save and build wealth. It could then honestly proclaim that it had stood up to special

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[553] Mike Haffling, *Hidden Fees Show How Investor Protections Can Backfire*, KIPLINGER, April 2017, http://bit.ly/2oxJJa6.

interests and made Washington work for the forgotten man and woman. That would be no small accomplishment.

Respectfully submitted,

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