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August 7, 2017

VIA Email to: EBSA.FiduciaryRuleExamination@dol.gov

Mr. Brian Shiker
Office of Exemption Determination, EBSA (Attn: D-11933)
US Department of Labor
200 Constitution Ave, NW, Ste 400
Washington, DC 20210

Re: RIN 1210-AB82

Dear Mr. Shiker:

ADISA (the Alternative & Direct Investment Securities Association)[1] appreciates the opportunity to respond to Department of Labor's (the Department) Request for Information Regarding the Fiduciary Rule and Prohibited Transaction Exemptions (collectively, the Fiduciary Rule), issued on July 6, 2017 (the RFI).

Among the many organizations that represent the financial services industry, ADISA seeks to express the views of and address concerns raised by those firms operating in the non-traded investment (i.e., direct participation program), arena. Speaking on behalf of our numerous members, which include program sponsors, broker-dealers, investment advisers and other industry participants, ADISA shares the overall concerns raised by the financial services industry at large regarding the Fiduciary Rule. ADISA has provided its perspective and input on the Fiduciary Rule in previous comment letters (July 2015, September 2015, and March 2017) as well as while appearing before the Department in August 2015 and the Office of Management and Budget in March 2016. As in previous submissions regarding the Fiduciary Rule, we focus here on those aspects which uniquely impact our subset of the space.

<u>Data relied Upon by the Department</u>.

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[1] ADISA is the nation's largest trade association for the non-traded alternative investment space. ADISA represents over 4,000 financial industry members, reaching over 220,000 finance professionals, with sponsor members having raised in excess of $200 billion in equity in serving more than 1 million investors. ADISA is a non-profit organization (IRC 501c6) with the ability to lobby and also has a related 501c3 charitable non-profit (ADISA Foundation) assisting with scholarships and educational efforts.

The RFI seeks, among other things, data that augments or expands upon the information previously provided to or identified by the Department in its drafting and adoption of the Fiduciary Rule. We note in this regard that the Department's more recent approach to the Fiduciary Rule was founded on data – in particular, the 2015 White House Council of Economic Advisers report on "conflicted" investment advice.[2] From that report came an estimate, much used during the Department's rulemaking efforts, that investors paid an annual "cost" of approximately $17 billion for so-called "conflicted" investment advice – to wit, advice that involved compensation elements that varied by the product recommended or the advice given. This $17 billion estimate was derived merely by reference to the statement that individual retirement account assets totaled roughly $1.7 trillion, and the CEA's belief, based on somewhat outdated research that purported to show that broker-sold (i.e., "load") funds underperformed so-called "no-load" funds by 1% per year. The CEA effectively concluded that the ability of advisers to retirement savers to choose or recommend load fund options for their clients therefore cost their clients roughly $17 billion annually in "lost" returns (or, as the CEA understood it), excessive costs (i.e., 1% of $1.7 trillion was being "lost" each year by retirement savers subject to so-called "conflicted" advice and the recommendations that presumably resulted from that model). In other words, the CEA – and thereafter the Department –embraced the concept that the availability of purportedly lower performing "load" funds caused retirement saver to lose $17 billion per annum. (For example, the report stated the following : the "average IRA rollover for individuals 55 to 64 in 2012 was more than $100,000; losing 12 percent from conflicted advice has the same effect on feasible future withdrawals as if $12,000 were lost in the transfer.")[3]

There have been many refutations of the CEA's (and the Department's) assumption that $17 billion in "losses" occurs each year because of the ability of advisers to retirement savers to recommend load funds over no-load funds. At bottom, the CEA did not look at whether the funds owned in retirement accounts in fact underperformed other available fund options, but merely extrapolated asserted "underperformance" from related (but not necessarily fully validated) research and concluded that such alleged underperformance was therefore felt across the entire spectrum of retirement savers using individual retirement accounts. The original estimate failed to asset-weigh the historical performance of the funds involved in the analysis - in other words, it was not based on what retirement savers invested in, but instead calculated theoretical "losses" derived from an overly simplistic comparison of the relative performance of load and no-load funds over a specific period. Perhaps more importantly, moreover, there were adjustments to the data set used in the research relied upon by the CEA. Professor Jon Reuter, author of one of the original studies used by the CEA, revised the estimated loss figure from 1% to 0.18%,[4] a difference which, if utilized in the CEA's overly simplistic approach, would eliminate roughly $14 billion from the CEA's original $17 billion annual loss estimate.

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[2] The (Obama) White House Council of Economic Advisers, *The Effects of Conflicted Investment Advice on Retirement Savings,* https://obamawhitehouse.archives.gov/blog/2015/02/23/effects-conflicted-investment-advice-retirement-savings , February 23, 2015.
[3] Ibid.
[4] Reuter, J. *Revisiting the performance of Broker-sold Mutual Funds*, Boston College; National Bureau of Economic Research, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2685375 November 2, 2015.

(Professor Craig Lewis, currently at Vanderbilt University and the SEC's former chief economist, points this out in questioning the original data assumption published by Forbes.)[5]

We mention this about the CEA's original data premise because it is important to consider costs and investor experience (i.e., results), in a broader context, one in which the impact of accessing and using financial advice is taken into account. In any search for what is best for retirement savers and other investors in the aggregate, it is necessary to look at and discern real effects based on actual behavior, and to understand whether a given approach will likely enhance the result for retirement savers and investors generally. Behavioral finance research tells us that investors are interested in the bottom line results, not in how fees are configured. An emphasis on bottom line, results-driven data over easy-to-apply labels (e.g., "conflicted advice"), helps ensure that undue speculation or extrapolation does not unfairly or inappropriately impact any conclusions drawn.

Given the Department's acknowledged aim in its Fiduciary Rule initiative to reduce or eliminate the purported impact of "conflicted advice," it is important to see and understand the impact of the Fiduciary Rule on the availability of investment advice to retirement savers. The Fiduciary Rule as adopted by the Department clearly and unquestionably imposes costs on advisers serving the retirement saver market, and justifies those costs (whether calculated correctly or otherwise), by reference to the asserted "losses" (as discussed above), attributable to so-called "conflicted advice." Looked at another way, and as borne out by newly obtained data, however, the Fiduciary Rule creates a significant and costly burden on one avenue by which retirement savers obtain investment advice – i.e., broker-dealers who employ a commission-based or "variable compensation" business model – which burden will necessarily impact the ability of that advice channel to provide advice to retirement savers. ADISA believes that the Department should take a closer look at the strong likelihood, borne out by data discussed below, that retirement savers will enjoy less access to investment advice as a direct result of the Fiduciary Rule's implementation, and re-visit whether the burden imposed by this important restriction is in fact likely to outweigh any purported "savings" (avoidance of losses), brought about by the Fiduciary Rule's provisions regarding "conflicted advice."

We start by re-visiting the idea that financial advice is important to all investors, no matter their relative wealth or amount invested. Data-based studies bear out the importance of financial advice to the results achieved by investors generally, including retirement savers:

- Small businesses that work with a financial advisor are 50% more likely to set up a retirement plan (and micro business with 1-9 employees are almost twice as likely.[6]

- Advised individuals, segmented by age and income, have at least 25% more assets than non-advised individuals.[7]

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[5] Lewis, C. *An Inflated $17 Billion Talking Point from the DOL,* Forbes Opinion, https://www.forbes.com/sites/realspin/2015/12/16/an-inflated-17-billion-talking-point-from-the-dol/#4be735782831 December 16, 2015.

[6] Oliver Wyman, *The Role of financial advisors in the US Retirement Market*, July 2015, http://dol.gov/ebsa/pdf/1210-AB32-2-00515.pdf

[7] Ibid. (based on Equifax data)

- For individuals aged 65 and older with less than $100,000 in annual income, advised individuals have on average 113% more assets than non-advised investors.[8]

- Advised investors have more diversified portfolios – they own twice as many asset classes, have more balanced portfolio asset allocations and use more packaged products for equity exposure compared with non-advised investors.[9]

- Using vast Equifax data, it appears that during the 2008 recession and afterwards, the ratio of advised to non-advised IRA assets in accounts for those savers making more than $100k per year grew by over 20% -- a possible indication of the increasing value of investment advice as the investing climate becomes more difficult to navigate.[10]

- Advised individuals are more likely to be diversified among a range of products across all ages and income levels. This is especially true for younger and smaller level advisors.[11]

- Households that use a financial advisor are twice as likely as non-advised households to have $100,000 or more in retirement savings, and three times as likely to have a retirement nest egg greater than $250,000.[12]

- People who engage a financial advisor are more likely to contribute at least 10% to their employer provided plan (a commonly recommended savings rate). This is much higher than the average default contribution rate of 3.4% that unadvised individuals make with automatic enrollment.[13]

We also note that the experience of the U.K. in relation to a regulatory initiative undertaken there with many similarities to the Fiduciary Rule – the so-called "RDR." According to data-based studies published in the wake of that regulatory regime's implementation, a bar or limitation on the use of commission-based business models for investment advice diminishes the use of investment advice by savers and investors generally, and particularly by lower income individuals. Importantly, studies done in the UK show that only 19% of individuals currently saving would be willing to pay out-of-pocket for financial advice.[14]

While studies done in academia as well as those sponsored by various industry groups show that advice is important overall, it appears to be even more important for those retirement savers who wish to diversify their portfolios using alternative (or direct participation) investment products.

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[8] Ibid.

[9] Oliver Wyman, *The Role of financial advisors in the US Retirement Market*, July 2015, http://dol.gov/ebsa/pdf/1210-AB32-2-00515.pdf

[10] Ibid

[11] Ibid.

[12] LIMRA, *Matters of Fact: Consumers, Advisors, and Retirement Decisions (and Results),* May 2015, http://www.limra.com/uploadedfiles/limra.com/LIMRA_Root/Posts/PR/_Media/PDFs/Facts-about-retirement-decisions.pdf

[13] Ibid.

[14] Clare, A. Thomas,S. Walgama, O. and Makris C., *The impact of the RDR on the UK's market for financial advice,* Cass Business School, City University of London, 2013.

Many alternative products are available only through advisors, so that curtailment of advice would be particularly detrimental. The value of non-traded and non-correlated assets came to the forefront with the stability of endowments during the 2008 recession, where the diversified endowment model proved vastly superior to the S & P 500.[15] Specific to the alternative space, the following data are collected:

- 78% of "millennials" and 70% of "Gen X" savers endorse using alternatives compared with only 58% of "baby boomers."[16]

- Investors are much more likely to use alternatives if using an advisor - 3% of investors were confident or very confident in using alternatives, while 67.9% of advisors were confident or very confident in using alternatives.[17]

- In the 10-year period from 1999-2009, the generic "balanced" (i.e., 60% equity/40% bond) portfolio after fees returned zero percent (0%), while the Yale, Harvard, and Stanford portfolios with alternatives generated returns ranging from 135% to 198% in total.[18]

Given the need for lower balance retirement savers to diversify their portfolios against market risk, the curtailment of financial advice could prove costly. It is impossible to predict how costly, of course, since one cannot foresee the occurrence and extent of a market decline. Judging from the decline of 2008, however, a lack of diversification into alternative, generally non-correlating assets can lead to significant losses (and/or missed opportunity costs). The assistance of a financial advisor not only in obtaining non-correlated products but in assessing the investor's overall portfolio needs remains paramount in helping all retirement savers; a regimen that will necessarily reduce the availability of advice to such savers, particularly low balance savers, seems completely at odds with their best interests.

<u>New data from Harper Polling</u>

To better ascertain what financial advisors are experiencing currently with their practices and with investors, the Financial Services Roundtable commissioned a research project in July of 2017 to evaluate the opinions of advisors nationwide; ADISA assisted with this effort. From a universe of over 50,000 registered financial advisors, a representative sample was drawn to yield statistically valid (MOE ±4%) data on the current behavior and opinions of the advice sector involved with retirement savings. The results, to be published shortly, indicate the following for those advising investors:

- They foresee three main changes associated with the implementation of the Fiduciary Rule:

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[15] Reuters, "University Endowments Beat S & P 500 last Year," December 10, 2009 (cited in Wildemuth, D. *Wise Money: How the Smart Money Invests*, McGraw Hill, 2012).
[16] Natixis Global Asset Management Survey, http://durableportfolios.com 2014.
[17] Financial Planners Association, and Real Estate Investment Securities Association (precursor to ADISA), *Alternative Investment Report*, 2011.
[18] Wildemuth, D. *Wise money: How the Smart Money Invests*. McGraw Hill, 2012, pp. 64-65.

    - Increased paperwork (72%)
    - Taking on fewer small accounts (62%)
    - Limiting the investment products offered (54%)

- As of July 2017, as the Rule went into effect, more than 9% of advisors indicated that they are already seeing increased paperwork and a reduction of types of investment product offered.
    - Advisors working for larger firms are more likely to say that the Fiduciary Rule will limit the investment products they offer.

- The overwhelming majority of advisors (81%) "always" discuss how the investment products relate to their own compensation. 27% of advisors say that investors ask on occasion.
- Many advisors (47%), note that higher compliance costs in the form of additional fees may be passed on to clients.

In examining the preliminary FSR data, we saw no significant demographic differences among regions or self-reported ethnic groups or gender. It appears, moreover, that the lower end of the saver spectrum, measured by portfolio size, will soon experience higher fees, according to the advisor responses.

C <u>Summary of Situation</u>

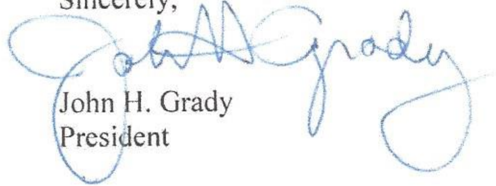
The data explored above show that investors may well experience higher fees, face fewer investment options and more limited investment advice as a result of the Fiduciary Rule. This is unfortunate. It appears to us, as we have stated previously, that the Fiduciary Rule is ultimately meant to limit the advice model that is built on variable (e.g., commissionable), product. This is a difficult result to understand, and is neither justified by the Department nor even well explained in its discussion of the Rule's intended effects. In a variable compensation model, those having larger portfolios pay progressively more, and those having smaller portfolios pay less. If the move toward a fee-only structure is the approach that the Department is insistent upon supporting, then the smaller portfolio investor ends up either paying more for advice or receiving no advice at all if the model is withdrawn from that part of the market. As appears to have been the case in the UK, eliminating or substantially burdening the variable compensation model effectively eliminates the ability of smaller investors to effectively maximize the value of his or her retirement savings.

ADISA believes in appropriate regulation for all of our members and their various activities, including those who handle retirement investors. Our overriding goal is to ensure that the cost imposed by a regulation is matched or exceeded by the benefit produced thereby. We see increasing evidence of the detriments for retirement savers imposed by the Fiduciary Rule, especially for the community of smaller savers and the firms that currently serve them. If and to the extent that the sale and distribution of "alternative" (i.e., non-correlated) investment programs and products becomes more difficult, the ability for the current and next generation savers to invest wisely with diversified product decreases, putting savings and returns at greater risk. We call upon the Department to do its best to consider the whole gamut of factors involved

in the retirement savings world to ensure a thriving marketplace for those savers, consistent with investor protection and appropriate compliance and oversight.

We appreciate the work that the Department carries out, and we stand ready to assist in any way we can. We would be happy to discuss our comments in person or by phone at your convenience.

Sincerely,



John H. Grady
President

cc: Catherine Bowman, ADISA Legislative & Regulatory Committee Chair