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Filed Electronically: e-ORI@dol.gov

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

Re: RIN 1210-AB32: Regulatory Impact Analysis, Definition of the Term "Fiduciary"; Conflict of Interest Rule—Retirement Investment Advice

Dear Sir or Madam:

The Investment Company Institute[1] appreciates the opportunity to comment on the Department of Labor's (the "Department") Regulatory Impact Analysis (the "RIA")[2] supporting the Department's proposed regulation defining who is a fiduciary of an employee benefit plan under the Employee Retirement Income Security Act of 1974 ("ERISA") or an individual retirement account ("IRA") under section 4975 of the Internal Revenue Code of 1986 ("Code"), as a result of giving investment advice to a plan or its participants or beneficiaries, or an IRA or IRA owner (the "Proposed Fiduciary Rule").[3] If adopted, the Proposed Fiduciary Rule would result in persons who provide services

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

[2] U.S. Department of Labor, Employee Benefits Security Administration, *Fiduciary Investment Advice Regulatory Impact Analysis* (April 14, 2015), available at www.Department.gov/ebsa/pdf/conflictsofinterestria.pdf.

[3] Notice of Proposed Rulemaking—Definition of the Term "Fiduciary"; Conflict of Interest Rule—Retirement Investment Advice, 80 Fed. Reg. 21928 (April 20, 2015) ("Fiduciary Rule Notice"). The Institute has provided comments on the Proposed Fiduciary Rule and proposed Best Interest Contract Exemption ("BIC Exemption") respectively, in separate letters from David Blass and David Abbey. As explained in detail in those letters, the effect of the Proposed Fiduciary Rule will be that all common educational, marketing, and sales interactions with a retirement investor—whether an existing client or prospect—that involve a discussion of investments or investment strategies will be deemed a fiduciary service

to Retirement Investors being fiduciaries under ERISA and the Code "in a wider array of advice relationships than the existing ERISA and Code regulation."[4]

The expanded fiduciary definition proposed by the Department will significantly affect American workers' ability to obtain the guidance, products and services they need to adequately prepare for their retirements through retirement plans and IRAs. This impact heightens the importance of a comprehensive and sound regulatory impact analysis of the Proposed Fiduciary Rule. The analysis must clearly justify any restrictions on future access to guidance, products, and services resulting from the Department's rule. The analysis must examine whether an expanded fiduciary definition is needed to solve a clearly identified market failure and must identify and analyze less burdensome alternatives for remedying that problem.

In this letter, we address the question of whether the RIA provides sufficient justification for the Department's proposal. As an organization with established research capabilities,[5] the Institute is in a unique position to evaluate the RIA. As discussed in detail below, we firmly believe that the RIA is not sound and does not support adoption of the Proposed Fiduciary Rule.

In evaluating the RIA, we have considered the specific requirements of Executive Order 12866 applicable to a "significant" regulatory action.[6] Among other requirements, Executive Order 12866

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subject to ERISA's prescriptive prohibited transaction rules. Therefore, continued access to even basic investment assistance and information for employee benefit plans, plan fiduciaries, plan participants or beneficiaries, IRAs, or IRA owners (collectively "Retirement Investors") will be dependent on the availability of the Department's proposed BIC Exemption. *See* Notice of Proposed Best Interest Contract Exemption, 80 Fed. Reg. 21960 (April 20, 2015). While the Institute supports the principle at the heart of the Department's proposal—that financial advisers should act in the best interests of their clients when they offer investment advice—we believe that the conditions to which advice providers are subject under the BIC Exemption essentially present a series of compliance traps and barriers for financial advice professionals and their firms, making the BIC Exemption unusable in its current form.

[4] Fiduciary Rule Notice, 80 Fed. Reg. 21928.

[5] The Institute serves as a source for statistical data on the investment company industry and conducts public policy research on fund industry trends, shareholder characteristics, the industry's role in U.S. and international financial markets, and the retirement market. For example, the Institute publishes reports focusing on the overall U.S. retirement market, fees and expenses, and the behavior of defined contribution plan participants and IRA investors. In its research on mutual fund investors, IRA owners, and 401(k) plan participants, the Institute conducts periodic household surveys that connect directly with investors.

[6] The Department states in the preamble to the Proposed Fiduciary Rule that the Office of Management and Budget has determined that the proposed rule is economically significant within the meaning of section 3(f)(1) of Executive Order 12866, because it likely would have an effect on the economy of $100 million in at least one year. *See* Fiduciary Rule Notice at 21951. Executive Order 12866 (*see* 58 Fed. Reg. 51735 (October 4, 1993)), as reaffirmed by the Administration in January 2011, pursuant to Executive Order 13563 (*see* 76 Fed. Reg. 3821 (January 21, 2011)), is well understood to govern

requires the regulatory agency to identify the problem that it intends to address in a "significant" regulatory action (including, where applicable, the failures of private markets or public institutions that warrant new agency action), and to assess the significance of the problem.[7]

The RIA does not meet this test. It does not demonstrate the Department's assertion that there is a "substantial failure of the market for retirement advice."[8] It also does not fully consider how the proposal actually could limit retirement savers' access to guidance, products, and services, or how such limits could affect savers—particularly lower- and middle-income savers with smaller account balances. In short, we question the validity of the RIA, and we further question whether the Department has, in issuing the Proposed Fiduciary Rule, acted in a manner that is consistent with the requirements of Executive Order 12866.

One key example illustrates the point. The Department bases much of the RIA on its supposition that funds sold through a broker ("broker-sold funds") "underperform," "possibly due to loads that are taken off the top and/or poor timing of broker sold investments."[9] It contends that such underperformance could cost IRA mutual fund investors "$430 billion over 10 years and nearly $1 trillion across the next 20 years."[10]

As we discuss in more detail below, the RIA does not provide an adequate basis for the supposition that broker-sold funds in fact do "underperform." The RIA also ignores how the Department's proposal, if adopted, could actually have a significant net societal harm. The Best Interest Contract Exemption ("BIC Exemption"), as drafted, could increase the cost of advice and service, reduce access to such advice, and create significant transaction costs that increase barriers to investors wishing to move from one financial adviser or asset manager to another—further harming investors.

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the rulemaking process. Executive Order 12866 provides that Federal agencies should promulgate only such regulations as are required by law, are necessary to interpret the law, or are made necessary by compelling public need.

[7] As the Proposed Fiduciary Rule is a "significant" regulatory action, the Department also is required to include, within its RIA: (i) an assessment, including the underlying analysis, of the benefits anticipated from the regulatory action; (ii) an assessment, including the underlying analysis, of the costs anticipated from the regulatory action; and (iii) an assessment, including the underlying analysis, of costs and benefits of potentially effective and reasonably feasible alternatives to the planned regulation, and an explanation why the planned regulatory action is preferable to the identified potential alternatives. *See* Executive Order 12866, section 6(a)(3)(C).

[8] RIA at 7.

[9] *Id.* at 98.

[10] *Id.*

In our other letters commenting on the Proposed Fiduciary Rule and the proposed BIC Exemption, we provide suggestions for reducing or eliminating much of the harm the proposed rules would create. In short, we make reasonable suggestions for amendments to those rules to make them workable in line with our understanding of the Department's goals.

In this letter, we focus on the RIA. We begin our comments below with an executive summary (Section I). Following the executive summary, we address four areas of concern about the RIA: The Academic Studies the RIA Cites Do Not Support Its Sweeping Claims (Section II); Investors' Actual Experience with Broker-Sold Funds Contradicts the RIA's Claims (Section III); The RIA Ignores the Economic Impact of Moving Investors to Fee-Based Accounts (Section IV); and The RIA Fails to Account for the Societal Harm of Investors Losing Access to Advice and Guidance (Section V).

I. Executive Summary

This comment letter does not attempt to catalogue every shortcoming of the RIA, nor to respond in detail to each issue it raises. Rather, we highlight its four most significant deficiencies.

A. The Academic Studies the RIA Cites Do Not Support Its Sweeping Claims (Section II)

- The academic studies cited in the RIA do not directly address or measure the core question raised by the Department's proposal—whether investors would be better off using financial advisers who are fiduciaries.

- The statement in the RIA that "[a] wide body of economic evidence supports a finding that the impact of these conflicts of interest on investment outcomes is large and negative"[11] is an inaccurate characterization of the academic research.

- The academic research itself does not capture the current state of the market for mutual funds sold with front-end loads. The data used in the academic studies are out of date and no longer represent the broker markets. The research that the RIA cites relies heavily on data from the 1990s and early 2000s, a period when fund markets were highly segmented between broker-sold funds and funds that were sold without loads directly to investors ("direct-sold" or "no-load" funds). Today, most mutual funds that offer share classes that

[11] *Id.* at 7.

are sold with front-end loads now also offer no-load share classes. The two markets are no longer segmented, and broker-sold funds and direct-sold funds compete head to head.

- The academic literature focuses on individual fund performance, not on overall investor performance. This distinction is crucial. By definition, some funds will underperform their peers. A key test of whether brokers are offering conflicted advice is whether investors' assets accumulate in underperforming funds. To assess where assets are accumulating, fund returns must be weighted either by fund assets or investors' additional purchases of fund shares. Only one of the academic studies provides asset-weighted returns, and these data were drawn from the 1990s and early 2000s and no longer represent the market.

- The RIA rests heavily on a paper by Christoffersen, Evans, and Musto (2013).[12] This paper has two fundamental errors that the RIA repeats. These errors present a false impression of the sensitivity of fund flows and fund performance to the payments of front-end loads to brokers. Once these errors are corrected, the sweeping statements in the RIA about brokers' incentives and investor harm collapse.

B. Investors' Actual Experience with Broker-Sold Funds Contradicts the RIA's Claims (Section III)

- Contrary to the Department's claims, investors who own funds that are sold with front-end loads actually have concentrated their assets in funds that outperform—not underperform—their Morningstar category. These facts contradict the statements in the RIA and demonstrate that there is no "compelling public need" for "significant regulatory action."

- We analyze returns among investors in front-end load share classes from 2007 through 2013. Contrary to the RIA's claims of "underperformance," investors in front-end load share classes earned returns (net of expenses) that exceeded their Morningstar category return by 27 basis points.

- We also find that sales-weighted returns on front-end load share classes exceeded the simple average return on front-end load share classes (both returns being measured net of expenses

[12] Susan Christoffersen, Richard Evans, and David Musto. "What Do Consumers' Fund Flows Maximize? Evidence from Their Broker's Incentives." *Journal of Finance* 68 (2013): 201-235.

and Morningstar category returns)—demonstrating that, if anything, investors' purchases are concentrated in better-performing front-end load share classes. These data contradict the claim in the RIA that brokers are pushing clients to weaker-performing front-end load funds.

- Another benchmark of relative performance used in the academic literature is to compare returns using front-end load funds with investor returns on direct-sold or no-load funds. After adjusting for 12b-1 fees—fees collected through the fund's expense ratio that are paid to brokers and their firms for providing services to fund investors—we find that investors in front-end load share classes underperform investors in retail no-load share classes by only 7 to 8 basis points, a small fraction of the 100 basis point underperformance claimed in the RIA.

- The data show that investors concentrate their purchases in front-end load share classes with lower expense ratios and that pay brokers lower-than-average loads. If brokers were steering investors to share classes that pay higher loads, then we should expect sales-weighted average load to be higher than the simple-average load paid. Instead, we find that the sales-weighted average load paid to brokers is less than the simple-average load paid.

- Similarly, sales of front-end load share classes are skewed toward those with below-average expense ratios, measured as either the total expense ratio (which includes the 12b-1 fee) or the "operating expense ratio" (the total expense ratio minus the 12b-1 fee). The sales-weighted and asset-weighted operating expense ratios on front-end load share classes are even below the simple-average operating expense ratios for retail no-load share classes. These data also contradict the notion that brokers systemically are not acting in the best interests of their clients.

C. The RIA Ignores the Economic Impact of Moving Investors to Fee-Based Accounts (Section IV)

- The RIA ignores market realities and assumes brokers will continue to offer advice and services despite substantial costs and burdens of using the BIC Exemption. This is not a realistic assumption. As the Institute points out in its accompanying comment letters, the BIC Exemption is unworkable and prohibitively costly. The result will be that brokers subject to the Exemption's many proposed limitations, burdens, and costs, as well as increased exposure to liability, are likely to move their clients to fee-based accounts.

- The RIA ignores the costs that investors incur for advice and services paid for outside of broker-sold funds, resulting in an inappropriate overstatement of the benefits of the proposal. The Department focuses solely on the costs of advice and assistance paid through a fund, through an up-front sales charge and 12b-1 fees. It does not consider the costs that investors will face—for example, the costs of fee-based accounts—if they are unable to use brokerage accounts for retirement savings.

- Adding together both annualized loads (as calculated by the Department in the RIA) and 12b-1 fees, the total annual cost for the services provided by brokers and their firms to investors in front-end load share classes is about 50 basis points. A recent study by Cerulli Associates finds that fee-based accounts—the most likely alternative to brokerage accounts—cost investors 111 basis points per year on average, in addition to fund expenses.

- If the Department adopts the proposed rules without the changes we recommend in our accompanying comment letters, we estimate that retirement investors' returns could be reduced by $1.1 billion in the first year and by more than $11 billion a year in the tenth year as a result of the additional fees they will pay to fee-based financial advisers on assets that were formerly in front-end load share classes.

- Even if the Department's proposal could narrow the small gap in performance between front-end load and retail no-load share classes (7 to 8 basis points), these higher returns would not be enough to pay for the added costs associated with fee-based accounts. Current IRA investors in front-end load share classes would experience a net reduction in their total return of $1 billion in the first year, growing to more than $10 billion a year by the tenth year.

D. The RIA Fails to Account for the Societal Harm of Investors Losing Access to Advice and Guidance (Section V)

- The Department fails to identify and analyze societal harms that will result from its proposal—specifically, the risk that at least some retirement savers could lose access to investment advice and information on which they currently rely to achieve their savings goals.

- If the problems with the Proposed Fiduciary Rule and Best Interest Contract Exemption are not addressed, investors could well lose access to the guidance, products, and services that investors currently receive from their brokers.

- Research shows that investors with access to advice have more diversified portfolios and take on more appropriate levels of risk than those who do not receive advice or information. The benefits of advice—and, conversely, the harm of losing access to advice—are significant.

- Factoring in the additional costs of moving some investors with larger balances from broker-sold funds to fee-based accounts, plus the lower performance for investors who would not be eligible for fee-based accounts, it is possible that annual losses to investors could mount to nearly $19 billion a year within ten years.

- Finally, in its current form, the BIC Exemption likely will raise transaction costs and create significant hurdles for investors wishing to move from one financial adviser or asset manager to another—further harming investors.

II. The Academic Studies the RIA Cites Do Not Support Its Sweeping Claims

The RIA points to a set of academic studies to buttress its claims that investors are harmed by their use of brokers. Our comments focus on the four most relevant studies and discuss their findings.[13] There are three overarching problems with using this research to argue that investors using brokers earn lower returns than if they received advice from a fiduciary.

First, none of these academic studies actually compares the outcomes of investing with a financial adviser that is a fiduciary to the outcomes of investing with a broker or other financial adviser that is not a fiduciary. Thus, the findings of underperformance cited in the RIA do not actually measure—and cannot measure, based on these studies—whether an investor using a fee-based ERISA fiduciary adviser would experience a different investment outcome than an investor using another financial adviser that is not an ERISA fiduciary.

[13] The RIA cites a study by Hackethal, Haliassos, and Jappelli (2012). *See* Andreas Hackethal, Michael Haliassos, and Tullio Jappelli. "Financial Advisors: A Case of Babysitters?" *Journal of Banking & Finance* 36, no. 2 (2012): 509-524. This study examines customers at a German bank. There are significant differences in regulatory and institutional details between the brokers in Germany and the United States, so we do not analyze this paper.

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

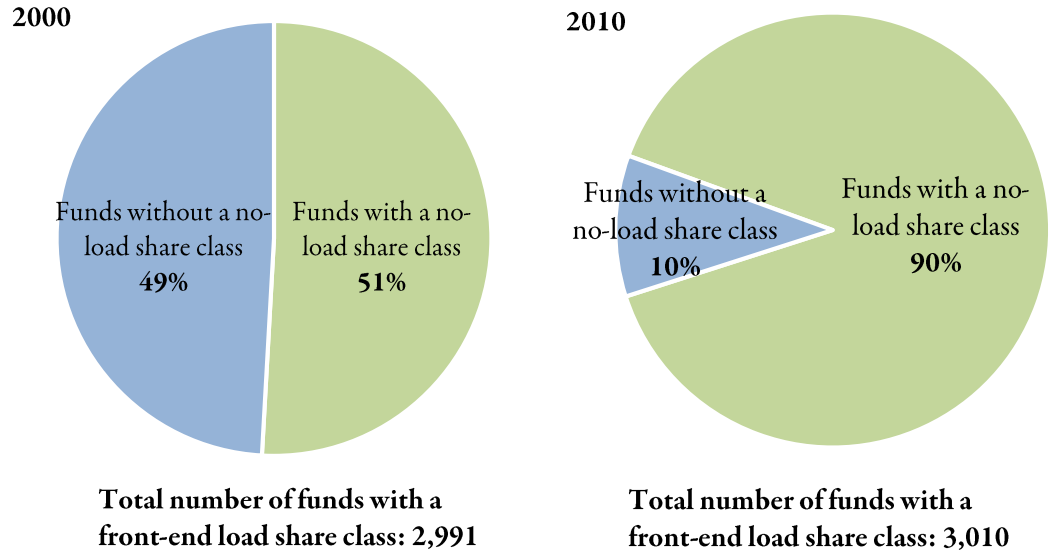
Second, most of the studies measure the relative performance of broker-sold funds using data from the 1990s and early 2000s. Fundamental changes in the mutual fund markets since that time have made these studies out of date. Fifteen to twenty years ago, mutual fund markets were segmented, with little head-to-head competition between broker-sold funds and direct-sold funds or funds that did not charge a load ("no-load" funds). Several of the academic papers argue that this segmentation led to broker-sold funds having weaker competitive pressures to produce returns.[14]

Reliance on these studies ignores significant changes in the mutual fund markets. For example, in 2000 only about half of the funds with a front-end load share class also had no-load share classes (Figure 1).[15] By 2010, however, 90 percent of funds with a front-end load share class also offered a no-load share class. These no-load share classes are available on investment-only 401(k) platforms, at discount brokerages, and through fee-based advisory firms. This head-to-head competition between broker-sold funds and no-load funds has transformed the market for mutual funds.

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

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

Figure 1
Front-End Load Funds with No-Load Share Classes Have Risen Since 2000
Percentage of funds with a front-end load share class; 2000 and 2010



Total number of funds with a front-end load share class: 2,991

Total number of funds with a front-end load share class: 3,010

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

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

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

These three problems with the academic literature highlight why it is inaccurate for the RIA to claim that "[a] wide body of economic evidence supports a finding that the impact of these conflicts of interest on investment outcomes is large and negative."[16] Furthermore, the academic literature does not support the statement that a "careful review of this data … consistently points to a substantial failure of the market for retirement advice"[17] and "that IRA holders receiving conflicted investment advice can expect their investments to underperform by an average of 100 basis points per year over the next 20 years."[18]

We discuss in detail why the articles cited in the RIA do not support these statements.

A. Bergstresser, Chalmers, and Tufano (2009)

Bergstresser *et al.* attempt to measure the returns to investors using broker-sold funds after adjusting for fund fees used to compensate brokers. The authors could not directly measure whether a fiduciary relationship produces superior returns, net of fees, over a non-fiduciary intermediary (*e.g.*, brokerage) relationship. Instead, Bergstresser *et al.* compare how the average broker-sold fund performs relative to how the average direct-sold fund performs. They also calculate an asset-weighted average return, comparing investors' returns as a whole for investors who use broker-sold funds versus those who use direct-sold funds.

The evidence in Bergstresser *et al.*, even if taken at face value, does not support the RIA's claim that investors in broker-sold funds underperform direct-sold funds by 100 basis points. Bergstresser *et al.* find that investors who invested in broker-sold funds between 1996 and 2004 earned lower asset-weighted returns on broad domestic equity funds and bond funds, but earned higher asset-weighted returns on international equity funds. Investors in broker-sold funds underperformed, relative to direct-sold funds in the same benchmark category, by 27 basis points for domestic equity funds and by 34 basis points for bond funds. Yet investors in broker-sold international equity funds outperformed direct-sold funds by 145 basis points, adjusting for benchmarks.[19] If underperformance is due to the

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[16] *See* RIA at 7.

[17] *Id.*

[18] *Id.*

[19] Bergstresser *et al.* also provide alphas produced from single- and multi-factor models. These models measure whether a portfolio manager is producing alpha by constructing a portfolio with superior stock picking skills or by favoring certain attributes of stocks—for example, constructing a portfolio that is more correlated with the market or that invests in small capitalization or value stocks. If the portfolio manager generates returns through superior stock picking skills, rather than through favoring certain types of stocks, the multifactor models will produce a positive alpha. While these measures are

conflicted compensation structure of the intermediary—as the RIA suggests—one would expect that the underperformance would occur in all types of funds.

B. Del Guercio and Reuter (2014)

Del Guercio and Reuter find that the average direct-sold, actively managed domestic equity fund outperformed the average broker-sold, actively managed domestic equity fund from 1992 through 2004. The paper speculates that the average broker-sold fund underperforms because of broker incentives, but it does not provide any test of this theory. Consistent with the limitations of Bergstresser *et al.*, Del Guercio and Reuter do not measure the net returns to investors using a fiduciary adviser compared with those investors using a broker. Nor does the paper provide asset-weighted or sales-weighted data to show whether *investors* in broker-sold funds underperformed or outperformed investors in direct-sold funds during the 1990s and early 2000s.

Since this paper does not measure the relative performance on an asset-weighted or sales-weighted basis, it does not support the claim that investors in broker-sold funds as a group underperform investors in direct-sold funds, even for the domestic equity funds that Del Guercio and Reuter examine. Nor does it support the claim in the RIA that investors in broker-sold funds as a group underperform by 100 basis points a year.

C. Chalmers and Reuter (2014)

Chalmers and Reuter attempt to measure the impact of broker recommendations on client portfolios. The authors find that participants in an Oregon University System retirement plan who used brokers offered by one of their defined contribution plan providers between 1996 and 2009 were likely to need help with asset allocation and fund selection. They then test whether participants using a broker would have had better outcomes if they had been defaulted into a low-cost, target date fund. Such a fund was not available as a default option during most of the period that the authors studied.

As with the other papers that the RIA cites, Chalmers and Reuter provide no evidence that investors using brokers would have fared differently if they had used ERISA fiduciaries instead. For example, the authors note that the brokers used a third-party computer algorithm to select funds for the participants, suggesting that the recommendations largely would have been the same had fiduciaries

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useful for detecting stock picking skills to achieve alpha, benchmark-adjusted returns provide a more accurate assessment of whether brokers are choosing funds within a particular style of investment that either underperform or outperform similar types of funds.

provided the advice.[20] The authors also point out that a significant component of the reported underperformance results from the payment to the brokers for their services, costs that investors also would have incurred to the same or greater degree if the financial advisers had been fiduciaries. Finally, given that the Oregon University System had a pre-specified selection of funds from which to choose, participant returns very likely would have been similar if fiduciaries had provided assistance rather than brokers. The authors do not provide any detail about the investment options provided to plan participants using the broker services, such as fees or performance of these funds and how they compared to the low-cost provider that did not provide advice services. This information would have indicated the types of funds that the brokers were able to select from and possibly explained the underperformance that the authors observed.

This paper certainly does not support the RIA's contention that individuals using brokers underperform those using fiduciaries by 100 basis points a year. Instead, the paper demonstrates one clear and compelling point: that well-designed target date funds provide a valuable default option for participants in employer-sponsored defined contribution plans. The Institute has long supported the use of balanced funds, such as target date funds, as default investments in defined contribution plans.[21]

D. Christoffersen, Evans, and Musto (2013)

The RIA relies heavily on a paper by Christoffersen *et al.* that purports to measure the cost to investors of investing in funds sold through brokers. The paper claims to find that funds that compensated brokers with higher-than-average loads, adjusting for a set of fund features, earned lower returns than funds in the same Morningstar category.

As with the other papers that the RIA cites, Christoffersen *et al.* do not measure or test whether these returns were lower than what investors would have received had they used a fiduciary adviser. Nor does the paper provide asset-weighted or sales-weighted returns to demonstrate how investors who use broker-sold funds performed as a group relative to those using similar funds in their Morningstar category. Finally, the sample period used in the paper extends from 1993 to 2009, relying largely on fund performance that is 10 to 20 years old.

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[20] *See* Chalmers and Reuter at 25.

[21] *See, e.g.,* Letter from Elizabeth Krentzman, General Counsel, Investment Company Institute, to Office of Regulations and Interpretations, Employee Benefits Security Administration, U.S. Department of Labor, dated November 13, 2006, available at www.dol.gov/ebsa/pdf/Krentzman111306.pdf.

Apart from these shortcomings shared by the other research that the RIA cites, this paper has two other serious errors that invalidate its conclusion that front-end load funds provide economic incentives to brokers to steer their clients to low-performing funds.

The first relates to how the paper interprets the relationship between loads paid to brokers and fund flows. Christoffersen *et al.* incorrectly argue that for the median fund an additional $1 in loads paid to brokers increases flows to that fund by $6.71. They argue that the sensitivity of fund flows is even greater when funds pay loads to brokers who are unaffiliated with the fund sponsor: an increase of $1 in loads paid to unaffiliated brokers for the median fund increases flows to that fund by $14.20.[22] The RIA repeats this claim,[23] implying that fund sales are highly sensitive to small incremental payments to brokers, creating a perverse incentive and potential market failure.

Christoffersen *et al.* arrive at these estimates through a complicated set of computations. First, they estimate an "excess load" by regressing the amount of loads paid to brokers, as a percentage of sales of new shares, on various fund features such as the type of fund and fund size. The difference between what a fund paid in front-end loads to brokers, as a percentage of sales, and what their model estimated that the fund would pay becomes the "excess load." In other words, the "excess load" is the residual from the regression. In a second regression, they use this calculated "excess load" (i.e., the residual from the first regression), and estimate the impact on fund sales, as a percentage of fund assets, if the "excess load" is positive or negative. They find a positive relationship between "excess loads" paid and flows: when "excess loads" are positive, funds have greater flows as a percentage of their assets. When "excess loads" are negative, funds have smaller flows as a percentage of assets.

The problem is how the authors apply this result. They assume that a fund can increase the amount that it pays to brokers without increasing the loads that it collects from investors. As the RIA acknowledges, funds pay out more than 80 percent of the loads they collect.[24] Using N-SAR data since 2010, we find that the average fund pays out about 85 percent of the loads that it collects. Therefore, to increase the amount that funds pay to brokers, most funds would be required to increase the load that they collect from investors. Yet, as Christoffersen *et al.* show, fund sales as a percentage of assets are lower among funds that collect higher total (not "excess") front-end loads. Christoffersen *et al.* ignore this second effect when computing the impact of the share of loads paid to brokers on fund sales.

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[22] *See* Christoffersen *et al.* at 223.

[23] *See* RIA at 87.

[24] *See* RIA at 104.

Accounting for the effect of paying out higher amounts to brokers, which must be recaptured by charging higher front-end loads, would lead to a drop in sales—not an increase in sales.

The second, and more serious, error is that Christoffersen *et al.* improperly apply the relationship between the "excess load" paid and the underperformance of the fund. In their analysis, they find that when the "excess load" (the residual from their first regression) is positive, the fund tends to underperform similar funds. If the "excess load" is negative, the fund tends to outperform similar funds. When they attempt to measure the economic significance for the investor, they incorrectly multiply the coefficient on the "excess load" variable by the *average load paid*, and argue that the typical fund underperforms by 1.13 percent annually. But the regression relating fund performance and loads was run not using the actual load, but using the "excess load." The residuals of their first regression measuring the "excess load" should have a mean of *zero*. Taking the results from their analysis literally, they should conclude that on average broker-sold funds neither underperform nor outperform their Morningstar category average.

The RIA repeats the error in the Christoffersen paper, and incorrectly concludes that the average fund underperforms its benchmark by at least 100 basis points.[25] The RIA further compounds the error by making the assumption that the average dollar invested in a broker-sold fund underperforms by 100 basis points.[26] Underperformance of the average dollar invested is an asset-weighted measure, a calculation that Christoffersen *et al.* do not provide.

These errors, on top of the misinterpretations of findings, invalidate the RIA's assertion that the typical investment in a broker-sold fund underperforms by 100 basis points. In turn, that claim of 100-basis-point underperformance is the foundation for the Department's claim that, unless it adopts its proposed rules, investors in front-end load funds will lose $500 billion to $1 trillion in foregone returns during the next 20 years.[27] In fact, that claim is mere hyperbole, unsupportable by the data.

As an additional note, the RIA implies that this is underperformance relative to funds sold through financial advisers with a fiduciary relationship. But as we have demonstrated, none of the academic papers actually makes this comparison. As we discuss in the next section, using various measures of relative fund performance, front-end load funds outperform the average fund, and only slightly underperform the sales or asset-weighted returns on retail no-load funds.

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[25] *Id.* at 98.

[26] *Id.*

[27] *Id.*

III. Investors' Actual Experience with Broker-Sold Funds Contradicts the RIA's Claims

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

To measure the experience of investors in broker-sold share classes, we use gross sales and assets of front-end load share classes from 2007 through 2013 and measure the performance of either these share classes or their funds in subsequent years to capture what investors would have experienced if they stayed in the funds.[28] The reason for focusing on the more recent time period is that the mutual fund market has changed significantly in the past twenty years, as we discussed in Section II.[29] We then calculate fund returns, net of fund fees, based on Morningstar data.[30]

As a baseline, we take one-year net returns of share classes with front-end loads for each year from 2008 through 2014 and subtract each share class's Morningstar category return for the same year to create a relative return. To measure how investors as a group using front-end load share classes perform, we then weight each fund's relative performance in the subsequent one-year period by sales or assets from the reference year. Similar measures are used for retail no-load funds to provide a basis for comparison.

Using sales from 2007 through 2013, we find that front-end load share classes tended to perform better than their Morningstar category average, and that investors concentrated their purchases (i.e., fund sales) in better performing front-end load share classes. As shown in Figure 2, weighting each share class's relative return by its previous year's gross sales as reported by funds to the ICI, the sales-weighted one-year relative return was 27 basis points. In other words, investors buying

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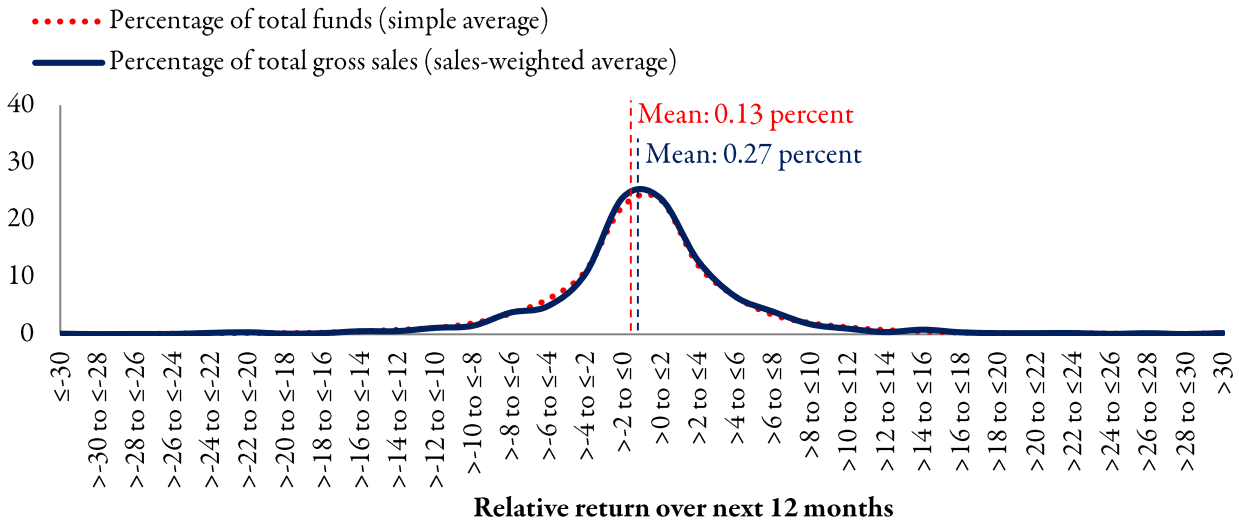
[28] Throughout the comment letter, references to ICI sales mean new sales plus exchange sales and are sometimes referred to as gross sales.

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

[30] The ICI maintains a survivorship-bias free database of Morningstar data.

front-end load shares in those years outperformed the average for share classes in the same Morningstar category by 27 basis points. The average front-end load share class outperformed its Morningstar category average by 13 basis points during this period. The fact that the sales-weighted average exceeds the simple average suggests that brokers tended to guide their clients to funds that subsequently slightly outperformed, not underperformed, the average front-end load share class.

Figure 2
Annual Returns on Front-End Load Share Classes Relative to Their Morningstar Category Returns
2008–2014



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

We tested how robust this finding was by measuring fund returns, net of fees, for the entire fund, weighting the net returns of each fund's share classes into a single asset-weighted fund return. We then computed an average fund return for each Morningstar category calculated as the simple average of the one-year returns for each fund in the Morningstar category. We calculate a relative return by subtracting each fund's Morningstar category average return from the fund's return. This is the technique similar to what Christoffersen *et al.* used to determine if front-end load share classes are

associated with funds that tend to underperform. We then weight these one-year relative fund returns with the sales or assets of the front-end load share classes in the previous year to calculate sales-weighted and asset-weighted relative returns. We calculated two sales-weighted measures—using gross sales of front-end load share classes reported to ICI and sales reported on the SEC form N-SAR that we retrieved from Strategic Insight Simfund—and one asset-weighted measure, using assets reported to Morningstar.

As shown in Figure 3, sales-weighted and asset-weighted average relative returns are negative in some years for funds with front-end loads, but they are positive for the whole period from 2007 through 2013 and from 2010 through 2013. And contrary to the implication in Christoffersen *et al.,* we find that since 2007 investors are concentrating their purchases in front-end load share classes of funds that outperform, not underperform, the average return of funds in their Morningstar categories.

Del Guercio and Reuter and Bergstresser *et al.* seek to measure the outcomes of investors using brokers by comparing returns on broker-sold funds with direct-sold funds, under the assumption that direct-sold funds capture how investors using broker-sold funds might perform if their brokers could use funds outside the broker-sold universe. As discussed in Section II, this is a test of how investors in broker-sold funds fare relative to direct-sold funds. The academic literature has used this as an indirect test for broker conflicts.

Figure 3
Annual Returns on Front-End Load Funds Relative to Their Morningstar Category Returns
Percent; selected periods

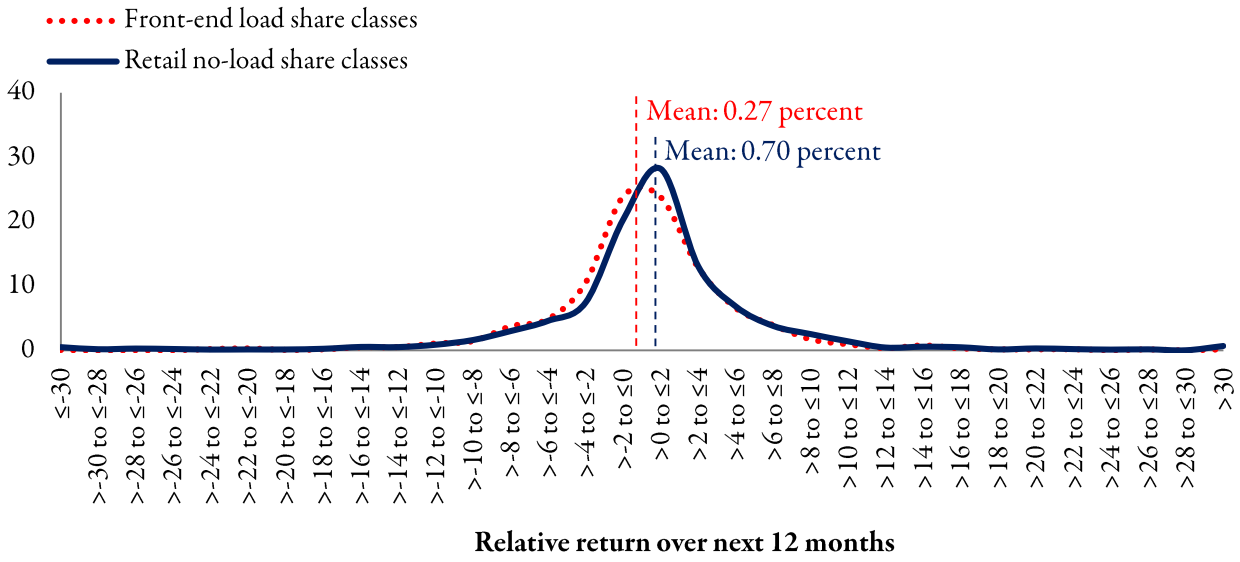
	Relative return		
	Sales-weighted		
Year of sales/assets	ICI gross sales	N-SAR sales	Asset-weighted
2007	-0.865		-0.063
2008	1.344		0.617
2009	-0.036		-0.347
2010	-0.476	-0.079	-0.302
2011	0.785	0.437	0.842
2012	0.205	0.108	0.267
2013	0.144	0.333	0.114
Average:			
2007–2013	0.160		0.149
2010–2013	0.172	0.197	0.225

Note: These fund level returns, which include all funds irrespective of whether any share class in the fund has a front-end load, are then averaged (unweighted) to create the "average return on funds in same Morningstar category." Next, the fund's relative return is calculated by taking the fund level return less the average return on funds in the same Morningstar category. Note that the Morningstar category average returns used in Figure 3 are not the same as the "Morningstar category returns" used in Figures 2, 4, and 5; "Morningstar category returns" in these figures are taken directly from Morningstar as reported in its Morningstar Direct database, which are simple averages of the returns on each individual share class in a given Morningstar category. The analysis includes equity, balanced, and bond mutual funds with at least one share class with a front-end load, excluding mutual funds available as investment choices in variable annuities and mutual funds that invest primarily in other mutual funds.
Sources: Investment Company Institute, Strategic Insight Simfund, and Morningstar

Figure 4 plots the distribution of sales-weighted returns for front-end load share classes and retail no-load share classes, both relative to their respective one-year Morningstar category returns. Investors in retail no-load share classes outperform their Morningstar category in the year after the purchase by 70 basis points for fund sales from 2007 through 2013, compared with 27 basis points for

front-end load share classes. This difference in relative returns of 43 basis points is 70 percent less than what Del Guercio and Reuter report for actively managed funds.[31]

Figure 4
Annual Returns on Front-End Load Share Classes and Retail No-Load Share Classes Relative to Their Morningstar Category Returns
2008–2014



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

Del Guercio and Reuter correctly point out that some of this difference is accounted for by 12b-1 fees, which compensate brokers and their firms for the services that they provide to their clients. Adjusting for 12b-1 fees, the difference between the sales-weighted relative returns of front-end load share classes and retail no-load funds shrinks to 21 basis points.

As the RIA points out, average holding periods for front-end load funds are longer than one-year. Figure 5, therefore, provides three-year relative returns for both front-end load and retail no-load

[31] Our calculation includes index funds for both front-end load and retail no-load share classes. Index funds account for a larger share of retail no-load fund assets than they do for broker-sold funds.

share classes, weighted by ICI gross sales and Morningstar assets. On a three-year relative return, the difference in returns between front-end load and retail no-load share classes shrinks further. When 12b-l fees are added back to measure the fees before compensating the brokers and their firms, the difference in returns between front-end load funds and retail no-load funds drops to 6 basis points on a sales-weighted average and 7 basis points on an asset-weighted average. These differences are less than one-tenth the 100 basis point "underperformance" that the RIA asserts.[32]

Figure 5
Three-Year Returns on Front-End Load Share Classes and Retail No-Load Share Classes Relative to Their Morningstar Category Returns
Percent; selected periods

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

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

There is further evidence that brokers do not systematically steer their clients to poor-performing funds with higher loads or fees. Figure 6 reports loads paid to brokers, measured as a

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

percentage of total fund sales subject to a load. We used data from Strategic Insight Simfund, which contains N-SAR data from 2010 to 2013. If brokers are skewing investors to funds that pay the brokers higher loads, then we should expect sales-weighted average loads to be higher than the simple average load paid. For each fund investment group, the sales-weighted average load paid to brokers is less than the simple average load paid. These data on loads contradict the notion that brokers are systematically steering their clients to funds that pay above-average loads. These data also are consistent with the finding in Christoffersen *et al.* that sales are greater among funds with lower front-end loads.

Figure 6
Sample Statistics of Loads Paid to Brokers as a Share of Total Sales Collected Subject to a Load
Percent; 2010–2013

Investment objective	Number of funds	10th percentile	90th percentile	Simple average	Sales-weighted average
Domestic equity	2,454	0.1	4.5	1.8	1.0
International equity	871	0.1	4.1	1.7	1.1
Taxable bond	1,208	0.1	3.1	1.2	1.1
Balanced	512	0.2	4.1	1.9	1.6

Note: Data exclude funds with no reported sales (NSAR: Q28h = 0), funds where loads paid to brokers exceeded sales (NSAR: Q32 + Q33 > Q28h), funds with reported sales less than $100,000 (NSAR: Q28h < $100,000), funds where loads paid to brokers equaled 0 (NSAR: Q32 + Q33 = 0), and funds where loads paid to brokers exceeded the maximum front-end sales load for the fund. The analysis excludes mutual funds available as investment choices in variable annuities and mutual funds that invest primarily in other mutual funds.
Sources: Investment Company Institute, Strategic Insight Simfund, and Morningstar

Fund expense data also show strong market forces at work driving investors to funds with below-average expenses. As shown in Figure 7, sales of front-end load share classes are skewed to those with below-average expense ratios, measured as either the total expense ratio (which includes the 12b-1 fee) or the fund expenses used to operate the fund (the total expense ratio minus the 12b-1 fee). In all four investment categories, sales-weighted and asset-weighted expense ratios for front-end load share classes are below the simple average total expense ratios or operating expense ratios for front-end load share classes.

Investors in front-end load share classes are paying fund expenses that are in line with retail no-load share classes. Sales-weighted and asset-weighted expense ratios are higher for front-end load share classes than for retail no-load share classes, but a large portion of the difference is that expenses of front-end load share classes include 12b-1 fees used to pay brokers or intermediaries for their services.

Focusing on the expenses used to operate the fund ("operating expense ratios"), investors in front-end load share classes generally are paying operating expenses near what investors in retail no-load share classes are paying. And the asset-weighted and sales-weighted operating expense ratios for front-end load share classes are below the simple average operating expenses charged by the average retail no-load share class in all but one case (the sales-weighted taxable bond). These figures undermine the Department's contention that investors "pay insufficient attention to expenses."[33]

In conclusion, our analysis shows that the experience of investors in front-end load funds since 2007 is dramatically different from the RIA's description of the experience of investors using front-end load funds. We find no evidence to support the RIA's assertion that there is a "substantial failure of the market."[34] Furthermore, as we discuss in the next two sections, the RIA overstates the benefits of the Department's proposal by failing to consider all of its costs. Under the proposal's current design, investors with small balances could potentially pay more for their services from financial advisers, be shut out of the advice market, or be faced with much larger switching costs. In fact, the net impact of the fiduciary proposal as it is currently designed could be negative for many IRA investors.

[33] *See* RIA at 97.

[34] *See* RIA at 3, 7, and 211.

Figure 7
Total Expense and Operating Expense Ratios of Front-End Load Share Classes and Retail No-Load Share Classes
Percent over the 2007–2013 period

Domestic equity	**Total expense ratio**		**Operating expense ratio**	
	Front-end load	Retail no-load	Front-end load	Retail no-load
Simple average	1.33	1.08	1.08	1.01
Asset-weighted average	0.98	0.63	0.74	0.61
Sales-weighted average	1.10	0.78	0.85	0.75

International equity	**Total expense ratio**		**Operating expense ratio**	
	Front-end load	Retail no-load	Front-end load	Retail no-load
Simple average	1.53	1.26	1.27	1.19
Asset-weighted average	1.02	0.84	0.78	0.82
Sales-weighted average	1.14	0.91	0.89	0.88

Taxable bond	**Total expense ratio**		**Operating expense ratio**	
	Front-end load	Retail no-load	Front-end load	Retail no-load
Simple average	0.98	0.73	0.75	0.66
Asset-weighted average	0.88	0.45	0.65	0.42
Sales-weighted average	0.90	0.50	0.66	0.47

Balanced	**Total expense ratio**		**Operating expense ratio**	
	Front-end load	Retail no-load	Front-end load	Retail no-load
Simple average	1.34	1.24	1.08	1.16
Asset-weighted average	0.80	0.58	0.57	0.57
Sales-weighted average	0.93	1.03	0.70	0.97

Note: The analysis excludes mutual funds available as investment choices in variable annuities and mutual funds that invest primarily in other mutual funds. The operating expense ratio is the share class's total expense ratio minus the share class's 12b-1 fee, which is used to pay for services provided by the broker or the broker's firm.
Sources: Investment Company Institute and Lipper

IV. The RIA Ignores the Economic Impact of Moving Investors to Fee-Based Accounts

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

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

The Department predicts that its BIC Exemption will induce brokers to reduce loads by about 65 percent over the next two years.[35] As the Institute points out in its accompanying comment letters, the BIC Exemption is unworkable; even if it could work, it would impose prohibitive costs on brokers. Brokers subject to the Exemption's many new limitations, burdens, and costs, as well as its increased exposure to liability, are likely to seek to move many of their clients to fee-based accounts. Such accounts, however, require much greater level of time and engagement through frequent rebalancing of investors' accounts a level of service that is unnecessary for an investors with a modest balance who is typically better off as a buy-and-hold investor. This additional ongoing engagement results in higher and ongoing expense for the investor.

Assuming that investors in broker-sold funds move to fee-based accounts, the costs these investors will pay will likely rise over time. A recent study by Cerulli Associates finds that fee-based accounts—the most likely alternative to brokerage accounts—cost investors 111 basis points per year on average, in addition to fund expenses.[36] Using the asset levels in the RIA (Table 3.4.2-1 Row B) and assuming that the current proposal causes investors to move from front-end load funds to fee-based

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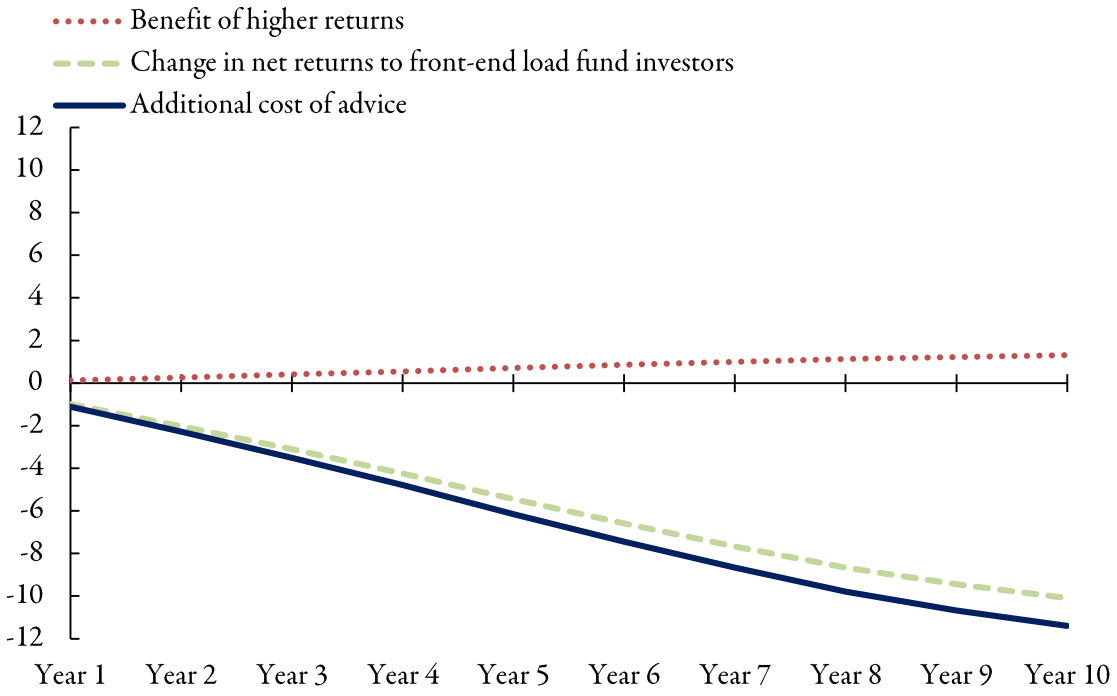
[35] *See* RIA at 113.

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

accounts over time at the rate based on the turnover in broker accounts as estimated in the RIA (Table 3.4.1-2), the additional fees that investors pay to financial advisers on assets that are currently in front-end load funds could reduce investor returns by $1.1 billion in the first year, rising to more than $11 billion a year in the tenth year.

Figure 8
Annual Effect on Investors in Front-End Load Funds of Higher Fees Paid to Fee-Based Advisers
Billions of dollars a year



Source: Investment Company Institute

Assuming a net increase in returns for investors using brokers equal to the difference in the three-year relative return between retail no-load and front-end load share classes, investors would receive a benefit of higher returns of $760 million in the first year rising to $1.31 billion in the tenth year, as shown in Figure 8. Combining the effects of the costs of higher payments to financial advisers and higher returns that investors receive, the proposed rules would result in a net loss to fund investors. In the first year alone, the net loss would be $1.1 billion. That loss would grow to $10.1 billion a year by the tenth year as more clients are moved to fee-based accounts.

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

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

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

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

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

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

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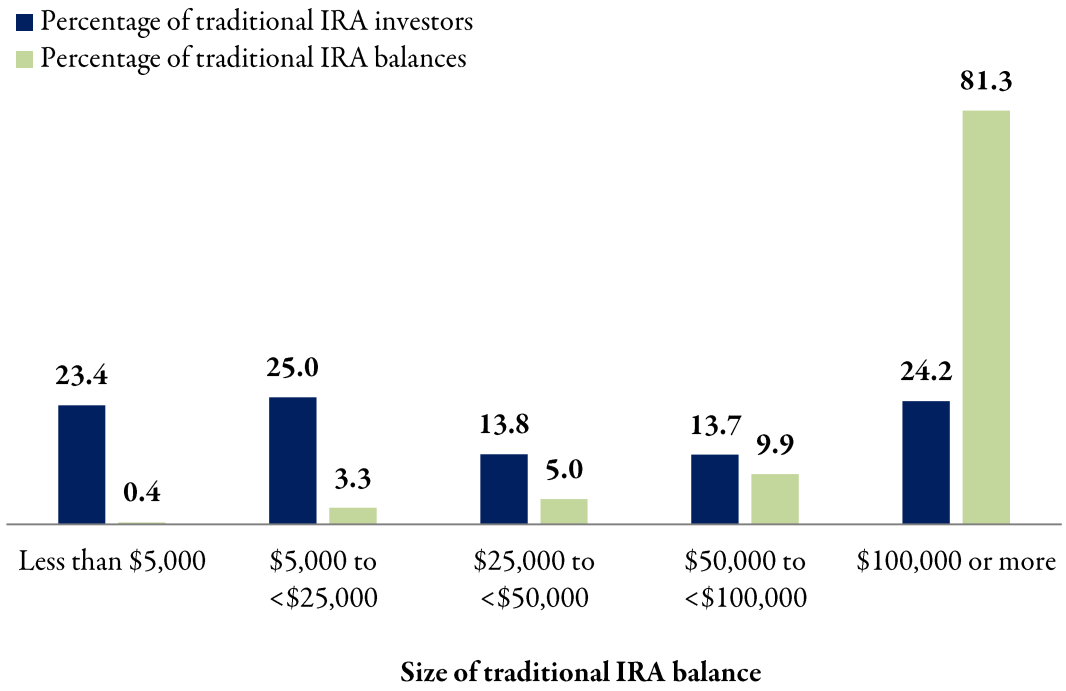
[37] *See* Sarah Holden and Daniel Schrass. 2015. "The Role of IRAs in U.S. Households' Saving for Retirement, 2014." *ICI Research Perspective* 21, no. 1 (January), available at www.ici.org/pdf/per21-01.pdf.

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

[39] *See* Investment Advice—Final Rule. 76 Fed. Reg. 66136, 66152 (October 25, 2011).

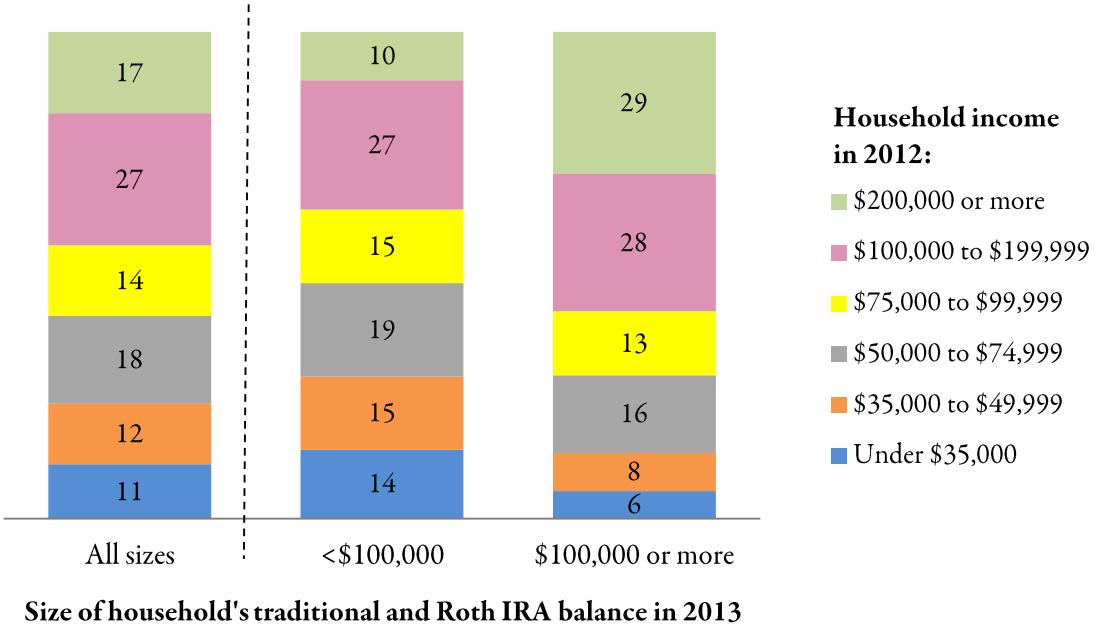
generate too little income to make the provision of ongoing advice profitable. As shown in Figure 9, 76 percent of traditional IRA accounts in The IRA Investor Database™ have less than $100,000 in them. And low- and middle-income households are more likely to have IRA balances below $100,000, as shown in Figure 10.

Figure 9
Distribution of Traditional IRA Investors and Traditional IRA Amounts
Percentage of traditional IRA investors and percentage of traditional IRA balances by size of traditional IRA balance, 2013



Note: The sample is 9.8 million traditional IRA investors aged 25 to 74 at year-end 2013. Components may not add to 100 percent because of rounding.
Source: The IRA Investor Database™

Figure 10
Households Owning Traditional and/or Roth IRAs
Percentage by household income and household IRA balances



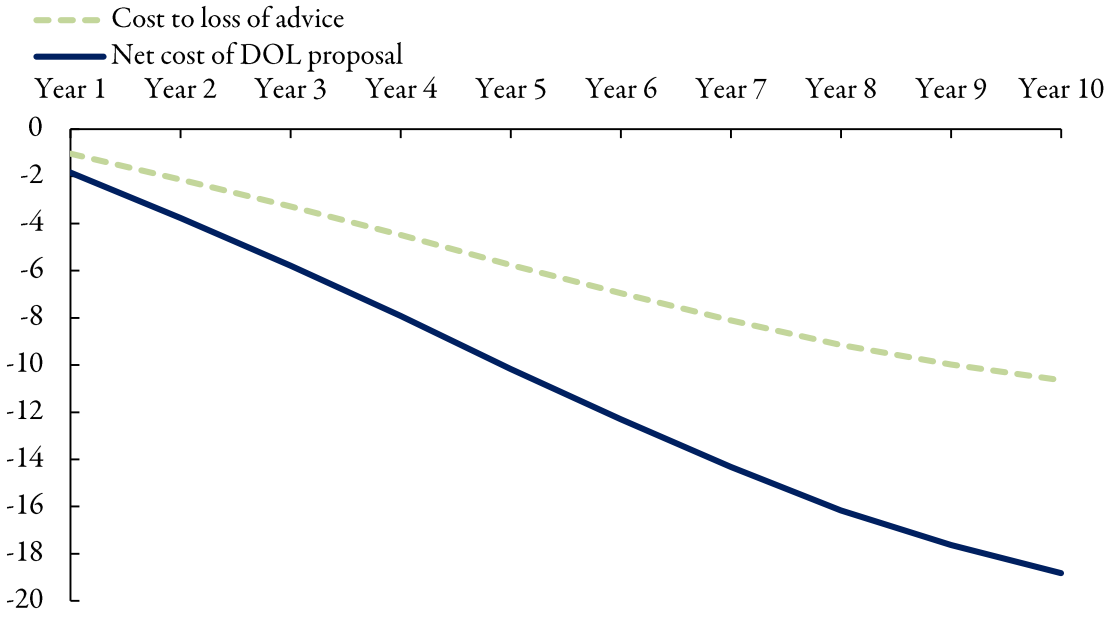
Note: In 2013, 65 percent of households with traditional or Roth IRAs had balances of less than $100,000 and 35 percent had balances of $100,000 or more.
Source: ICI Tabulation of Federal Reserve Board 2013 Survey of Consumer Finances

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

Assuming that investors with less than $100,000 in IRA balances no longer have access to advice because the BIC Exemption is not workable, then over time these investors are likely to experience lower returns because of poor asset allocation and market timing, or because they incurred tax penalties by taking early withdrawals. Factoring in the lower performance for these investors, and adding to the additional costs for the other 81 percent of IRA assets that would shift to fee-based

accounts, it is possible that the net loss from the proposal, if adopted, could impose annual losses to investors mounting to nearly $19 billion a year within 10 years (Figure 11).

Figure 11
Annual Effect on Investors If They Lose Access to Financial Advice
Billions of dollars a year



Source: Investment Company Institute

We are, of course, unable to quantify another significant potential cost to the current proposed rules. As we discuss in our comment letters, the BIC Exemption likely will create significant barriers for investors—particularly investors with small account balances—seeking out advice and assistance, even outside the broker market. Increasing information barriers and transaction costs certainly would reduce the ability of IRA investors to move from one adviser to another or from one fund provider to another, further harming investors.

The Department's scant attention to the potential harm to investors resulting from its rule proposal is surprising given the proposal's likely impact on retirement savers. In our view, to meet the standards of Executive Order 12866, the RIA at a minimum should have included information derived from quantitative or qualitative data focused more clearly on showing the problem that the proposal is intended to solve, as well as the anticipated costs and benefits of the proposal as a solution:

- As discussed above, the Department fails to provide supportable data and other information describing the nature and magnitude of the costs arising from persons and financial services

firms with alleged potential conflicts. In attempting to support the existence of such a finding, however, the Department, consistent with its regulatory obligations, should also have provided data and other information on the benefits stemming directly or indirectly from the services provided by these persons and financial services firms. For example, given the Department's identification of front-end loads or the receipt of 12b-1 fees as creating a potential conflict, it also should have identified and analyzed the benefits to investors of advice or information provided to them by the broker-dealers who receive those fees (for example, through the greater availability of guidance, diverse product offerings, educational tools, and information generally.) The RIA's one-sided perspective creates a significant gap in the Department's analysis.

- The Department also should have described whether and the extent to which IRA investors are confused about potential conflicts involving the persons or financial services firms providing services to them and the costs that arise from that confusion. As discussed above, there is no evidence of systematic underperformance stemming from the very arrangements on which the Department bases its conclusions of market failure, refuting the Department's supposition that such potential conflicts lead to underperformance.

- The Department should have included data and other information describing the effectiveness of disclosure to correct any confusion about whether or not a service provider is acting as a fiduciary and about potential conflicts involving the persons or financial services firms providing services to consumers of IRA products and 401(k) participants. While the Department speculates that disclosure alone would be insufficient to protect investors, it provides no data or test findings supporting this supposition.

- The Department should have provided data and other information comparing IRA investors' returns (net of gross fees, commissions, or other charges paid to the financial professional) for investors who pay directly for services from persons or financial services firms with those of investors who pay indirectly (for example, through commissions or 12b-1 fees). As discussed above, our review of publicly available data shows that sales-weighted relative returns on front-end load share classes exceeded the simple average relative return on front-end load share classes—demonstrating that, if anything, brokers steer their clients to better performing front-end load share classes. These data contradict the claim in the RIA that commission-based brokers are pushing clients to weaker performing front-end load funds.

- The Department should have provided data and other information describing and comparing the product selections of IRA investors s and 401(k) participants based on whether they are served by persons or financial services firms whose fee is paid directly by customers (as an asset-based or fixed fee) or by advisers who are paid indirectly (for example, through commissions, 12b-1 fees or revenue sharing). To the extent the Department believes that differences in fee

structure contribute to differences in the types of products offered or recommended, we would have expected to see data and other information showing why the types of products offered or recommended may differ. In fact, as shown above, front-end load funds—which the Department contends lead to conflicted advice—tend to perform better than their Morningstar category average.

- The Department should have provided data and other information showing the extent to which limiting access of IRA customers to services provided by persons or financial services firms who are paid indirectly (for example, through commissions and 12b-1 fees)—a likely result of the proposal—would eliminate or otherwise impede IRA customer access to such accounts, products, services and relationships (for example, through higher costs and account minimums). Such data findings should be segmented by account size, income levels and, to the extent available, race and ethnicity of consumer. Simply put, the Department's RIA offers little analysis of the limits on future access to guidance, products and services resulting from the Department's rules.

Again, this is not an exhaustive list. Rather, these are just a few of the data points that are missing from the Department's RIA. Their absence, however, adds to the overall failure of the RIA to comply with the specific requirements applicable to agency rulemaking.

VI. Conclusion

The Department's RIA does not demonstrate that there is a "substantial market failure" in the provision of advice to IRA investors in the broker market. Indeed, in their current form, the Department's fiduciary proposals could impose billions of dollars of net harm to IRA investors, particularly those with small balances. These conclusions significantly undermine the validity of the RIA and suggest that the Department has, in issuing the Proposed Fiduciary Rule, acted in a manner that is inconsistent with the requirements of Executive Order 12866.

As we discuss in our accompanying letters to the Department, we agree that financial advisers should act in their clients' best interest. But the added layers of complexity and confusion that the Department proposes to pile on top of that simple best-interest principle creates the risk that many savers will receive *no* advice or service, or advice and guidance that is considerably more costly with little to no additional benefit to investors. Indeed, adopting the current proposals could well reduce the current level of competition in the market by making it more difficult for investors to switch from one financial adviser to another or from one fund manager to another. This outcome would harm not help investors who need and want financial advice to make informal investment decisions.

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We appreciate the opportunity to comment on the Department's Regulatory Impact Analysis. If you have any questions regarding our comments or would like additional information, please contact Brian Reid, Chief Economist, at (202) 326-5917 or brian.reid@ici.org, Sean Collins, Senior Director of Industry and Financial Analysis, at (202) 326-5882 or sean.collins@ici.org, or David Blass, General Counsel, at (202) 326-5815 or david.blass@ici.org.

Sincerely,

/s/ Brian Reid

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Appendix

The Appendix provides a detailed discussion of how we calculated the economic impact of the Department's Fiduciary Proposal. To the extent possible, we used data from the Department's RIA to compute the costs and benefits. We assume that the proposal is adopted as currently drafted, and we provide annual data for ten years following the adoption of the proposal.

The Department provides an estimate for a baseline beginning-of-year front-end load fund assets in the RIA (Table 3.4.2-1 Row B). We use these assets for our estimates of assets for the first ten-years after the implementation of the proposal (Column A). As noted in our letter, based on the current level of annualized load payments that the Department used in the RIA and the average 12b-1 fees on front-end load share class, we estimate that investors in front-end load share classes pay 50 basis points annually to brokers. Fee-based advisors charge, on average, 111 basis points. The difference in the fees is roughly 60 basis points (Column B), which is the additional amount that each investor moving to a fee-based account would pay. Next we estimate the dollar amount of the additional fees that investors would pay to financial advisers if all front-end load assets were in fee-based accounts (Column C). We assume the accuracy of the Department's analysis that the turnover in front-end load assets would occur over time, and we use the rate of turnover in the RIA (Table 3.4.1-2), which we replicate in Column D. The cumulative share of front-end load fund assets that are moved to fee-based accounts is reported in Column E. The annual cost of financial advice for fee-based accounts (Column F) is the product of Columns C and E.

Assuming, solely for this analysis, that investors would earn a higher return and achieve a benefit by investing with fee-based advisers, we use the difference in three-year relative returns on retail no-load share classes and front-end load share classes, which is 7 basis points after adjusting for 12b-1 fees. The annual dollar value of the benefit of the additional return (Column G) is calculated by multiplying the product of Columns A and E by 7 basis points. The annual net benefit to investors shifting to fee-based accounts is the sum of Columns F and G as reported in column H.

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. And the BIC Exemption would cause brokers to pull back from providing services. Investors with IRA balances below $100,000 would likely lose access to education and guidance. As shown in Figure 9 of the comment letter, 19 percent of traditional IRA assets are in accounts with less than $100,000. Assuming that 19 percent of the assets that turn over each year lose access to advice, we multiply columns Columns A, E, and I to get the cumulative amount of assets losing advice each year. We assume that

these assets underperform by 3 percent a year compared to their performance with a broker, producing a cost to lost advice in Column J.

The 3 percent underperformance reflects lower allocation to stocks and higher allocation to cash, early withdrawals and elimination of tax deferral, and poor market timing decisions. An example of this underperformance can be observed in IRA accounts that are automatically rolled out of their previous employers' defined contribution plan and placed in an IRA. The default for these rollouts is a cash account. As we show, these accounts tend to remain invested in cash over long periods of time.* In addition, other research has shown that smaller account balances are more likely to leak from the system, incur early withdrawal penalties, and lose the advantages of tax deferral.**

The total cost to investors if the Department's current proposal is adopted, shown in Column K, is the sum of Column J and 81 percent of Column H.

* Sarah Holden and Steven Bass. "The IRA Investor Profile: Traditional IRA Investors' Activity, 2007–2013." *ICI Research Repo*rt (July 2015), available at www.ici.org/pdf/rpt_15_ira_traditional.pdf.

** The Vanguard Group. *How America Saves 2015: A Report on Vanguard 2014 Defined Contribution Plan Data*. Valley Forge, PA: The Vanguard Group, Vanguard Center for Retirement Research (2015), available at https://institutional.vanguard.com/iam/pdf/HAS15.pdf.

Year	Front-end Load Mutual Fund Assets (billions of dollars) (A)	Additional Cost of Fee-based Advice (percent) (B)	Additional Cost of Fee-Based Advice (billions of dollars) (C)	Annual Turnover of Front-end load assets (ratio) (D)	Cumulative Turnover of Front-end Load Assets (ratio) (E)	Additional Cost of Advice (billions of dollars) (F)	Benefit of Higher Returns (billions of dollars) (G)	Net Change in Total Return to Front-end Load Fund Investors (billions of dollars) (H)	Share of Front-end Load Fund Assets in Accounts Less than $100,000 (I)	Cost to Loss of Advice (billions of dollars) (J)	Net Total Annual Cost of the Department's Proposal (billions of dollars) (K)
1	1087	0.006	-6.631	0.168	0.168	-1.114	0.128	-0.986	0.190	-1.041	-1.840
2	1161	0.006	-7.082	0.154	0.322	-2.280	0.262	-2.019	0.190	-2.131	-3.766
3	1238	0.006	-7.552	0.142	0.464	-3.504	0.402	-3.102	0.190	-3.274	-5.787
4	1319	0.006	-8.046	0.132	0.596	-4.795	0.550	-4.245	0.190	-4.481	-7.919
5	1402	0.006	-8.552	0.124	0.720	-6.158	0.707	-5.451	0.190	-5.754	-10.169
6	1489	0.006	-9.083	0.100	0.820	-7.448	0.855	-6.593	0.190	-6.960	-12.300
7	1579	0.006	-9.632	0.080	0.900	-8.669	0.995	-7.674	0.190	-8.100	-14.316
8	1672	0.006	-10.199	0.060	0.960	-9.791	1.124	-8.668	0.190	-9.149	-16.170
9	1768	0.006	-10.785	0.030	0.990	-10.677	1.225	-9.452	0.190	-9.977	-17.633
10	1868	0.006	-11.395	0.010	1.000	-11.395	1.308	-10.087	0.190	-10.648	-18.818