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U.S. Department of Labor  
200 Constitution Avenue, N.W.  
Washington, DC 20210

Reference : RIN 1210-AB82

Ladies and Gentlemen:

The Securities Industry and Financial Markets Association (“SIFMA”)<sup>1</sup> appreciates the opportunity to respond to the Department of Labor’s (“Department”) *Request for Information Regarding the Fiduciary Rule and Prohibited Transaction Exemptions* (the “RFI”).<sup>2</sup> We also appreciate the Department’s seeking public input before it proposes changes to the redefinition of the term “fiduciary” under section 3(21) of ERISA and section 4975(e) of the Internal Revenue Code (the Code”) and its exemptions (the “Rule”). We reiterate our strong view that significant changes are necessary to the Rule and its exemptions. We look forward to working with the Department to make the Rule more consistent with ERISA and the Code and to make the necessary exemptions workable. Retirement savers must be able to choose the kind of investment services they want, and the exemptions cannot be so burdensome that they prevent those services from being provided in an affordable manner. It is critical that the Department revise the Rule and its exemptions to eliminate the level of confusion that the current Rule has created among retirement savers.

In an earlier letter dated July 14, 2017, SIFMA urged the Department to delay the January 1, 2018 applicability date of the provisions in the Best Interest Contract Exemption, the Principal Transaction Class Exemption, and Prohibited Transaction Exemption 84-24 that are not

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<sup>1</sup> SIFMA represents the broker-dealers, banks and asset managers whose nearly 1 million employees provide access to the capital markets, raising over \$2.5 trillion for businesses and municipalities in the U.S., serving clients with over \$18.5 trillion in assets and managing more than \$67 trillion in assets for individual and institutional clients including mutual funds and retirement plans. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association (GFMA). For more information, visit <http://www.sifma.org>.

<sup>2</sup> Dept. of Labor Request for Information, 82 Fed Reg. 31278 (July 6, 2017).

now in effect. We also respectfully requested that the Department delay the provisions of the remaining exemptions, amended in 2016, until the President's requested study is completed.

We believe the voluminous record before the Department dating from April 6, 2016 through the present reflects the harm to retirement savers that the Rule and its exemptions have caused. They will continue to cause significant disruption, loss of services and loss of choice for retirement savers, as described not only in this comment letter and the accompanying market impact study, but also other comments and studies provided to the Department since March 2017. The negative consequences outlined in detail in these submissions, including the cutbacks in products and services to retirement accounts that have occurred since April will be exacerbated if the exemptions, as finalized in April 2016, take effect on January 1, 2018. We urge the Department to carefully review the data that has been collected that supports the conclusion that the Rule has resulted in significant harm to retirement savers. SIFMA's members have invested a substantial amount of time and resources to come into compliance with this regulation. Unfortunately, there has not been a regulatory project in recent memory that has cost the industry more, while being of questionable benefit to the people it is supposed to protect. Implementing the changes required by the Rule has distracted our members and other financial industry participants from many other projects that could benefit retirement savers and consumers alike, and has been inconsistent with the need to provide Americans with greater access to investment services and affordable choices.

As noted above, most critical in the short run is a delay in the January 2018 applicability date. Although the Department's review of the Rule and exemptions directed by the President's February 3, 2017 Memorandum has not been completed, the entire financial services industry continues to devote the massive resources needed to ensure compliance with the Rule and related exemptions by January 1, 2018. There is less than five months until that date and the Department's review is not complete. The comprehensive reexamination directed by the President's Memorandum cannot be completed by January 1, 2018. If the review concludes there have been harmful effects or if it otherwise conflicts with the President's priority that Americans be empowered to make their own financial decisions, revisions, which must be proposed for notice and comment and the opportunity for a hearing, surely cannot be completed by that date.

Unlike other significant rulemakings, both the financial services industry and the public have seen in real time the negative effect that the Rule and its accompanying exemptions have had on retirement savings and on retirement investors. Loss of choices, loss of a financial professional to talk to, more expensive products, more limited product choices, relegation of retirement savers to the internet or call centers – these are but a few of the negative impacts on the clients the industry serves and underscores the upheaval for retirement savers in the 15-month period during which financial institutions have struggled to find workable solutions to comply with the Rule and the exemptions. We have seen small accounts terminated, shifts to advisory solutions for retirement savers, confusing differences between the products and services

that may be offered to personal taxable accounts versus retirement accounts, access to municipal bonds and new issues cut off, even Treasury bonds being purchased and sold on an agency basis with commissions and markups – the record is replete with an avalanche of bad news for retirement investors, even before the Rule and its exemptions are fully effective. Retirement savers, who have been incorrectly led to believe the Rule did not require anything other than that their financial professionals act in their interest and therefore would have little impact on them, are upset at what they see as irrational wholesale changes in the products and services available to them, along with fundamental changes in their relationship with their financial professional.

It is clear to us that under the standard of review the President required the Department to undertake, the Rule and its exemptions will need substantial changes, assuming the Department does not conclude they need to be rescinded altogether. It is critical that the Department delay the January 1, 2018 date, carefully consider the Rule's harmful effects thus far on the marketplace for retirement savings, rethink its economic analysis based on real-world data, analyze what parts of the Rule and its exemptions have caused these effects to occur, and meet with interested persons to discuss changes in the Rule and the exemptions, while taking into account the SEC's (and other agencies' and SROs')<sup>3</sup> consideration of a revised standard of conduct for all retail investors.

### **Executive Summary**

To assist the Department in its review of the Rule, we are providing the following:

- New data based on a review of a cross-section of our member firms to show the market impact of the Rule and Exemptions so far (p.6 and Appendix I);
- Three analyses on which the Department should focus as they review the previous record, including a new analysis from April 2017 (p.13);
- An explanation of why it is unnecessary to create a new private right of action to change the standard of conduct in the financial services sector (p.14);
- Changes to the regulatory language needed to help make this Rule work for retirement savers (p. 16);
- Comments regarding the Exemptions (p.22); and
- A proposed new principles-based exemption that protects investors and provides certainty to service providers seeking to comply with the Rule's intent (p. 32).

### **Guiding Principles**

As an initial matter, we respectfully request that the Department review the record and propose solutions with the following principles in mind:

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<sup>3</sup> SROs are Self-Regulatory Organizations, such as FINRA (Financial Industry Regulatory Authority), NASDAQ, NYSE (New York Stock Exchange), and MSRB (Municipal Securities Rulemaking Board), among others.

- Do not impose conflicting standards. The financial services industry is already well and comprehensively regulated. It is important that the Department not add to the complexity of that regulatory framework by creating additional or conflicting standards when dealing with retail investors, regardless of whether the account is a personal account or a retirement account. The Department should not substitute its judgment for that of primary regulators, nor substitute its judgment for a retirement saver's judgment with respect to "appropriate" products or services for retirement accounts.
  - Inconsistent standards, products, pricing and disclosure between personal accounts and retirement accounts are confusing and in no one's interest. The SEC, the NAIC and others have signaled their intention to move forward with considering what the appropriate standard of care should be and working together with the Department. It is critical that these changes are coordinated and that the standards are consistent.
  - The SEC is ready and eager to work with the Department to make sure that the standard of care for an investor's taxable account is consistent with the standard of care for his IRA, and that the investor can make the investments he wants in either of the accounts. As the press has recently reported, Chairman Clayton voiced the following concerns:

"The top U.S. securities regulator identified some issues he wants to tackle, including finding 'common ground' with the Labor Department's rule requiring brokers who give investment advice to put their clients' interest ahead of their own potential commissions.

In an appearance at the U.S. Chamber of Commerce, SEC Chairman Jay Clayton raised some concerns about the Labor Department's so-called 'fiduciary rule,' which aims to reduce conflicts of interest among brokers offering advice on retirement investments. Consumer groups pushed for the Obama administration rule, saying excessive fees eat away at needed retirement income. Financial companies opposed it, saying it limits consumer choice. The Labor Department is seeking comments on whether to scrap or amend the rule. The SEC, the primary regulator of brokers with power to write its own fiduciary rule, has also asked the public to weigh in.

"It would be extremely disappointing to me if whatever direction we go here resulted in a substantial reduction in choice for the individual investor," Clayton said, echoing the criticism Wall Street firms have put forward.

He added that it would be problematic to have two disparate regulatory regimes for how brokers offer advice between the SEC and the Labor Department.<sup>4</sup>

- The Department's paternalistic approach, while perhaps well-intentioned, predictably interferes with the marketplace for investment products. The Department should not put its imprimatur on certain kinds of business models the Department favors, with "streamlined" exemptions, while taking a punitive approach to others.
- New exemptions must not be limited to business approaches or products of which the Department approves, or toward which it wants the industry to move. Respectfully, it is not for the Department to determine whether advisory fees are better than brokerage commissions, clean shares are better than T shares, mutual funds are better than stocks and bonds, index funds are better than actively managed funds, or fixed annuities are better than indexed annuities. As the President and the Secretary of Labor have said, Americans need to be able to have the opportunity to make their own financial decisions. The Department should not weight the scale in favor of a product, an industry, a business model or a compensation structure.
- Regulations should not delegate enforcement to plaintiff's attorneys. With respect to IRAs, enforcement is the responsibility of the IRS and the Department of the Treasury. Department of Labor officials have repeatedly stated that the IRS does not enforce the prohibited transaction rules and thus the need to deputize plaintiff's attorneys by creating the Best Interest Contract exemption. There are several problems with this line of thinking, including the fact that there are other regulatory agencies, such as the SEC and FINRA, who already provide robust oversight of investment services provided to retail investors. High stakes private litigation is not the way to create a new standard of care for brokers and other financial services firms paid on a commission-basis. Ambiguities of this Rule should be resolved through regulatory guidance.
- The penalty regime attached to a breach of an inherently subjective standard of conduct is not tied to the harm experienced by the retirement saver. The problem with the Department's regulation is that it vastly expands the universe of who is subject to a fiduciary best interest standard and then uses exemptions to create a penalty regime that applies to any infraction, no matter how minor, and the penalties apply regardless of whether there is any harm to the retirement saver.

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<sup>4</sup> The Wealth Advisor, July 26, 2017.

- The Department should not dictate the drafting of new policies and procedures. Our members already have extensive policies and procedures, consistent with the requirements of their primary regulators, governing their conduct with clients, imposing the duty of fair and accurate disclosure, and requiring fair dealing.
  - The Department should not, on its own, draft model policies and procedures or model disclosures. As we have seen over the last 15 months, there are many different business models and therefore varying procedures that need to be drafted to fit the business model. The Department should not draft model procedures that all financial institutions would then need to apply to their own business model. The BIC exemption is clear evidence of the Department's unrealistic view of what constitutes model disclosure. Instead, we think this is the kind of project that benefits from industry and the Department working together.
- Currently, in the insurance and mutual fund arenas, many costs are largely paid by the insurers and fund companies through third party fees. The Department has issued rules which attempt to change this widely accepted business model by making it so burdensome and fraught with litigation risk that the financial services industry will submit to the Department's apparent mandate to charge client's fees directly.
  - The direct fee business model may be different, but not necessarily better for the client. Any revised exemption should not assume that somehow, these costs now covered by manufacturers, will disappear. They will not. Some share classes may permit these costs to continue to be borne by the mutual funds; others will impose these costs directly on retirement investor accounts. To the extent different versions of clean shares are created, direct costs on retirement clients will differ. It seems clear that at least some additional costs will hit client accounts directly, while it is not at all clear that retirement investors will find the change favorable.

### I. The Market Impact of the Rule and Exemptions Thus Far

The questions raised by the Presidential Memorandum on the Rule issued on February 3, 2017 are critical to a thoughtful analysis of the Rule. There is already significant evidence in the record before the Department relating to the experience that the industry has had in preparing for the June 2017 applicability date, as well as the January 2018 applicability date. The Rule and its accompanying exemptions have caused many financial institutions to change business models, limiting the choices available to retirement savers and their access to advice and increasing product pricing. While these results were predicted in our original comments, and dismissed by the Department, they have actually come to pass.

The President's Memorandum provides:

"one of the priorities of the Administration is to empower Americans to make their own financial decisions, to facilitate their ability to save for retirement and build their individual wealth necessary to afford typical lifetime expenses ...." [i]f you make an affirmative determination as to *any of the considerations* identified in subsection (a) or you conclude for any other reason after appropriate review that the Fiduciary Duty Rule is inconsistent with the priority identified earlier in this memorandum - *then you shall publish for notice and comment a proposed rule rescinding or revising the Rule*, as appropriate ..." (Emphasis added).

The Rule and its accompanying exemptions are not consistent with the current Administration's stated priorities and therefore, pursuant to the President's instructions, they must be rescinded or substantially revised.

We believe the record is replete with clear evidence of significant, and for retirement savers, largely negative changes in the industry on account of the Rule and the exemptions. Hundreds of millions of dollars have been spent by financial services firms to understand the Rule and to fashion a business model they believe complies with the Rule. But no one can be certain that the models adopted will comply, in some cases due to uncertainty created by several of the Department's FAQs. The industry continues to spend significant resources to craft and adopt the necessary policies, procedures, training, and communications to implement their new model. *Virtually no existing brokerage model would have complied with the Rule and its accompanying exemptions.* Further, the industry is not close to having completed the work it would take to comply with these rules.

Virtually every broker-dealer has made at least some changes in its business model, and many of these changes, caused only by the Rule and the exemptions, have restricted choices available to retirement savers. Many financial institutions have cut back on the number and kind of mutual funds available to retirement savers. Others are limiting their offerings to advisory programs. Still others are requiring any brokerage account to use either a call center or the internet.

The Department has focused on concepts such as clean shares and T-shares. Within a period of just a few months, financial institutions announced a move to T-shares, and then some financial institutions announced a delay in any rollout of a T-shares program. Mutual fund companies spent significant resources rewriting prospectuses and selling agreements and obtaining approval for T-shares. As other ideas surface, they spend significant resources responding to those ideas. Many mutual funds are pursuing T-shares, clean shares and other industry suggestions. Broker-dealers continue to consider these options, but the uncertainty around the Rule and the exemptions, and the likelihood that they will be withdrawn and replaced or revised with a Rule and exemptions that are more straightforward, is disruptive and expensive.

Financial institutions and their consultants have spent significant amounts struggling to create the recordkeeping systems that clean shares would require, and it is unclear whether those shares will be acceptable to investors, who are not used to seeing the transaction's costs in their account.

Despite the Department's apparent view that clean shares are a good solution for mutual fund families, there is no consensus that (i) clean shares will be better for retirement savers, (ii) that they can be implemented by brokers at a reasonable cost, or (iii) that they are a solution that could be put into place in a reasonable time frame.<sup>5</sup> The entire cost of buying, selling, and holding these shares will be charged to the retirement saver's account and it will exceed the amounts paid by the mutual fund, since the change will require the creation of expensive new systems to accommodate the required recordkeeping currently done by the mutual fund complexes.<sup>6</sup>

In today's world, the A share front end sales charge/commission is taken out of the investment amount at the time of sale and passed electronically from the Funds to the intermediary. However, the industry is still defining a variation of a clean share as being able to support a Sub-TA payment, which would still allow operational support provided by the financial firm to be paid by the mutual fund. The system upgrades that are being considered are for the support of a commission charge that is applied on a non-commissionable share class and retained by the financial firm.

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<sup>5</sup> Our members estimate that it would take from 18 months to three years for all mutual funds and all broker-dealers to move to clean shares if they decided to do so. The majority of mutual fund positions are now held omnibus at the broker/dealer. In order to record keep this business, a "sub-accounting" system is used to perform mutual fund only specific functions like; pricing, 12b-1 fees, tracking statements of intent, CDSC on B/C shares, etc. There are three primary sub-accounting systems, all of which are essentially transfer agent platforms. Because of that, pricing takes only into consideration holdings within a particular mutual fund family. Clean shares are challenging because relationship pricing will have to expand to include all mutual fund holdings and not just those within a particular fund family. If, however, clean shares and a new pricing model include non-mutual fund holdings, the sub-accounting system has to know about those assets as well when extending mutual fund trades.

On the Fund side, the Fund companies have to do the business assessment to determine whether to offer clean shares and, if so, determine what work is entailed. After making that determination, they need to get approval from the fund's Board. Then they must craft prospectus language, determine marketing plans, etc., file a prospectus and obtain No-Action letters. Only then can the brokerage firms begin to build the systems they need after deciding the kind of model to have for pricing.

<sup>6</sup> Investment News, May 13, 2017, "The Truth about T Shares"; Barrons, January 10, 2017: Morningstar: T shares to Kill off A Shares; Barrons, May 15, 2017, "Clean Shares, T Shares Could Dominate"; Investment News, February 2, 2017, "Clean Shares Could Revolutionize the Industry". Benefits Pro, July 20, 2017, "Morningstar: Industry's idea of clean shares may not be clean enough: Who pays for record-keeping under the fiduciary rule?"



News articles and commentary accurately reflect an industry reeling from these changes.<sup>7</sup> This expenditure of resources is a direct result of the confusion caused by the new rules. This path seems to be a social experiment – i.e. whether a single rule by the Department might cause the elimination of third party fees for all investors. But in our view, the changes all come at the expense of retirement savers. As will be discussed more fully below, these changes, largely driven by the Department’s like or dislike for a particular product or the newest innovation, are not good for or welcome by the retirement savers they were designed to protect. They also certainly have not been good for the industry. The money and other resources expended thus far will ultimately show up in higher prices for retirement accounts. It is not responsible for a regulator to require the industry to haphazardly, and on very short notice, chase the newest “Department-favored” product, which might not have been tested yet, or had possible challenges worked out. There must be a more holistic method of regulation. We are mindful of the views expressed by Chairman Roe when the Rule was first introduced: “And, quite frankly, just listening for a long time I guess I’ll use a medical metaphor, it sounds like we’re doing a heart transplant when all you need to do is get up off the couch and walk around the block.”<sup>8</sup>

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<sup>7</sup> Kelly, Bruce. "Ameriprise will stick with IRA commissions under DOL fiduciary rule." *Investmentnews.com*. 26 Oct. 2016. <http://www.investmentnews.com/article/20161026/FREE/161029927/ameriprise-will-stick-with-ira-commissions-under-dol-fiduciary-rule>; Michael Wursthorn. "A Complete List of Brokers and Their Approach to ‘The Fiduciary Rule’." *WSJ*. 6 Feb. 2017. <https://www.wsj.com/articles/a-complete-list-of-brokers-and-their-approach-to-the-fiduciary-rule-1486413491>; see also, e.g., *Wall Street Journal*, *Edward Jones Shakes up Retirement Offerings Ahead of Fiduciary Rule* (Aug. 17, 2016) (Edward Jones announces it will limit mutual fund access for retirement savers in accounts that charge commissions); Crain’s, *Why State Farm agents are getting out of the investment game* (Sep. 3, 2016) (State Farm directs 12,000 securities-licensed agents to no longer provide their clients with mutual funds, variable annuities and other investment products); Maxey, Daisy, *Wall Street Journal*, *New Rule Helps No-Load Funds—But Investors Still Need to Watch for Other Fees* (Nov. 7, 2016) (Charles Schwab stops selling fund share classes with front-end sales loads in May 2016). See, e.g., Benjamin, Jeff, *Fiduciary Focus*, *DOL Fiduciary Rule Class-Actions Costs could Top \$150M a Year* (Feb. 9, 2017) (“Some firms, including Merrill Lynch, Capital One, and Commonwealth Financial Network, have already announced plans to use a streamlined [BIC exemption] that does not include a contract or variable commission rate, making them exempt from class-action lawsuits. Other firms will be rolling the dice.”); AdvisorHUB, *Merrill to End Commission-Based Retirement Business on Retail Accounts* (Oct. 6, 2016) available at <https://advisorhub.com/exclusive-merrill-end-commission-based-retirement-business-retail-accounts/> (Merrill Lynch announces, in response to the fiduciary rule, that its 14,000 brokers cannot receive commissions for advice on retirement accounts and will have to shift clients who remain with the firm to fee-based advisory accounts). ThinkAdvisor, *DOL Rule Casualty: Commonwealth Drops Commission Retirement Products* (Oct. 24, 2016) available at <http://www.thinkadvisor.com/2016/10/24/dol-rule-casualty-commonwealth-drops-commission-re> (last visited Apr. 13, 2017). Idzelis, Christine, *InvestmentNews*, *Bank of America Merrill Lynch tells advisers to stop selling mutual funds in brokerage IRAs now* (Nov. 1, 2016) available at <http://www.investmentnews.com/article/20161101/FREE/161109984/bank-of-america-merrill-lynch-tells-advisers-to-stop-selling-mutual> (last visited Apr. 13, 2017). Investment News, May 8, 2017, “Decision to cut Vanguard funds likely due to DOL Fiduciary Rule”; CNBC, March 10, 2017, “Merrill Lynch May Keep Commission based Retirement Accounts”.

<sup>8</sup> Chairman Roe’s comments on the first proposal: “The fiduciary’s advice must be provided pursuant to a mutual agreement and be the primary basis for resulting investment decision. However, the labor department has now decided to rewrite the rules of the road. Among other changes proposed by the department, fiduciary status would no longer hinge on whether advice was provided regularly or served as a primary reason for an investment decision.

While we support looking at tailored changes to address real changes that have occurred in the market, the current proposal is an ill-conceived expansion of the fiduciary standard. It will undermine efforts by employers and service

The annuity world presents similar issues. Some institutions have cut back on their sale of annuities, or restricted the kind of annuities sold, simply because proving neutral factors in the compensation setting seems fraught with legal risk.<sup>9</sup> Some firms have limited their sales of indexed annuities, while others have limited their product offerings to variable annuities. The landscape changes daily, and several institutions have adopted a new model, only to change it a few months later. This disruption is not only harmful to retirement savers, but it is also not in alignment with the view that individual choice and robust competition will better serve Americans than overly intrusive regulations. We reiterate Secretary Acosta's editorial in the Wall Street Journal:

America was founded on the belief that people should be trusted to govern themselves. Citizens sit on juries and decide the fate of their fellow citizens. Voters elect their representatives to Washington. By the same token, Americans should be trusted to exercise individual choice and freedom of contract. At a practical level, this means Washington should regulate only when necessary. Limiting the scope of government protects space for people to make their own judgments about what is best for their families.<sup>10</sup>

The overly-broad Rule and its overly-prescriptive exemptions, in fact, stultify innovation because they require the industry to remain static, regardless of technological or other advances.

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providers to educate workers on the importance of responsible retirement planning. Regrettably, the proposal may deny investment opportunities and drive up cost for the individuals it is intended to protect.

Remarkably, the department failed to examine all the potential costs of its proposal. For example, despite clear indications this proposal may force small business plan sponsors to face higher fees and receive fewer services. The department neglected to conduct any analysis of the potential ramifications.

Similarly, the department failed to explore how its proposal could affect the IRA market. One study suggests that some IRA related fees may increase by as much as 195 percent. That's an unacceptable amount of money that will never make it into a retirement account.

This is a difficult issue and we should never lose sight of the real world impact these changes may have on the investments and long-term retirement security of workers and retirees. We need to challenge any proposal that would curb investment opportunities, raise the cost of investing and reduce the return on those investments for individuals saving for retirement." Chairman Roe, transcript of July 26, 2011 hearing before the House Committee on Education and the Workforce. See also, Yale Law Journal, 2005, Yale Law Journal titled "Questioning the Trust Law Duty of Loyalty: Sole Interest or Best Interest." by John Langbein, principal drafter of the Uniform Prudent Investor Act.

<sup>9</sup> Investment News, May 18, 2017, "Indexed, variable annuity sales slump as DOL fiduciary rule looms." Investment News, March 28, 2017, Department of labor's Fiduciary Rule Blamed for Insurer's Massive Hit on Variable Annuity Sales. Barrons, March 29, 2017, "Fiduciary Rule Crushes Variable Annuities". Time.com, August 21, 2016, "Why Edward Jones Won't Let Investors Buy Funds, ETFs in IRAs"; Investment News, June 7, 2017, "DOL fiduciary rule: Edward Jones changing stance on mutual fund commissions in IRAs".

<sup>10</sup> Wall Street Journal, May 22, 2017.

We urge the Department to recognize that its effort to predict or fashion the next “innovation” is misconceived. For example, the RFI suggests that fee-based annuities and clean shares are the answer. There is no evidence, however, that fee-based annuities or clean shares are what retirement savers want. In addition, fashioning exemptions based on today’s business model is shortsighted. Any exemption based on today’s “innovation” will quickly become outdated.

The Department’s RFI seeks short term, temporary solutions for today’s latest innovation. We fear, however, that the innovation and the exemptions will be outdated tomorrow. We urge the Department to avoid alighting on innovations that the staff believes are appropriate, in the best interest of retirement savers, or most “workable.” The cornerstone of a free market system is that market participants will themselves adapt to provide the new and innovative services and products to customers without a prescriptive regulatory approach from the Department. They will do so because they know, if they do not, they will lose those customers.

We need a new approach. The Rule needs to take a more common-sense approach to who is a fiduciary. Service providers should be allowed to be clear about their role and clients should be allowed to decide the level of service they want and the standard of care and legal culpability. The parties should be permitted to agree not to have an advisory arrangement if it is made clear there is no duty of loyalty or prudence. Suggestions about transfers, distributions, contributions and rollovers, standing alone, should not be deemed to be investment advice under the Rule. Exemptions for fiduciaries should be general, work for any business model, and be based on the concepts that have marked the Department’s administration of these statutes until the last few years: maintain policies and procedures designed to ensure that one acts fairly, loyally and prudently, makes full and fair disclosure, and charges reasonable compensation. And most important, the revised Rule should recognize that the Department should not substitute its judgment for that of individual retirement savers when it comes to their own retirement savings.

SIFMA engaged Deloitte & Touche (“Deloitte”) to facilitate a study<sup>11</sup> with a cross-section of its members to understand and analyze the realized and potential impacts to retirement savers and financial institutions which resulted from decisions made and steps taken by study participants to comply with the Rule’s first applicability date on June 9, 2017 and the anticipated steps for January 1, 2018 compliance. The 21 financial institutions participating in the study represent 43% of US financial advisors and 27% of the retirement savings assets in the market. This study is included as an appendix to this letter.

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<sup>11</sup> Attached as Appendix I

The study found that access to brokerage advice services has been eliminated or limited by many financial institutions as part of their approach for complying with the Rule, and that retirement savers chose to shift assets to fee-based or advisory programs because of those limitations. Specifically, as of the Rule's first applicability date on June 9<sup>th</sup>, 53% of study participants reported limiting or eliminating access to brokerage advice for retirement accounts, which the firms estimate impact 10.2 million accounts and \$900 billion AUM. Industry promotion of fee-based accounts may result in an increase of average fees paid per year by retirement savers who are seeking to retain access to investment services and for which those products are in their best interest. Several firms indicated that they plan to make additional changes to their advised brokerage offering should the current version of the exemptions go into effect on January 1, 2018.

The study also found that there has been a reduction by financial institutions in the diversity of products available for retirement savers. Roughly 95% of study participants indicated that they have reduced access to or choices within the products offered to retirement savers because of efforts to comply with the Rule. Products affected include mutual funds, annuities, structured products, fixed income, private offerings, and more, impacting an estimated 28.1 million accounts. Examples of the reduction in mutual fund availability include: 1) the elimination of no-load funds from brokerage platforms; 2) the elimination of mutual funds held directly at the mutual fund company; 3) reduced product offerings; and 4) elimination of other share classes.

The study further found that Rule implementation and ongoing compliance efforts have caused operational disruption and increased costs for financial institutions. Across the industry, broker-dealers will have spent more than \$4.7 billion in start-up costs relating to the Rule, much of which has already been spent. This is considerably more than the Department estimated in its 2016 Regulatory Impact Analysis, which estimated total start-up costs for broker-dealers alone between \$2 billion and \$3 billion. The ongoing costs to comply are estimated at over \$700 million annually, which is also greater than the Department estimated at the high end.

SIFMA believes that the responses and approaches to complying with the Rule have varied widely, resulting in disruption and uncertainty for financial institutions and retirement savers. SIFMA believes the unprecedented variation of approaches to comply with the Rule is the result of a poorly crafted regulation that is creating chaos in the marketplace for firms and investors alike. The uncertainty around the Rule and potential changes has amplified both real and opportunity costs associated with compliance. The overall effect of which, SIFMA believes, will have a chilling effect on savings, in addition to the significant disruption caused by the Rule.

## II. Flaws in the Department’s Economic Analysis

Numerous studies have shown that the Department’s Regulatory Impact Analysis (“RIA”) is seriously flawed. The data that the Department continues to rely upon to support the need for the rule is outdated, and has been credibly challenged by later studies. For example, in its review of the Department’s RIA, the National Economic Research Associates (“NERA”) found that the academic research cited in the Department’s RIA is misapplied and the Department made several erroneous conclusions on investor behaviors, rendering the Department’s RIA unreliable and incomplete.<sup>12</sup> In fact, the most frequently cited paper in the RIA uses results from a statistical analysis on certain types of funds with higher-than-average loads and misapplies those results to all funds. This oversight alone exaggerates the importance of the findings cited by the Department. Furthermore, the cited literature focuses on mutual funds, yet the Department inappropriately applied the results more widely. These are just a few of the flaws outlined by one critique of the Department’s RIA, and there are numerous other studies challenging the Department’s sweeping generalizations and extrapolations which make up the basis for its rulemaking.

One other analysis we would highlight is a comment submitted by the Mercatus Center at George Mason University in April 2017. The comment focused on the flaws of the Obama Administration’s Council of Economic Advisers (“CEA”) report.<sup>13</sup> In particular, the Mercatus Center notes that “review, analysis, and the introduction of new data reveal that the CEA report is quite weak and should not serve as the basis for such an extensive rulemaking of the structure of the financial services and retirement industries.” Their analysis then proceeds to pull apart various aspects of the study and analysis done by the CEA, and further highlights that none of the studies utilized by the CEA are directly relevant to the issue of whether a fiduciary standard, as put forth by the Department, will improve, or even impact, investment performance.

If the Department continues down this path, substantial harm will come to consumers. As we have long argued, the rule will lead to greater costs, fewer choices for retirement savers, and decreased access to valuable education and assistance. A mounting body of evidence supports these claims and several studies highlight the importance of education, guidance and one on one assistance. One such study, “The Gamma Factor and the Value of Financial Advice,” builds upon prior research and reconfirms the positive value of financial assistance.<sup>14</sup> The updated analysis corrects for issues of causality and oversampling that were present in the original

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<sup>12</sup> <http://www.sifma.org/issues/item.aspx?id=8589955443>

<sup>13</sup> Mercatus Center comment letter (Apr. 17, 2017), available at <https://www.dol.gov/sites/default/files/ebsa/laws-and-regulations/rules-and-regulations/public-comments/1210-AB79/01303.pdf>

<sup>14</sup> Study, *The Gamma Factor and the Value of Financial Advice*, available at <https://www.cirano.qc.ca/files/publications/2016s-35.pdf>

analysis, and still retains with statistical significance the value of education and personal assistance. Specifically, the study found that among comparable households, those that use the services of a financial professional gained 69% more value for their investment assets after four years, and after 15 years or more, the additional value reaches 290% for an advised household. This is 3.9 times the value of assets of an equivalent household that does not consult a financial professional. This outcome cannot be ignored. Limiting access to critical financial education and guidance will have a substantial negative impact on millions of American households.

### III. The Industry Will Comply with the Law; Additional Enforcement Mechanisms Like the Private Right of Action are Unnecessary

During the prior Administration, the Department decided that financial institutions would not comply with the law unless the threat of private plaintiff litigation loomed before them. That assumption was wrong then, and it is wrong now. The IRS enforces the prohibited transaction provisions of the Code just as it enforces the income tax provisions of the Code. Entities subject to taxation are required to self-report and failure to do so can result in interest, penalties and other consequences. The Department should not assume that industry will ignore the prohibited transaction provisions or that the IRS will not do its job.

Over the eighty-plus years since the passage of the Exchange Act, the SEC, FINRA and state securities regulators who oversee broker-dealers have developed a fulsome regulatory regime based on brokers' duty of fair dealing.<sup>15</sup> This regime includes the obligation to make suitable recommendations, ensure best execution, and observe high standards of commercial honor and just and equitable principles of trade – a concept that, itself, embodies fiduciary principles.<sup>16</sup> As stated by SEC staff and FINRA guidance, the suitability obligation generally requires a broker-dealer to make recommendations that are “consistent with the best interests of his customer.”<sup>17</sup> Numerous securities cases have explicitly held the same.<sup>18</sup>

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<sup>15</sup> See MORGAN, LEWIS & BOCKIUS LLP, Department of Labor Retirement Initiative Fails to Consider Current Regulatory, Regime, Which Comprehensively Protects Investors Including IRA Investors, and Preserves Investors Choice (2015) (explaining how the current framework governing financial professionals protects investors as broker-dealers and their registered representatives are subject to extensive regulatory oversight in addition to investors' private rights of action) available at [https://www.morganlewis.com/~media/files/publication/morgan%20lewis%20title/white%20paper/im\\_whitepaper\\_dolretirementinitiative\\_march2015.ashx](https://www.morganlewis.com/~media/files/publication/morgan%20lewis%20title/white%20paper/im_whitepaper_dolretirementinitiative_march2015.ashx).

<sup>16</sup> See *In re E.F. Hutton & Co. Inc.*, Release No. 25887, 41 S.E.C. Docket 413, 418 (July 6, 1988) (“The concept of just and equitable principles of trade embodies basic fiduciary responsibilities....”).

<sup>17</sup> SEC Staff Study on Investment Advisers and Broker-Dealers (January 2011), at 59, available at <https://www.sec.gov/news/studies/2011/913studyfinal.pdf>; FINRA Regulatory Notice 11-02 (January 2011), at 7 n. 11, available at <http://www.finra.org/sites/default/files/NoticeDocument/p122778.pdf>.

<sup>18</sup> FINRA Rule 2111 (Suitability) FAQs, at A7.1, n. 69 (citing numerous cases) available at <https://www.finra.org/industry/faq-finra-rule-2111-suitability-faq>.

Congress intentionally decided not to include a private right of action in the Code and that has worked for investors for 40 years. The Department may disagree with Congress' decision, but it must respect that decision and not seek to find means around it. The Code is not the only statute where Congress made that decision. There is no private right of action under the Investment Advisers Act of 1940, and the lack of a private right of action does not mean that the regulated advisors ignore the law. The private right of action, including the requirement of a contract and warranties, should be abandoned. Not only is the creation of a private right of action by an agency unlawful, but it is unnecessary. It makes the exemptions complex and unworkable, let alone fraught with uncertainty and expensive. It is an unwarranted gift to the plaintiff's bar, which will only cause fees to increase to cover the risk of frivolous lawsuits.

The exemptions appear to have been drafted to make virtually any foot fault the subject of a class action law suit. We disagree with this approach. To facilitate the use of, and compliance with, the exemptions, the exemptions should be drafted so that they can be readily understood by both the firms and retirement savers alike. They should not be a trap for the unwary and should not allow an immaterial infraction or unintended error to cause a financial institution to lose all the relief under the exemption. They should not require millions of dollars in technology investments, or such detailed disclosure that the very information that the Department wants retirement savers to see will be ignored because of its complexity. Financial institutions have complied for 40 years with section 408(b)(2), PTE 75-1, PTE 77-4 and numerous other exemptions that took only a few paragraphs and some well understood principles to get their point across: trade at arms' length, employ fair market interest rates, adhere to reasonable and necessary services at appropriate pricing, do not engage in "double-dipping" of asset management fees and disclose the use of affiliated funds. No private right of action is needed to ensure compliance with these standards. Further, as noted above, the private right of action is unlawful because Congress chose not to include a private right of action in the Tax Code with regard to IRAs.

The exemptions the Department promulgated in connection with the Fiduciary Rule bear little resemblance to the Department's historic exemptions and the statutory exemptions crafted by Congress. Articulating clear principles in a reasonable manner, without hundreds of conditions that would require an army of compliance people to understand, will lead to exemptions that will be protective, in the interest of participants, and administrable. Contracts, warranties, websites and other prescriptive requirements with plaintiffs' bar as the preferred enforcement mechanism are counterproductive.

#### IV. The Rule Itself Needs to be Revised

The RFI contains nearly a half-dozen questions that suggest, based on today's "market innovations," a new streamlined exemption should be proposed. However, the problems posed by the Rule and its accompanying exemptions cannot be fixed with a single streamlined exemption based on new market trends. This list of issues with the Rule itself and our suggestions highlight the unworkability of a single exemption:

1. We urge the Department to create consistency with the priorities the President outlines in his Memorandum, and the concept Secretary Acosta highlights in his letter to the editor about Americans deciding for themselves whether they want, and want to pay for, a fiduciary service or not. If they want to talk to a salesman, broker, or other person, with the full knowledge that the person gets paid for the selling and is incented to do so, they should be able to do so. A fiduciary standard must encompass some agreement between the parties that a fiduciary service is being provided. This mutual agreement avoids needless disputes, and allows the financial institution to put in place policies, procedures and training that govern fiduciary services. In addition, it is critical that both the financial professional and the retirement saver see the conversation as more than a sales call. Thus, the concepts of mutual agreement and reliance must be put back into the Rule.
2. Not every conversation is a fiduciary conversation, even with a person who agrees to give investment assistance. Thus, the list of the topics that make one a fiduciary must be revised. The statute defines a fiduciary as a person rendering investment advice for a fee. This statutory test does not include suggestions regarding distributions, transfers, or contributions, and accordingly, these facets of the definition of fiduciary advice should be removed from the rule.<sup>19</sup> The definition of fiduciary must be realistic and track the statute in a common-sense manner.
3. We urge the Department to adopt the kind of selling rule that was proposed in 2010, as modified by our comments on that proposal. Fully disclosed selling is not fiduciary advice. In addition, there must be a sophisticated investor exception for individuals for their own IRAs. We note again, as we did when the rule was proposed, that it seems overly protective for the Department to decide that investors who are treated as sophisticated under all other investment regimes are not sophisticated enough to hear a

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<sup>19</sup> We note that the RFI and certain of the FAQs issued by the Department previously suggested that recommendations on contributions are covered by the statute and the regulation. The Department takes a different position, which is a more common-sense interpretation, with its new FAQs, issued on August 3, 2017. The new FAQs can be found here: <https://www.dol.gov/sites/default/files/ebsa/about-ebsa/our-activities/resource-center/faqs/coi-transition-period-2.pdf>



mutual fund offer from their financial professional, or hear about an IPO from their brokerage firm, simply because the investment will be held in a retirement account rather than a taxable account. The frustration of individual IRA owners on this issue alone has been extraordinarily disruptive, and the Department's rationale – even the wealthiest, most sophisticated individuals cannot understand the difference between selling and fiduciary advice – is a paternal approach inconsistent with the Secretary's clear pronouncements. Any sophisticated investor test should be product based, and should only be needed when the product being sold is particularly complicated. The Department's current formulation does not distinguish between the most readily understood index funds and the hardest to understand alternative investment funds – in the Department's view, a person needs to control \$50 million to understand either of those products. We strongly believe that there should only be one “sophistication” test across regulatory regimes and that test should be developed by the SEC and FINRA, considering their actual experience in the marketplace. In short, investors are not less sophisticated when they are dealing with their retirement assets rather than their taxable personal assets.

4. There must be an exception for clearly disclosed selling. The 2010 Proposal contained such a provision and it reflected the common-sense notion that when a salesperson clearly discloses that he is selling, not advising in the recipient's best interest, that recipient is able to understand the difference between sales and fiduciary advice. Indeed, the common law of trusts reflected this notion by distinguishing between salespersons and fiduciaries. The rule should have an exception that reads substantially as follows:

A person shall not be considered to be a person described in paragraph (c)(1) of this section with respect to the provision of advice or recommendations if the recipient of the advice knows or, under the circumstances, reasonably should know, that the person is providing the advice or making the recommendation in its capacity as a purchaser, seller or lender of a security or other property or a seller of services, a counterparty in a swap, repurchase agreement or other bilateral agreement, or as an agent of such a purchaser, seller, lender or counterparty. A person will be deemed to have demonstrated that the recipient of the advice knows or should know that the recommendation is made in its capacity as a purchaser, seller, lender, counterparty, or agent if the person has disclosed in writing at the outset of the relationship, i.e., prior to the first transaction in the course of the relationship, and in the case of a relationship extending beyond twelve months, at least annually thereafter, that it is not acting as a fiduciary, that its financial interests may be affected by the transaction, that it may earn a fee, spread or other compensation if the transaction is consummated or the service is provided and that the recipient of the advice will not have the remedies that it would have if the person were agreeing to act as a fiduciary.

The Department believes that it has accomplished this goal in its “hire me” exception. It has not, and its preamble explanation makes clear what little use the “hire me” exception has. Even where the Department seemed to appreciate that when a financial professional urges a retirement saver to hire him, such self-proclaimed marketing should not be deemed to be fiduciary advice, the Department goes on to say that if you say anything other than “hire me,” you will be giving investment advice. For example, the preamble notes:

The final Rule draws a line between an advisor’s marketing of the value of its own advisory or investment management services, on the one hand, and making recommendations to retirement investors on how to invest or manage their savings, on the other. An advisor can recommend that a retirement investor enter into an advisory relationship with the advisor without acting as a fiduciary. But when the advisor recommends, for example, that the investor pull money out of a plan or invest in a particular fund, that advice is given in a fiduciary capacity even if part of a presentation in which the advisor is also recommending that the person enter into an advisory relationship. The advisor also could not recommend that a plan participant roll money out of a plan into investments that generate a fee for the advisor, but leave the participant in a worse position than if he had left the money in the plan. Thus, when a recommendation to “hire me” effectively includes a recommendation on how to invest or manage plan or IRA assets (e.g., whether to roll assets into an IRA or plan or how to invest assets if rolled over), that recommendation would need to be evaluated separately under the provisions in the final Rule. 81 Fed. Reg. 20968.

Under the Department’s interpretation, an investment manager can say “Hire me; I’m the best” but not if the only way to hire him is to roll over assets into an IRA; the Department sees that as disguised investment advice to take a distribution and roll it over to an IRA. An investment manager can say “Hire me; I’m terrific” but he cannot say “I’m terrific at fixed income management” because such a statement could “effectively include” a fiduciary recommendation to allocate assets to fixed income, according to the Department. We think this is too broad an interpretation, and too narrow an exception to create any practical likelihood that either party would understand when it is being used, creating too great an opening for plaintiff’s lawyers. That should not be the purpose or result of effective rulemaking.

5. The current sophisticated fiduciary exception must be substantially simplified. It would not be an exaggeration to say the current formula for that exception has resulted in millions of written communications between dealers and managers, plans and service providers, plans and investment managers, mutual funds and their distributors, and insurers and their distributors. The current formulation requires that the person providing assistance know or have a reasonable belief that the independent fiduciary satisfies certain requirements (where the person may rely on written representations

from the fiduciary in this regard) can result in overwhelming exchanges of paper which is impractical, unnecessary and expensive. The process envisioned by the Department was a tremendous waste of time and resources. It should be quickly abandoned in favor of a flat exclusion: communications between any advisor, broker-dealer, bank or insurance company are never treated as covered investment advice.<sup>20</sup> In the context of “professional” fiduciaries (i.e., those where the \$50 million requirement does not apply), the Department stated: “The use of the term “plan fiduciary” in the proposal was not intended to suggest that ordinary business activities among financial institutions and licensed financial professionals should become fiduciary investment advice relationships merely because the institution or professional was acting on behalf of an ERISA plan or IRA.” However, that is exactly what has happened in practice. At the least, the exception should be revised to provide that if the counterparty is a licensed and regulated financial services provider, any “advice” related to transactions between the parties should automatically be excluded from the Rule with no other requirements beyond a reasonable belief that the counterparty is a bank, B/D, RIA, etc. This will create certainty and avoid the need for obtaining redundant representations regarding the ability to evaluate investment risks, exercise independent judgment, and the like. For conversations with plans of any size, the rule should simply be that the parties can decide whether they are receiving fiduciary services. The Department should refrain from predetermining the capacity (fiduciary) in which a party will be acting, without any regard to the views or preferences of the plan fiduciary, participant or IRA owner. In addition, (i) the Part II FAQ 28 on the meaning of independence must be revised; (ii) the last prong of the exception regarding compensation should not cover payment for research, regardless of whether the research is provided as part of commissions or paid for explicitly, as will be required in some jurisdictions; and (iii) one can rely on the exception if the firm is paid for the “advice” by the corporate sponsor, not the plan.

6. The exceptions for platform providers must be expanded to be available for IRAs as well as any ERISA employee benefit plan. By their terms, the exceptions permit only factual analytics that do not include recommendations. There is no reason why a platform provider cannot provide this information to IRAs or Defined Benefit plans, for example. The exceptions – one for platform providers offering an investment menu from which to choose, a narrowing, if you will, of 9000 mutual funds to 100, or 1000 corporate bonds to 50, and the other, identifying a limited set of investments that meet certain criteria specified by the plan fiduciary – are just exactly what any investor, plan or IRA owner would find helpful. The exceptions deny assistance to the very people most interested in this kind of generalized help without a single, specific investment

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<sup>20</sup> The independence test is particularly troublesome, since it would appear to make an insurance company or mutual fund employee a fiduciary when talking to their affiliated broker-dealers.

called out as a fiduciary recommendation. The limitation that makes this help potentially unavailable to individuals, regardless of the cautionary disclosure, is another example of the pitfalls of the Department's approach. It fails to recognize the ability of individuals, and ERISA plans other than DC plans, to understand disclosures. Contrast the SEC's and FINRA's regulatory regime that relies on such disclosures and trusts an investor to read it. We urge the Department to have more faith in retirement savers and their ability to understand the information they are provided.

7. The General Communications exception is narrowly written and the explanatory preamble makes it even narrower. Words like "general circulation," which can be read to exclude communications to all or a subset of a financial institution's clients, or "widely attended," which could be read to suggest that the attendees must exceed the institution's client base, or "reports prepared for general circulation," which seems to indicate that unless any person on the street can access the report, it is not widely distributed enough, raise a number of questions. These exceptions should be available for use, not a reality in which they will not apply to anyone.<sup>21</sup> Any reasonable exception must make clear that materials on a public website should be viewed as general communications, and research materials prepared by the global research department can be distributed by business groups to their clients without falling outside of the exception.
8. The Department's prohibition of the use of examples in investment education simply hurts rather than helps retirement savers. As we noted in our 2015 comment letter on the proposed Rule, the exception for participant education has been neutered by its prohibition of concrete examples of funds in an asset class. If the participant does not understand the financial categories that the financial professional is talking about, the education carve-out will be virtually useless to a participant who is not financially literate and cannot translate generalities into some realistic choices. There are hundreds of funds in each class and subclass of investment categories. While the final Rule permits limited use of examples for qualified plan participants, it does not permit examples for IRA owners. We believe that the ability to populate asset allocation models should extend to IRA owners. The Rule relegates participants to the internet to try to figure out which funds are in which asset class. If the financial professional cannot show the retirement investor two prospectuses and illustrate the differences in permitted investments, benchmarks, risks, etc., the education is not worth very much.

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<sup>21</sup> The preamble substantially weakens the breadth of this exception, suggesting that if a television or print ad suggests that an institution provides one on one counseling, any document provided to them would be investment advice: "Nor should they be able to continue the practice of advertising advice or counseling that is one-on-one or tailored to the investor's individual needs and then use boilerplate language to disclaim that the investment recommendations are fiduciary investment advice." 81 Fed. Reg. 20971.

Lack of financial literacy is a universally recognized problem; giving asset classes without allowing examples will not help participants. They will be paralyzed by their choices. Unless they choose to pay for advice from a financial professional, their choices will be uninformed and haphazard, if not entirely incorrect, and driven by confusion in the least volatile markets and panic in the most volatile markets. SIFMA believes that the education exception is useless without examples, further leaving participants to fend for themselves. This limitation will likely have an enormous adverse effect on retirement savers. The Department can fashion a rule based on disclosure that would allow the education provision to help retirement savers. Forcing everyone to pay an advisory fee to obtain concrete examples is not the right solution. Nor does it make sense for plan sponsors to pay an advisory fee to obtain suggestions on asset allocation.

9. The swap exception must cover pooled funds and must be revised as described above in connection with the sophisticated fiduciary exception. As written, it has the same deficiencies as that exception and in addition, it fails to apply to ERISA covered pooled funds without explanation, since the point was raised repeatedly by the 2015 comments.
10. The Department's definition of "compensation" in connection with rendering investment advice for a fee is overbroad. The Rule takes the position that a firm has rendered investment advice for a fee when the firm receives a commission for a sale, regardless of the fact that another person pays the same fee without talking to anyone and without receiving a recommendation, suggestion or trading idea. It makes no sense and is thus unreasonable to impute fiduciary advice into a fee which does not change in the absence of advice. Trading costs are not for investment advice; they are for trading. Congress specified in the Investment Advisers Act of 1940 that advice incident to a brokerage trade is not subject to the Adviser's Act assuming certain conditions are met and the Department should similarly not treat them as investment advice that triggers fiduciary status. The definition of a fee should be an amount in excess of the trading costs, custody costs or other costs incurred by other clients who are not receiving investment suggestions or recommendations.
11. As noted earlier, guidance on rollovers, transfers, distributions and contributions should not be fiduciary advice. In addition, there should be an explicit exception that makes clear that the recommendation of a rollover will not be deemed to be fiduciary advice, even if it implicitly suggests the sale of plan securities, if the factors contained in FINRA Notice 13-45 are provided in writing to a prospective rollover client. If the financial representative provides a balanced statement of the pros and cons of staying in a plan or rolling assets into an IRA, that should not be deemed to be a fiduciary recommendation.

12. Any determination of fiduciary status under the Rule should be limited to the person (applying general employment and agency principles) with a direct nexus/privity with the plan, participant, or IRA owner and not sweep in any manufacturer of a product who might speak to a broker who might speak to an IRA owner.

#### V. Withdrawal of BIC and Principal Transaction Exemptions and Replacement with New Exemption

Said simply, the BIC and Principal Transaction exemptions are unworkable and should be withdrawn. Our prior comments have detailed the ways in which these exemptions have missed the mark. To recap:

- The impartial conduct standards, the warranties, the private right of action that undercuts arbitration, and in particular, the requirement that the financial representative and his firm act “without regard to the financial interest of the advisor or the financial institution” are impractical and unreasonable. As SIFMA stated in its previous letters to the Department, that standard requires that the professional *not know* what his financial interests are with respect to the recommendation of a service or a product, which is an impossible standard for anyone to meet. The concept may be directionally correct but we had asked that the Department instead use the more common and more readily understood concept: that the professional place his client’s interest before his own.
- The written contractual commitment and warranties forming the basis of private rights of action are the main reason that many broker-dealers will not use these exemptions. The IRS enforces these prohibited transaction rules. Excise tax penalties, which are exceptionally onerous, become due and owing upon engaging in a prohibited transaction, without regard to whether the IRS opens an investigation or seeks to collect the taxes. The Department’s new rules were drafted with the clear expressed intent to allow the standard of care and warranties to be enforced primarily in private litigation. The cost of this needless and expensive litigation will be restrictive product offerings and higher costs for retirement savers.
- The adverse effects of these exemptions are already apparent from the news articles describing the changes that financial institutions have already made.<sup>22</sup> These exemptions require nothing less than the redesign of the retail financial world, from sales loads to revenue sharing, to revenue streams from the sale of equities and fixed

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<sup>22</sup> See footnote 7 supra.

income, to IPOs, from recruitment bonuses to training of financial professionals. The cost of these changes will be reflected in the products and services provided to retirement investors.

- These exemptions address problems that do not exist or are not nearly the problems the Department describes: actively managed funds, broker-sold funds and excessive trading. Even if they were, why the Department is in charge of addressing these securities laws issues rather than the SEC remains a mystery. FINRA Rule 3110 requires brokerage firms to have reasonably-designed supervisory procedures, which means that these firms will have developed supervision around the suitability rule, including excessive trading. As described in more detail elsewhere in this comment letter, the Department has no evidence for its oft-cited proposition that IRAs are plagued by excessive trading. We think the evidence shows just the opposite; retirement assets are long-term investments and the majority of IRA owners do not trade very much.<sup>23</sup> What is more important, however, is that the primary regulators of brokerage firms, FINRA and the SEC, have addressed these issues for more than 80 years. It is inappropriate for the Department to decide that excessive trading is now its responsibility. FINRA's approach is coupled with its deep understanding of the market and its recognition of how a sudden change in approach can disrupt the market and hurt investors. Additionally, it should not be in the Department's purview to make it harder for investors to buy any particular type of mutual fund – actively managed, broker-sold, or otherwise.
- The BIC exemption is entirely subjective. Firms are concerned that this subjectivity will lead to a misinterpretation of the BIC exemption requirements. These legitimate concerns have led many financial institutions to decide that they simply will not take on the risk of failure to comply with the BIC exemption. As a result, firms have determined that the best way to address this risk is to change their business models, in whole or in part, making certain products unavailable to retirement investors – which limits investor choice and increases their cost.
- The documentation of every material conflict is overly prescriptive, unrealistic, and burdensome. It appears the Department is trying to make sure that any misstep leads to reversal of any transaction that has not worked out to the investor's liking, regardless of whether the conflict was actually material or related to the transaction at hand. Institutions attempting to comply with the BIC exemption have spent the better part of the last 12 months trying to identify and address the Material Conflicts of Interest.

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<sup>23</sup> Johnson, Woodrow T., Do Investors Trade Uniformly through Time? (August 20, 2009), Journal of Empirical Finance, Vol. 17, No. 4, 2010, available at <https://ssrn.com/abstract=891739>.

However, it is almost impossible to “specifically identify” and “document” every Material Conflict of Interest, where Material Conflict of Interest is defined as any conflict that could affect the exercise of a financial professional’s best judgment as a fiduciary.<sup>24</sup> Even the most well-intentioned financial institution attempting to comply with the exemption will be challenged to specifically identify every conceivable conflict that could, in theory, have such an impact; a failure to identify a conflict that did not seem material to the financial institution could result in loss of the exemption. Our members work diligently to identify and mitigate, where appropriate, *material* conflicts of interest – not just any conflict, but material conflicts -- under FINRA rules today. All a plaintiff has to do is quibble that a conflict has been omitted to cause the firm to lose all benefit of the exemption. It is little wonder that so few institutions are comfortable assuming the risks of using this exemption. Every transaction for which relief is needed would need to be reversed and an excise tax paid. Further, because of the subjective nature of the test – whether such a conflict could affect one’s best judgment as a fiduciary – there could very well be inadvertent omissions.

- Although neither the SEC nor FINRA believes that all conflict should be removed from advisor compensation, the BIC exemption realistically mandates that change. Even more difficult for the financial institutions that have spent the last year trying to build a program that complies with the BIC exemption is its requirement that the policies and procedures require:

that neither the Financial Institution nor (to the best of its knowledge) any Affiliate or Related Entity<sup>25</sup> use or rely upon quotas, appraisals, performance or personnel actions, bonuses, contests, special awards, differential compensation or other actions or incentives that are intended or would reasonably be expected to cause Advisers to make recommendations that are not in the Best Interest of the Retirement Investor.

This warranty appears to require the overhaul of the compensation structure of virtually every financial institution. While the Department allows compensation to be based on neutral factors, firms have struggled with applying that standard, which has resulted in leaning towards charging clients an asset based fee as the primary way to meet the

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<sup>24</sup> A “Material Conflict of Interest” exists when an Adviser or Financial Institution (terms defined by the BIC Exemption) has a financial interest that a reasonable person would conclude could affect the exercise of its best judgment as a fiduciary in rendering advice to a Retirement Investor. See Exemption, Section VIII(i).

<sup>25</sup> Related Entity is defined as any entity in which the financial institution has an interest that might affect its best judgment. It is unclear what the threshold would be – whether one would look to a controlling interest or possibly the number 25% and two board seats. This is another example of the complications with complying with the exemption. The Department has suggested informally that the industry is reading these requirements too broadly. However, when the penalty for a misstep is the unavailability of the exemption, reversal of all transactions under it, the payment of an excise tax and a private plaintiff’s class action, many firms conclude that they have little choice but to read it narrowly.



Department's suggested compensation structure. The shift for retirement accounts to asset-based fee arrangements, which may be costlier for buy and hold investors, should be expected by the Department, as it is the direct result of its Rule. It is not a "principles-based" change to require this kind of massive overhaul in the way all brokers are compensated. In 2010, the Department suggested that it wanted a change in the law to make its enforcement program easier. We are very concerned that this exemption has the same aim, but at a huge cost to the financial services industry and those saving for retirement.

- The BIC exemption contains a provision that was intended to protect professionals and institutions from being deemed to be fiduciaries and violating the prohibited transaction provisions when assistance is given to (i) a person who never becomes a client or (ii) an individual client in a financial counseling or financial planning setting, that is not specifically directed at plan investments, but the counseling client takes the suggestion and implements it in his retirement account held at a different firm. The BIC exemption provides that if the professional is not paid, the transaction will be covered by the BIC exemption but only if there is no existing contract between the individual and the financial institution. This exemption is drafted too narrowly. The person may have a contract for one account and not the retirement account, or for a plan account but not an IRA account, or for general financial counseling and not for a plan or IRA account. This problem illustrates the breadth of the rule, and its adverse effect on holistic financial counseling. This relief should simply provide that if a person executes a transaction without using the professional and without the professional receiving compensation for the account, the transaction shall not be deemed to be related to a fiduciary recommendation.
- The BIC exemption has a two-tier transaction disclosure requirement which will drive additional costs of compliance to firms. The on-demand transaction disclosure has the potential to delay transactions, a delay which would be harmful to retirement savers and is operationally challenging due to the complexity and recordkeeping requirements. The exemption gives retirement savers the right to request disclosure of costs, fees and other compensation including Third Party Payments associated with a recommended transaction from the financial institution and financial professional. The requirement for on-demand disclosure creates several problems. One of those problems is timing. If the retirement saver makes the request before the trade, it will impact the timing of the trade, most likely causing a delay of the recommended transaction. The condition indicates that the requested information "must be provided prior to the transaction if requested before the transaction." The on-demand requirement also creates operational difficulties. If the disclosure is to be generated systemically, many operational steps need to occur to gather the data, which often resides on different systems. Effectively, this condition requires multiple systems to coordinate and provide the information

requested. No one system holds all the details that can be compiled and easily presented to a retirement investor. For example, security systems, holding certain detail about the securities a firm trades in, would need to communicate with compensation systems, holding detail about the compensation received by the firm and financial professional. In the event information is not available internally, the process would have to accommodate receiving it from external vendors. Spending resources to create these systemic connections or accessing information from a third party is an additional cost, increasing the costs of compliance for financial institutions, which may ultimately be borne by retirement savers. The on-demand requirement also creates a need for the financial institution to retain and store information related to each trade because the retirement saver has the right to request it for a period of up to six years after the trade. Financial institutions will need to store all the relevant data because fees change and investments evolve. Firms will need to be prepared simply because a retirement saver *might* make such a request. This creates unnecessary costs for the financial institution and may create additional costs to retirement savers in support of their accounts.

- The BIC exemption requires the financial institution to maintain a web page that lists all “direct or indirect material compensation” payable to the professional for services in connection with each asset (or, if uniform across a class of assets, the class of assets) that an investor is able to purchase, hold or sell through the professional and that has been purchased, held or sold in the last 365 days, along with the source of the compensation and how it varies within and among assets. This presumably requires the detailing of every insurance company separate account, every collective trust by unit class, every mutual fund by share class, every annuity contract and every Guaranteed Investment Contract (GIC). The web page requirement is overly broad, very impractical, and extremely costly and cumbersome to build, administer and maintain. The entire idea should be abandoned. Moreover, the web page disclosures have no direct connection to the transactions with respect to exemptive relief is being provided, the provision of investment advice to a discrete person. For that reason, the required web page disclosures would appear only to serve as a tool to assist the plaintiffs’ bar in mining potential litigation claims.
- Another very impractical and unnecessary provision of the BIC exemption relates to Section IV, which permits financial institutions that restrict recommendations “in whole or in part” to proprietary products or those that generate third party fees only if it makes a written finding that its limitations “on the universe of recommended investments” do not prevent the investment professional from providing assistance that is in the investor’s best interest. This provision is a means to discourage financial institutions from selling funds that pay third party fees and to stop selling proprietary products. The number of requirements, often duplicative of other requirements, coupled with the

findings required and the standard financial institutions are required to meet in recommending a product that pays third party fees, or a proprietary product, make it extremely difficult and expensive for a financial institution to meet the terms of this section of the exemption. In addition, the exemption uses the language “prudent recommendation.” The Department and the courts have said repeatedly that prudence is a process, and investments are looked at through the lens of the whole portfolio and the process by which they were selected.<sup>26</sup> Accordingly, the implication in section IV of the BIC Exemption that a fiduciary must meet some different standard for a proprietary product than he would be required to meet for a nonproprietary product in order to meet a prudence test is simply incorrect as a matter of law. We note that investors may come to a broker-dealer in order to have access to its proprietary products; it would seem counterintuitive to suggest that a retirement saver should have to hire a professional from Firm A in order to be able to access the products of Firm B.

For all of these reasons, there are many institutions considering not selling their proprietary products to retirement savers, while limiting their mutual fund offerings to those that have identical third-party payments. This kind of interference with retirement savers’ choices is not consistent with the views expressed by the President and Secretary Acosta.

- The Grandfather Rule is inadequate. By way of example, an appropriate grandfather rule would simply isolate the assets in the account as of the effective date and allow the financial representative to make suggestions and recommendations without being deemed a fiduciary so long as the client has been informed that he or she is receiving nonfiduciary suggestions and the representative is in compliance with prior law. The current rule significantly limits new contributions and prohibits any recommendation that could cause the professional or financial institution to earn more, even if that recommendation was clearly in the client’s interest. The restriction is artificial and unrelated to the client’s best interest. In the case of small plans and SEPs, it will cause new participants to lose the benefit of load waivers. It has required limitations, recordkeeping workarounds, new accounts, different sweep vehicles and additional paperwork and agreements from retirement savers who are confused by the many changes occurring as a result of the Fiduciary Rule and its exemptions. Moreover, the manner in which it is drafted could be read to cover additional investments into already held positions, regardless of whether the professional made a recommendation to do so after the applicability date. We do not believe the Department intended that result, as a client’s decision, after the effective date, to add to an existing position, without a new

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<sup>26</sup> See, e.g., the Department’s regulation under ERISA Section 404, 29 CFR 2550.404a-1, 44 FR 37225 (June 26, 1979).

recommendation from the professional after the applicability date, needs no exemption because it is not the result of any action taken by the professional after the applicability date. This proposition should be patently clear, and we urge the Department to add a provision to the Rule itself that provides as follows:

Notwithstanding any other provision of this regulation, if a plan, plan fiduciary, plan participant or beneficiary, IRA, or IRA owner enters into any investment transaction without an investment recommendation made after the applicability date, such transaction shall not be deemed to be a transaction recommended by a person under this rule, regardless of whether such transaction was recommended by such person prior to the applicability date. Effectively, the Rule would provide that no recommendation made prior to 6/9/17 would be considered “investment advice” for purposes of 3(21), regardless when a person might act on that recommendation.

As we have said before, we believe the BIC exemption should be rescinded altogether and replaced with a streamlined exemption. But, if any part of it remains, we urge the Department to grant a free-standing grandfather exemption that provides substantially as follows:

Exemption from 406(a) and (b) (and section 4975(c)(1)(A-F)):

With respect to all accounts in existence on June 8, 2017 and any additions or additional investment thereto, the provisions of ERISA section 406 (a) and (b) and the sanctions imposed by Code section 4975(a) and (b), by reason of Code section 4975(c)(1)(A-F) shall not apply to any transaction with, extension of credit from or to, or any service, use of plan assets by or for the benefit of a party in interest, including a fiduciary with respect to the account, or any receipt of fees or other compensation, and any advice in connection with such transactions, if the following conditions are met:

- a) The financial institution maintains policies and procedures reasonably designed to ensure that any recommendation reflects the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims, based on the investment objectives, risk tolerance, financial circumstances, and liquidity needs of the Retirement Investor;
- b) The financial institution maintains policies and procedures reasonably designed to ensure that, at the time of the recommendation, the fiduciary

and its affiliates put the interest of the plan or Retirement Investor ahead of their own.

- c) Statements by the Financial Institution and its Advisers to the Retirement Investor about the recommended transaction, fees and compensation, and conflicts are not materially misleading at the time they are made.
  - d) Any inadvertent violation of these conditions is promptly corrected after discovery.
  - e) Compensation is fairly disclosed.
  - f) Compensation is reasonable, as that standard has been interpreted under section 408(b)(2) of ERISA, without regard to the other conditions of that exemption.
- The Principal Transaction Exemption is similarly flawed. All our comments on the contractual requirement, the warranties, the posting of every single client's contract on the dealer's website, the drafting of the impartial conduct standards detailed above in connection with the BIC exemption are applicable here as well. We know of no dealers who are intending to use this exemption for sales of securities to retirement accounts when the remaining conditions go into effect. The cost to retirement savers who want to purchase even the limited securities permitted under the exemption will be high, and will need to be assessed as part of the Department's revised cost study when new exemptions are proposed. The Department will also need to assess the effect on the capital markets if retirement accounts virtually cease to purchase Treasury bonds.

The Principal Transaction Exemption also perpetuates the error in the proposed BIC exemption that only allows certain securities to be covered by the exemption, an error that was corrected in the final BIC exemption but largely left uncorrected in the Principal Transactions Exemption. It denies exemptive relief for many types of securities, including all equity securities and all municipal bonds, for currencies and for other investment products commonly held (and currently held) by retirement accounts such as private placements, preferred shares, structured notes such as principal protected notes, securities issued by charitable institutions, agency mortgage backed securities, foreign corporate securities, preferred securities, and foreign sovereign debt.

- New issues of equity and debt securities where one's own financial institution is part of the underwriting syndicate are not covered under the exemption and as a result, IRAs are unable to purchase any new issues. We asked in 2015, and we ask again why the

Department should approve some types of securities and not others. This paternalistic approach to retirement savers is simply not appropriate. The Secretary noted that American savers know best what is best for them. The Department should adopt this approach. There is no sensible rationale for the proposed exemption's limitations on the assets that can be transacted on a principal basis, and these limitations are not in the best interest of retirement savers. Our members are inundated with complaints about not being able to buy currency from their broker and not being able to participate in new issues. Closed end funds are demonstrably worse for all investors because they cannot be purchased by retirement savers in initial public offerings, thus making the scale of the fund smaller. Similarly, IPO asset raises are smaller, reducing the diversification of assets and diminishing the benefits of scale.

- We have no answer for these complaints. Indeed, we agree with them. These limitations make no sense at all. As we said in 2015:

The proposed exemption assumes that principal transactions in the securities listed above are complex, and they are not. It assumes that principal transactions in these securities are riskier than in the three "approved" bonds, and they are not. It assumes that the conflicts of interest with respect to principal transactions are of a different, more troublesome sort than any other conflict addressed by this exemption and they are not. It assumes that the impartial conduct standards, including the best interest standard, are a nullity, and they are not. Finally, it appears to ignore a financial institution's duty to comply with FINRA rules and guidance, including the duty of best execution, which overarches all of these requirements. These are well-known and well-regarded regulatory standards with teeth, and it should not be dismissed in favor of flat prohibitions on the best and most efficient, economic way to trade these instruments.

- The Principal Transaction Exemption interferes with compliance with the securities laws. The proposed exemption may impair a broker-dealer's ability to exercise reasonable diligence under FINRA and MSRB rules by adding a significant hurdle for dealers to act in a principal capacity. FINRA's Best Execution rule and MSRB's Best Execution rule (effective December 7, 2015) require that dealers exercise reasonable diligence to ascertain the best market for the subject security and to buy or sell in that market so that the resultant price to the customer is as favorable as possible under prevailing market conditions. FINRA and MSRB provide a list of factors that will be considered when determining whether a dealer exercised reasonable diligence.<sup>27</sup> The

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<sup>27</sup> The MSRB rule set has a number of customer protection rules that operate similarly, but not identically to FINRA rules, including MSRB Rule G-17 (Fair Dealing), G-18 (Best Execution), G-19 (Suitability of Recommendations and Transactions), Rule G-30 (Prices and Commissions). The MSRB's Electronic Municipal Market Access (EMMA) website was designed to provide market transparency specifically to retail investors. Discussions herein referring to FINRA rules are equally applicable to the municipal securities market, but have been truncated for ease

duty of best execution applies whether a broker-dealer is acting as an agent or a principal and applies across retirement and non-retirement accounts. The Department's Principal Transaction Exemption conflicts with a dealer's best execution obligations, in that if a dealer has used reasonable diligence and has determined that its own principal inventory is the best available market under prevailing market conditions, under FINRA and MSRB rules it must execute in that market. As we said in 2015:

To us, the proposal seems to substitute the Department's judgment for that of a participant, plan fiduciary or IRA. And the proposed exemption appears to substitute the Department's judgment for that of the primary securities and banking regulators, who understand and regulate these markets on a daily basis and have done so for years, who have far more experience than the Department does in these markets, and who have rules and regulations in place that carefully assess the conflicts and the risks of principal transactions. SIFMA is concerned that financial professionals will be obligated to warn their retirement plan clients that other securities may be in the best interest of the account but the Department has prohibited their purchase entirely or permitted the purchase only in a manner that is demonstrably more expensive and less efficient.

- The Principal Transaction Exemption has negatively impacted liquidity in the market and increased the cost of securities because of the need to create new mechanisms to accommodate agency trades in securities that are virtually always traded as principal. There is nothing inherently different about the trading of other debt instruments, or other products sold on a principal basis that should, as a policy matter, eliminate a dealer's ability to sell them to their retirement plan clients in the most efficient manner that the market can provide. It is unreasonable to make the purchase and sale of principally traded products more expensive and more burdensome because the Department is uncomfortable with those products and the way they have been sold. Neither the SEC nor FINRA, whose job it is to regulate these markets, has prohibited the purchase and sale of these publicly traded products, even for the smallest retail account nor required them to be traded as agent. As we said in 2015:

We are mystified at the Department's picking and choosing among securities, blessing some and nixing others. No basis is provided in the preamble or elsewhere for the Department's choices. There is no evidence that the Department considered the knock-on effect of its "legal lists" on the capital markets. Nor does the Department consider the effect on the mortgage market if all IRA holders of these securities are compelled to liquidate their holdings in 8 months. Moreover, the Department is moving away from its principles based exemptions like QPAM, toward exemptions that will quickly become outdated as new products are introduced to the markets that may be better, safer, more efficient, and/or more

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of readability (including the discussion of FINRA Notice 14-52 on matched trades).

flexible. In 1975, there were no ETFs. If Congress or the Department had had a “legal list” of permissible securities, how long would it have taken for the Department to amend its exemptions to add ETFs, other new products and new innovative products in the future? We think this is a bad approach, for the markets in general and for retirement investors in particular. Unless the Department has no faith in its fiduciary rule, and in its impartial conduct standards, it should leave the investment choices to retirement savers.

- We strongly urge the Department to withdraw the BIC and Principal Transactions Exemptions and start over with a principles-based approach like PTE 75-1, Part II, 77-4 and QPAM.

#### VI. The Department’s Continued Favoring of Particular Business Models

In its questions 7 through 10 in the RFI, the Department seems to want to continue its practice of landing on a product solution it likes by memorializing it in an exemption. Exemptive relief should not depend on today’s innovation, which will be outdated tomorrow. It should not focus on, and favor, a class of mutual fund shares or a type of annuity or index funds over actively managed funds, or mutual funds over individual securities, etc. In its 2015 proposal, the Department asked this same question and was resoundingly rebuffed in its request for a comment on a low-cost index fund exemption. We reiterate our strong view that this is not a useful path for the Department to take. Nor should the Department be writing financial institutions’ policies and procedures or writing our disclosure or favoring particular business models. What the last two years has taught this industry, and hopefully has brought the Department to understand, is that one size does not fit all. The aim must be to provide retirement investors with the programs they prefer, not to push the industry into the business model the Department prefers. It should propose reasonable rules, readily understood, using terms that are part of the financial industry regulatory lexicon, and not create cathedrals which will be quickly abandoned.

#### VII. A Principles Based Exemption

We respectfully request that the Department consider a principles-based exemption that will not be outdated as new innovations are designed. Such an exemption would consist of the following principal conditions:

- a. The compensation for any service is reasonable, within the meaning of ERISA section 408(b)(2) and Code section 4975(d)(2).



- b. Any principal transaction or extension of credit with the fiduciary or its affiliates, or any use of plan assets by or for the benefit of the fiduciary or its affiliates is at arms' length.
- c. The financial institution maintains policies and procedures reasonably designed to ensure that any recommendation reflects the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims, based on the investment objectives, risk tolerance, financial circumstances, and liquidity needs of the Retirement Investor;
- d. The financial institution maintains policies and procedures reasonably designed to ensure that, at the time of the recommendation, the fiduciary and its affiliates put the interest of the plan or Retirement Investor ahead of their own.
- e. Statements by the Financial Institution and its Advisers to the Retirement Investor about the recommended transaction, fees and compensation, and conflicts are not materially misleading at the time they are made.
- f. Any inadvertent violation of these conditions is promptly corrected after discovery.
- g. Compensation is fairly disclosed.
- h. Records are retained that demonstrate compliance with these conditions.

These conditions are the bedrock of fiduciary conduct without micromanagement, requirements of expensive technological changes, burdensome obligations without substantive meaning, foot fault liability, monumental websites, private rights of action, or the like. The financial services industry knows what these concepts mean: the arms' length standard is in several existing exemptions. The prudence rule is the subject of scores of court opinions. The best interest standard is unencumbered by such tests as "without regard" to the interests of the financial institution. Fair disclosure is a concept all financial institutions understand. The prohibition against materially misleading statements is found in a variety of existing securities laws and regulations. No particular product is favored by this exemption. No particular business model receives preference. The exemption will neither limit choice nor increase costs to investors. Financial institutions will likely believe that a principles-based exemption such as the one we suggest will allow them to comply without switching their business models. We urge the Department to work with us on this simple, straightforward exemption.

Conclusion

We look forward to working with the Department to revise the Rule and to work on replacement exemptions for the current BIC and Principal Transaction exemptions. In addition, we urge the Department to delay the changes to the remaining exemptions that were amended in 2016, so that all the exemptions can be reviewed fully.

If you have any questions with regard to these comments, please contact me at (202) 962-7329.

Sincerely,

A handwritten signature in cursive script that reads "Lisa J. Bleier".

Lisa Bleier  
Managing Director & Associate General Counsel

# Appendix I



## **The DOL Fiduciary Rule: A study on how financial institutions have responded and the resulting impacts on retirement investors**

August 9, 2017

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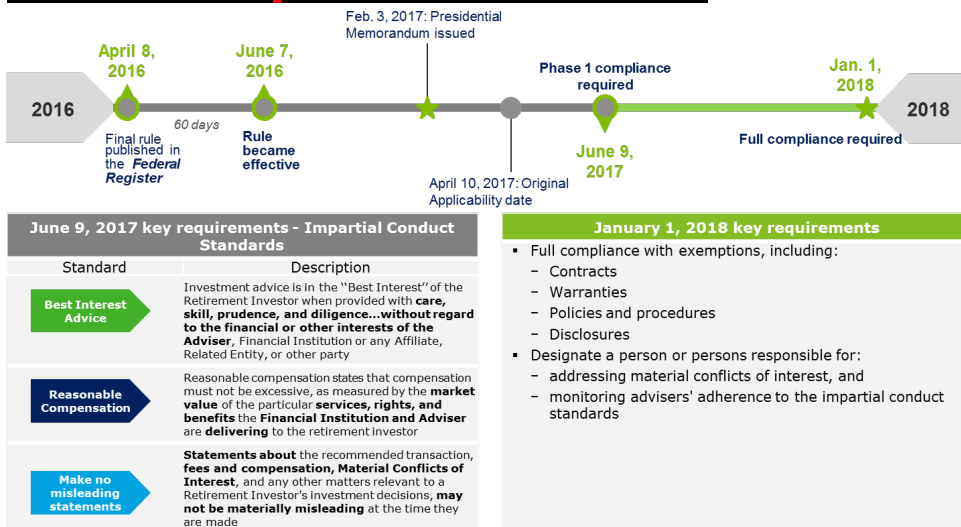
# 1. Executive Summary

## 1.1 Background

On April 20, 2015, the Department of Labor (“DOL”) proposed a new definition of who is a “Fiduciary” under the Employee Retirement Income Security Act of 1974 (“ERISA”) and the Internal Revenue Code of 1986. On the same day, the DOL published new administrative class exemptions from the prohibited transaction provisions of ERISA (29 U.S.C. 1106) and the Code (26 U.S.C. 4975(c)(1)): The Best Interest Contract Exemption (“BIC” Exemption) and the Class Exemption for Principal Transactions in Certain Assets Between Investment Advice Fiduciaries and Employee Benefit Plans and IRAs (“Principal Transactions Exemption”), as well as amendments to previously granted exemptions (referred to collectively as “the Rule” throughout this document).

The Rule became effective on June 7, 2016 and was originally scheduled to be phased in across two compliance dates with the first phase of compliance beginning on April 10, 2017. Following a Presidential Memorandum<sup>1</sup> directing an updated economic analysis of the Rule, the DOL removed certain transition period requirements, delayed the initial applicability date to June 9, 2017, and postponed the onset of certain Rule and exemption requirements until January 1, 2018.

**Figure 1.1: Updated Rule timeline and requirements**



## 1.2 Approach

The Securities Industry and Financial Markets Association (“SIFMA”) engaged Deloitte to facilitate a study with 21 SIFMA member firms (referred to as the “study participants” or “financial institutions” throughout this document) whose businesses include providing individual investors with financial advice and related services. The study was conducted to understand and analyze the

<sup>1</sup> Source: <https://www.whitehouse.gov/the-press-office/2017/02/03/presidential-memorandum-fiduciary-duty-rule>

realized and potential impacts of the Rule on retirement investors and financial institutions.

Through the analysis of information gathered via facilitated interviews of study participants, as well as data received from them, Deloitte sought to identify the impacts from study participants' business and compliance decisions to retirement investors in the following areas:

- Access to investment advice
- Access to investment products
- Costs of investment advice and products

Furthermore, this study assessed the impacts of the Rule and corresponding business and compliance decisions on the study participants in the following areas:

- Operational impacts and associated costs
- Litigation and regulatory risks

While the focus of this report is on retirement accounts under the purview of the DOL, there were instances noted where non-retirement accounts were also impacted.

### 1.2.1 Overview of Financial Institutions Participating in the Study

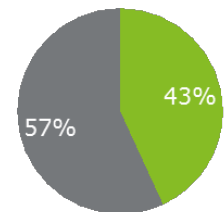
The 21 member firms invited by SIFMA and choosing to participate in the study account for more than 132,000 financial advisors<sup>2</sup>, representing 43% of US financial advisors<sup>3</sup>. The study participants serve approximately 35 million retail retirement accounts holding approximately \$4.6 trillion in assets, which represents 27% of the \$16.9 trillion US retirement savings marketplace<sup>4</sup>.

In addition to covering a large portion of the marketplace, the range of size and business mix of study participants reflects the diversity of the financial institutions offering retirement advice to retail investors in the US.

The assortment of participating financial institutions included, but was not limited to, coverage of the following characteristics:

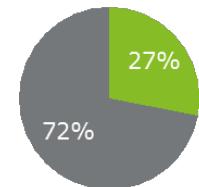
- Firm size: Small, medium and large firms by assets under management ("AUM"), number of clients, number of advisors and amount of net capital
- Business models: wirehouses, regional broker-dealers, independent broker-dealers, bank-owned broker-dealers, dual registrants and boutique firms

**Figure 1.2: Study participants covered a large cross section of the industry**  
**All Financial Advisors**



Our data represents **132,767** out of the 310,504 financial advisors in the United States

**All Qualified Assets**



Those advisors manage an aggregate **\$4.6T qualified assets** out of the \$16.9T retirement savings marketplace

■ Participating Firms  
■ Remaining Marketplace

<sup>2</sup> This study uses the term "advisor" to mean individuals registered with broker-dealers or dually registered broker-dealers/registered investment advisors, maintaining the securities licenses to conduct activities they engage in (e.g., Series 6, 7, 63, 65)

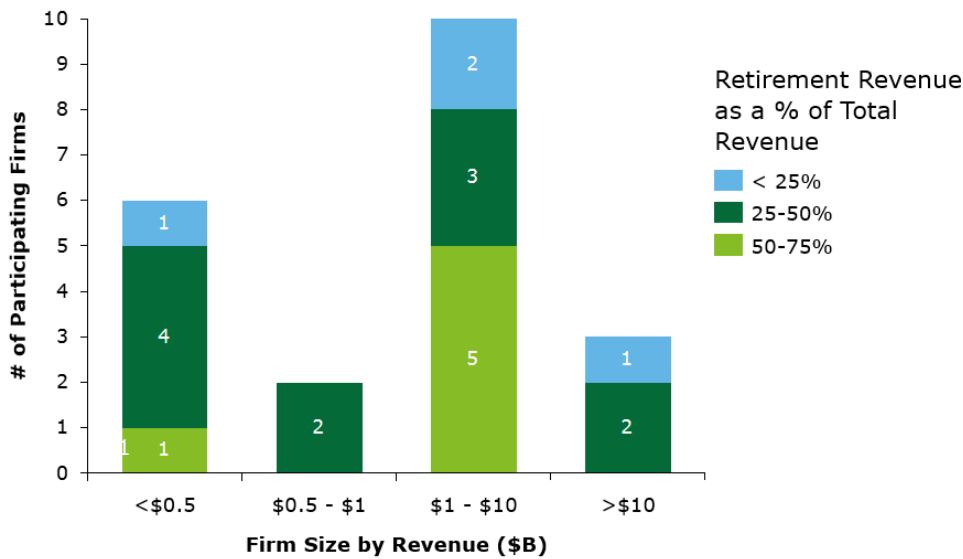
<sup>3</sup> Based on comparison of study participants' financial advisor population to Cerulli 2016 data

<sup>4</sup> Board of Governors of the Federal Reserve System, "Financial Accounts of the United States: Flow of Funds, Balance Sheets, and Integrated Macroeconomic Accounts: Fourth Quarter 2016" Federal Reserve Statistical Release Z.1; available at: <http://www.federalreserve.gov/releases/Z1/current/z1.pdf>. DB assets do not include claims of pension fund on sponsor. Also see Investment Company Institute (ICI), "U.S. Retirement Market, Fourth Quarter 2016"



- Client segments served: mass market, mass affluent, high net worth, ultra-high net worth
- Product Offerings: equities, fixed income, mutual funds, annuities, directly held funds, alternative investments and managed accounts

**Figure 1.3: Study Participant breakdown by advisor count and retirement revenue percentage**



### 1.3 Summary of Findings<sup>5</sup>

#### 1.3.1 Primary findings

- **Access to brokerage advice services has been eliminated or limited by 53% of study participants as part of their approach for complying with the Rule**
- **The shift of retirement assets to fee-based or advisory programs has accelerated as the result of the elimination or limitation of brokerage advice services**
- **95% of study participants have made changes to the products available to retirement investors, including limiting or eliminating asset classes offered and certain share classes or product structures**

#### 1.3.2 Additional findings

- **Financial institutions' responses and approaches to complying with the Rule have varied, reflecting the wide ranging legal and compliance interpretations of the Rule**

<sup>5</sup> The findings were made based on the analysis of information and data provided by the study participants to Deloitte. Deloitte has analyzed, aggregated and summarized the information provided, but was not asked to and did not independently verify, validate or audit the information presented by the study participants.

- **Rule implementation and ongoing compliance efforts have caused significant operational disruption and increased costs for financial institutions**
- **Uncertainty surrounding the future of the Rule is causing financial institutions to incur additional real costs as well as ongoing opportunity costs**

## 2. Overview of Financial Institutions' Responses and Approaches to the Rule

Financial institutions' responses and approaches to the Rule varied widely, though enhancements to fee-based services and reductions in advised brokerage products and services were common themes.

### **2.1 There was wide variability in financial institutions' approaches for complying with and operating under the Rule**

Based on the information provided to Deloitte, steps that study participants' have taken to comply with the June 9, 2017 applicability date, as well as in their preparations for the January 1, 2018 applicability date, vary widely.

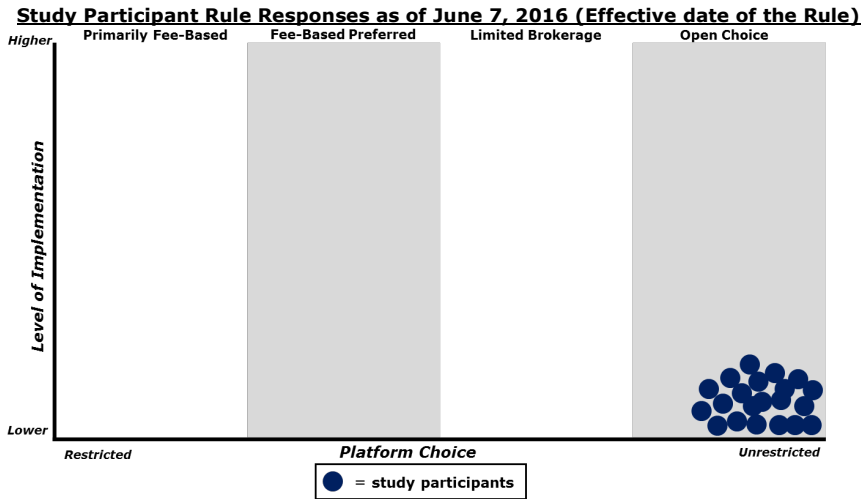
The variations in approaches generally resulted from the combination of how financial institutions differed on decisions and outcomes within the following areas:

- Service offerings
- Product offerings
- Level of implementation

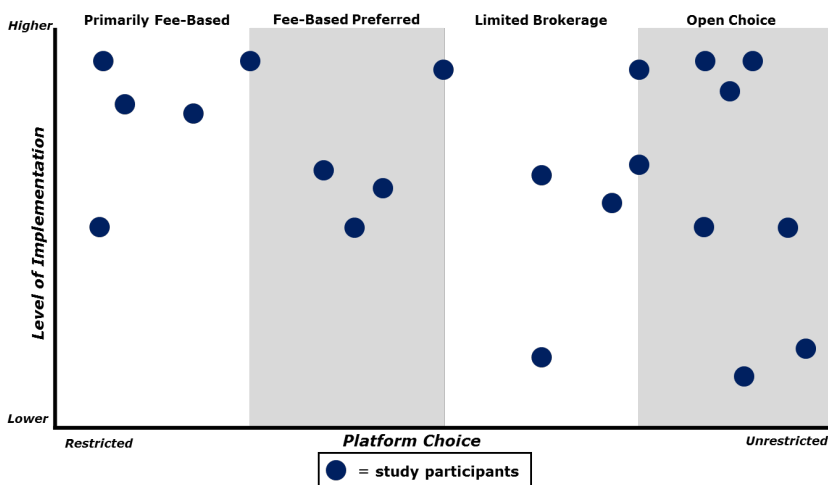
Many financial institutions that had similar profiles before the Rule, in terms of service and product offerings, diverged considerably in their post-Rule operating models, some extensively and some in minor ways. The variety of responses also reflects the wide ranging legal and compliance interpretations of the Rule and its requirements.

Because implementation efforts for many financial institutions are ongoing as they optimize their June 9<sup>th</sup> requirements and prepare for January 1<sup>st</sup>, it is possible that there will be more changes to financial institutions' operating models that will result in even more divergence in approaches to complying with and operating under the Rule.

**Figure 2.1: Study Participants' responses to the Rule as of June 7, 2016 and June 9, 2017**



**Study Participant Rule Responses as of June 9, 2017 (Applicability date of the Rule)**



**2.2 Although there was variability in the specific changes to service and product offerings, generally the changes resulted in a shift towards fee-based accounts and a reduction in available products in retirement brokerage accounts**

Although responses to the Rule resulted in a wide array of changes to individual financial institutions' advice services and product offerings for retirement accounts, these responses can be broadly categorized into four different approaches:

- **Primarily Fee-Based:** Elimination of, or vast reduction in advised brokerage; retirement advice offered via a fee-based platform
- **Fee-Based Preferred:** Introduction of enhanced fee-based offerings and program changes intended to promote the fee-based platform over advised brokerage alternatives (e.g., ETF and mutual fund model portfolios with low account minimums)

- **Limited Brokerage:** Limiting access to advised brokerage platforms based on account minimums or product availability (e.g., mutual funds only, fixed income / equities only)
- **Open Choice:** Retaining broad access to advised brokerage and fee-based platforms

It should be noted that while the Rule was the primary driver of the strategies noted above, in certain cases, advice service and product changes were extended to non-retirement accounts as well, broadening the impact of the Rule. For example, in some cases fee schedule changes were made in response to the Rule but were applied to both retirement and non-retirement accounts.

It should also be noted that within each of the categories above, study participants' decisions and strategies varied widely. For example, financial institutions that chose the "open choice" model differed from each other in how they implemented that strategy.

### 2.3 Many of the expected impacts of financial institutions' responses to the Rule have not yet been realized because financial institutions are at different stages of implementing those responses

Though all financial institutions indicate they are currently in compliance with the Rule, some are further along in their implementation of changes meant to optimize operations supporting the June 9<sup>th</sup> requirements or to meet the January 1<sup>st</sup> requirements. Many of the changes and decisions that have not yet been implemented include changes or additional refinements to advice service offerings, products, compensation, operational processes, internal controls, and technology.

As a result of the variation that existed in financial institutions' level of implementation, Deloitte categorized each financial institution as "Lower," "Medium," or "Higher" according to the level of implementation based upon the information provided by each as compared to the definition of the categories set out below.

- **Lower Level of Implementation:** Financial institutions that are awaiting clarity on timing and potential changes to the Rule before finalizing decisions and beginning implementations
- **Medium Level of Implementation:** Financial institutions that have made key decisions and planned for implementation, but are awaiting Rule clarity before executing most implementation plans, or are trying to build flexibility to account for possible changes
- **Higher Level of Implementation:** Financial institutions that have made and implemented many key Rule decisions and are largely planning on going forward with these decisions even if the Rule changes

However, many of the study participants that were categorized as "Lower," or "Medium" indicated that their pace of planning and implementation was primarily driven by concerns that making significant investments in changing their business models and supporting people, processes and technology could become "throw-away" costs if the Rule were to be substantially changed or delayed (please see Section 5, *Impact of Rule Uncertainty to Investors and Financial Institutions*, for a more detailed discussion).

If the Rule remains substantially intact with the January 1<sup>st</sup> applicability date, based on responses from study participants it is likely that many of the "Lower" and "Medium" financial institutions will increase their implementation levels and shift their approaches away from "open choice" and towards "fee-based."

#### **2.4 Litigation risk has been a key driver in business and compliance decisions**

Almost all study participants indicated that litigation risk has been a primary concern throughout their process to prepare for the Rule. These concerns became one of the most prevalent driving factors in the majority of business and compliance strategy decisions taken to date and the study participants stated that such concerns will continue to weigh heavily in compliance strategies for the January 1<sup>st</sup> applicability date.

Financial institutions indicated that the unease over litigation risk was amplified because they felt that it is virtually impossible to quantify this risk since there are (i) no precedent of lawsuits or enforcement actions, (ii) relatively minor compliance or reporting errors could lead to fiduciary liability, and (iii) the litigation risk is perpetual.

These amplified concerns often led to financial institutions taking conservative approaches to compliance that resulted in risk-based decisions to eliminate or limit services or products to retirement investors. Many financial institutions felt that products and services they chose to eliminate could have been offered in a way that complied with the spirit and letter of the Rule, but that the risk of litigation was too great.

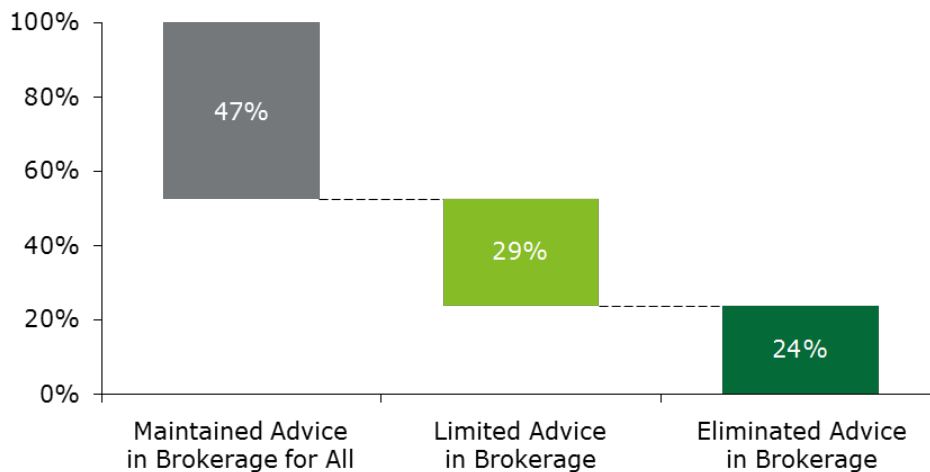
# 3. Impact to Investors

In many instances, financial institutions' responses to the Rule resulted in a reduction of choice in services and products available to investors.

**3.1 There were substantial changes in service model options available to retirement investors, with the most common change being the reduction of brokerage services as an option**

As of June 9<sup>th</sup>, 53% of study participants reported limiting or eliminating access to advised brokerage for retirement investors, impacting 10.2 million accounts and \$900b AUM.

**Figure 3.1: Elimination or limitation of access to advised brokerage**



It was observed that 53% of study participants eliminated or limited retirement investors' access to advice in a brokerage account. The study participants that are classified as "Eliminated Advice in Brokerage" did so by exiting advised brokerage services for retirement investors, and the study participants that are classified as "Limited Advice in Brokerage" increased account or household minimums required to continue to receive advice. As business and service models changed, retirement investors with advised brokerage accounts at one of these financial institutions generally chose to:

- **Transition from an advised brokerage account to a fee-based account**

- **Transition from an advised brokerage account to a self-directed account**
- **Transition their advised brokerage account to a different financial institution continuing to offer the service**

It should be noted that all of the study participants, including those classified as “Maintained Advice in Brokerage for All,” have made at least some changes to the products within their advised brokerage platforms, including eliminating certain asset classes, product types, and share classes.

In addition, several financial institutions noted that they plan to make additional limitations to their advised brokerage offering should the current version of the Rule go into effect on January 1, 2018.

### 3.1.1 Transitions from advised brokerage to fee-based

*The trend towards fee-based accounts was likely accelerated by the Rule*

In order for investors to retain access to advice on retirement accounts from the study participants who eliminated or limited advised brokerage access, 10.2 million accounts, with \$900 billion in assets, would have to move to a fee-based option. To accommodate clients leaving advised brokerage, 62% of study participants broadened access to advice through fee-based programs by lowering account minimums, launching new offerings, or both.

*The fee-based model is significantly different from advised brokerage and carries with it a different fee structure*

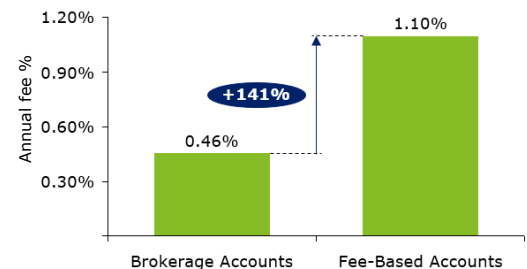
Fee-based accounts are Fiduciary accounts regulated by the US Securities and Exchange Commission under the Investment Advisers Act of 1940. Typically, fee-based accounts offer a higher level of service than brokerage accounts and often include automatic rebalancing of accounts, comprehensive annual reviews, enhanced reporting to account holders, and access to third party money managers. The fees are generally an “all-in” asset-based fee that is generally higher than the fees paid in an advised brokerage account (to compensate for the additional services).

Out of the subset of study participants that provided their average advised brokerage and fee-based account fees, it was observed that annual fee-based account fees were 64 bps higher than advised brokerage fees, on average (110 bps versus 46 bps).<sup>6</sup>

*There are likely additional reductions in service model options to come*

It was noted that the majority of the study participants that were classified as having a “Higher” level of implementation, as well as a “Medium” level of implementation, had eliminated or limited their advised brokerage offering, as well as noticed a large number of retirement investors choosing to transition their brokerage accounts to a fee-based relationship.

**Figure 3.2: Fee-based options often carry an increase in services and fees<sup>6</sup>**



“Study participants, particularly those with a ‘Medium’ or ‘Lower’ level of implementation, have planned to execute account transitions...but have not yet implemented those changes.”

<sup>6</sup> Average annual account fees for advised brokerage and fee-based programs were provided by a subset of study participants. An aggregate average was taken for each program, as noted above



Study participants reported that additional retirement investors would lose access to an advised brokerage account if the Rule were to go into effect as is on January 1, 2018. Study participants, particularly those with a “Medium” or “Lower” level of implementation, have planned to execute account transitions to a client’s chosen option (generally fee-based accounts if in the retirement investor’s best interest, or self-directed brokerage accounts) but have not yet implemented those changes.

### **3.1.2 Transitions from advised brokerage to self-directed**

63% of study participants that limited or eliminated access to advised brokerage had retirement investors elect to move to a self-directed account. These investors lost access to personalized advice for any assets transitioned to the self-directed model.

Financial institutions that eliminated or limited their advised brokerage platforms gave retirement investors an option to either transition to a fee-based program, self-directed brokerage account, or in some cases, a new platform they were launching. Study participants indicated that many retirement investors moved into a self-directed brokerage account for one or several of the following reasons:

- the retirement investor did not want to move to a fee-based account
- it was not in retirement investor’s best interest to move to a fee-based account
- the retirement investor did not meet the account minimums required for a fee-based account
- the retirement investor wished to maintain positions in certain asset classes which were not eligible for a fee-based account

### **3.1.3 Decrease in access to Rollover Advice for Retirement Investors**

19% of study participants limited or eliminated rollover advice for retirement investors, restricting advisors to an education-only capacity when discussing rollovers with retirement investors.

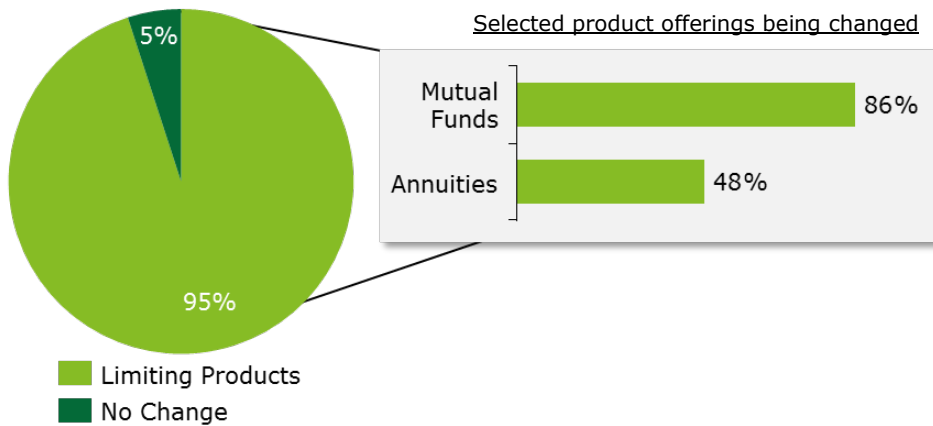
Of the 81% that retained access to rollover advice, study participants added requirements for investors to produce additional documentation around plan fees and services. This documentation is not easily accessible and does not exist in a single database or source. Study participants report that it is too early to understand the impact of these changes but some expect to see a decrease in rollovers as a result (please see Section 4, *Impact to Financial Institutions’ Operations*, for a more detailed discussion).

## **3.2 Reductions and changes in access to products for retirement investors**

95% of study participants reduced access to or choice within the products offered to retirement investors regardless of the level of sophistication of the retirement investor. Products affected included, but were not limited to, mutual funds, annuities, structured products, fixed income, and private offerings. It was also noted that study participants had to limit asset classes for which a prohibited transaction exemption was not available (e.g., risk-based principal sales of non-investment grade debt, certain underwriting and new-issue activities). The limitation of products available to retirement investors

potentially impacted 28.1 million accounts and \$2.9 trillion in AUM of study participants.

**Figure 3.3: Percentage of study participants changing available products<sup>7</sup>**

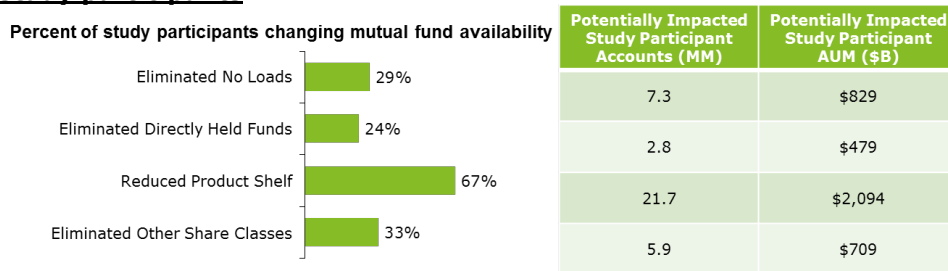


### 3.2.1 Reduction in Mutual Funds Available to Investors

The most commonly seen change to product offerings was a reduction in the number and types of mutual funds available to retirement investors, with 86% of study participants reporting having done so. The reduction in available mutual funds primarily took shape in three common ways:

- Elimination of certain share classes
- Elimination of certain mutual fund families or specific funds
- Elimination of all mutual funds in advised brokerage platforms

**Figure 3.4: Potential impact of reduction in mutual fund availability by study participants<sup>8</sup>**



#### *Elimination of No Load Funds*

It was observed that 29% of study participants eliminated No Load funds from their brokerage platform. The elimination of No Load funds from advised

<sup>7</sup> Changes were not mutually exclusive

<sup>8</sup> Ibid

brokerage platforms results in retirement investors losing access to what is sometimes the lowest cost share class of certain funds.

#### *Elimination of Directly Held Funds*

24% of study participants eliminated mutual funds held directly at mutual fund companies, and additional participants stated that if the Rule goes into effect as is for January 1<sup>st</sup>, they plan to do the same.

Eliminating directly held mutual funds potentially changes the service model for the retirement investor. Retirement investors who do not move directly held funds to their financial institutions will lose access to advice on those assets. Additionally, they will need to interact directly with the fund company for any future servicing needs. For investors moving directly held funds to their financial institution, increased costs may be incurred. Directly held funds are typically less expensive for investors due to the elimination of certain costs, such as account and maintenance fees, associated with holding a fund in a brokerage accounts at a financial institution.

#### *Reduction in Mutual Fund Product Shelf*

67% of the study participants reduced the number of mutual funds offered to retirement investors. Reductions included removing funds offered from certain families and funds within families. Often, the reduction in the mutual fund product shelf occurred during the enhanced product due diligence efforts financial institutions undertook during their Rule compliance implementation, as well as while renegotiating compensation agreements with fund families.

The reduction of the mutual fund product shelf for the majority of the financial institutions impacts investors by reducing their choice of available funds.

#### *Eliminations of Other Share Classes (not including A shares)*

Close to 33% of study participants that continue to offer an advised brokerage platform to all or a subset of retirement investors eliminated other share classes, including B shares and C shares.

### **3.2.2 Reduction in Annuities Available to Investors**

Throughout the course of the study, it was observed that 48% of study participants made reductions to their annuity offerings to retirement investors.

**Figure 3.5: Potential impact of study participants’ change in annuity availability**



In addition, a few study participants communicated that they had, or were exploring, eliminating variable annuities and/or fixed indexed annuities from their offerings to retirement investors.

*Reduction in Annuity Share Class*

Study participants limited the available share classes specifically for variable annuities to their retirement investors. Limitations were commonly placed on C shares, which have no up-front or back-end sales charges, as well as a few other share classes. It was observed that 24% of study participants reduced the share classes available for annuities to retirement investors. Common reasons for doing this included due diligence and compensation changes.

*Consolidation of Carriers Available*

In addition to study participants reducing the share classes available for variable annuities, study participants also consolidated the carriers that they offer variable annuities from to their retirement investors. 43% of study participants reduced the annuity carriers available to their retirement investors.

Reduction in carriers occurred as a result of study participants performing a product due diligence exercise and renegotiating compensation terms with the carriers. Several study participants reduced and simplified the way they compensated their advisors and collected third party payments from annuity carriers to remove conflicts of interests, and carriers that were unable or unwilling to accommodate changes to compensation structures were often removed.

# 4. Impact to Financial Institutions' Operations

Complying with the Rule has required significant investment and resulted in operational impacts across people, process and technology.

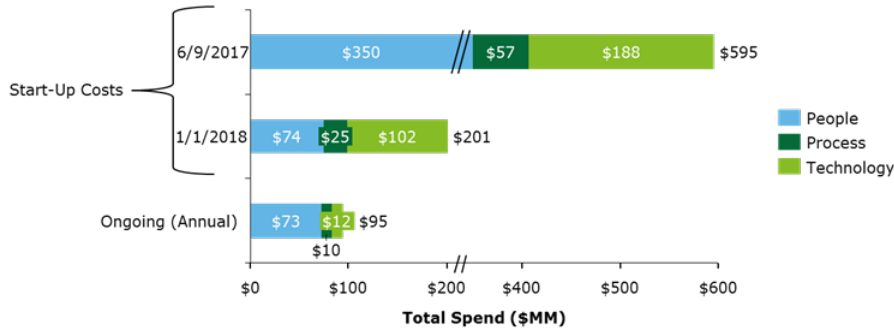
## 4.1 Study participants have spent over \$595 million on Rule readiness activities to date

Across people, process and technology, study participants spent approximately \$595 million preparing for June 9<sup>th</sup> and expect to spend over \$200 million more before the end of 2017 ("start-up costs"). Total ongoing annual spend by study participants to support Rule decisions is estimated to be nearly \$100 million with their annual estimates ranging from \$125,000 to \$15 million. The breakdown of average spend by financial institution based on size is shown below:

<b>Financial Institution Size<sup>9</sup></b>	<b>Net Capital</b>	<b>Average Start-Up Spend Per Financial Institution (\$MM)</b>	<b>Average Ongoing Spend Per Financial Institution (\$MM)</b>
<b>Large</b>	Greater than \$1 billion	\$54.64	\$5.89
<b>Medium</b>	\$50 million to \$1 billion	\$16.37	\$3.15
<b>Small</b>	Less than \$50 million	\$2.3	\$1.1

<sup>9</sup> The financial institution size categories used are the same categories used by the DOL in their Regulatory Impact Analysis (source: <https://www.dol.gov/sites/default/files/ebsa/laws-and-regulations/rules-and-regulations/completed-rulemaking/1210-AB32-2/conflict-of-interest-ria.pdf>, Page 216, Section 5.2.6)

**Figure 4.1: Study participants' total spend on people, process and technology<sup>10</sup> to support Rule decisions**



Even with the significant spend to date, study participants noted that many of the operational changes put in place for June 9<sup>th</sup> are highly manual, stop-gap measures, which are unsustainable long-term due. Additionally, study participants highlighted that ongoing spend estimates cannot account for potential risk events such as litigation, regulatory changes, or marketplace shifts which could substantially change costs.

**4.1.1 Estimated total broker-dealer costs**

In order to understand the potential costs to the broader broker-dealer industry, Deloitte multiplied the average cost estimate of each financial institution size category by the number of institutions<sup>11</sup> in their respective size category.

Financial Institution Size	Net Capital	Number of broker-dealers in industry, per DOL <sup>12</sup>
Large	Greater than \$1 billion	42
Medium	\$50 million to \$1 billion	147
Small	Less than \$50 million	2,320

Applying this methodology, but excluding small financial institutions<sup>13</sup>, broker-dealers are estimated to have spent in excess of \$4.7 billion on start-up costs relating to the Rule. This estimate is considerably greater than the range of start-up cost estimates provided by the DOL in their 2016 Regulatory Impact

<sup>10</sup> "People, process and technology" describes human capital, process change and technology costs. See sections 4.2.1, 4.3 and 4.4 for further details of each category

<sup>11</sup> Source: DOL Regulatory Impact Analysis <https://www.dol.gov/sites/default/files/ebsa/laws-and-regulations/rules-and-regulations/completed-rulemaking/1210-AB32-2/conflict-of-interest-ria.pdf>

<sup>12</sup> DOL Regulatory Impact Analysis (source: <https://www.dol.gov/sites/default/files/ebsa/laws-and-regulations/rules-and-regulations/completed-rulemaking/1210-AB32-2/conflict-of-interest-ria.pdf> , Page 233, Figure 5-9 Total Costs for BDs (In Millions of Dollars))

<sup>13</sup> In the 2016 Regulatory Impact Analysis, the DOL appears to have excluded small firms from their total costs estimates. Deloitte has followed this same methodology when calculating estimated total start-up and ongoing costs for the marketplace

Analysis, which estimated that the total start-up costs for the broker-dealer marketplace would be between \$2 billion and \$3 billion<sup>14</sup>.

Notably, the total broker-dealer marketplace start-up cost of \$4.7 billion is nearly identical to the start-up cost estimate that was included in the "Report on the Anticipated Operational Impacts to Broker-Dealers of the Department of Labor's Proposed Conflicts of Interest Rule Package" published by Deloitte in 2015<sup>15</sup>, though that report underestimated the total start-up costs for large financial institutions and overestimated the total start-up costs for medium financial institutions.

Estimated total broker-dealer start-up costs to comply with Rule requirements				
Financial Institution Size Category	Number of Financial Institutions	Cost Per Financial Institution (\$MM)	Total Cost (\$MM)	DOL 2016 Projection <sup>16</sup> (\$MM)
Large	42	\$ 54.64	\$ 2,295	
Medium	147	\$ 16.37	\$ 2,407	
<b>Estimated Total Start-up Cost</b>			<b>\$ 4,702</b>	<b>\$2,052- \$3,001</b>

Following the same methodology, when applied to ongoing costs, it is estimated that broker-dealers will spend over \$700 million annually to comply with the Rule. The 2016 Regulatory Impact Analysis conducted by the DOL estimated total ongoing costs for the broker-dealer marketplace between \$463 million and \$679 million.

Estimated total ongoing annual costs to comply with Rule requirements				
Financial Institution Size Category	Number of Financial Institutions	Cost Per Financial Institution (\$MM)	Total Cost (\$MM)	DOL 2016 Projection <sup>17</sup> (\$MM)
Large	42	\$ 5.89	\$ 248	
Medium	147	\$ 3.15	\$ 463	
<b>Estimated Ongoing Annual Cost</b>			<b>\$ 711</b>	<b>\$463 - \$679</b>

<sup>14</sup> DOL Regulatory Impact Analysis (source: <https://www.dol.gov/sites/default/files/ebsa/laws-and-regulations/rules-and-regulations/completed-rulemaking/1210-AB32-2/conflict-of-interest-ria.pdf> , Page 233, Figure 5-9 Total Costs for BDs (In Millions of Dollars))

<sup>15</sup> Source: Report on the Anticipated Operational Impacts to Broker-Dealers of the Department of Labor's Proposed Conflicts of Interest Rule Package <https://www2.deloitte.com/content/dam/Deloitte/us/Documents/regulatory/us-advisory-broker-dealers.pdf>

<sup>16</sup> DOL Regulatory Impact Analysis (source: <https://www.dol.gov/sites/default/files/ebsa/laws-and-regulations/rules-and-regulations/completed-rulemaking/1210-AB32-2/conflict-of-interest-ria.pdf> , Page 233, Figure 5-9 Total Costs for BDs (In Millions of Dollars))

<sup>17</sup> See footnote 9, above

**4.1.2 Opportunity cost of the Rule**

While difficult to quantify in terms of dollars, 100% of study participants indicated substantial opportunity costs incurred across people, process and technology due to the Rule. The focus on Rule priorities led to the delay or abandonment of projects and initiatives spanning people, process and technology, including but not limited to:

- Customer experience enhancements
- Business development initiatives
- Investor education activities

**4.2 Study participants' human capital spend will exceed \$420 million before 2018, with an additional \$70 million in estimated ongoing annual costs**

Generally, human capital needs to support financial institutions' responses to the Rule and ongoing compliance have or will be addressed through:

1. Additional full-time employees ("FTE") or reallocating existing employees
2. Engaging third parties (e.g., contractors, vendors)

According to study participants, these resources are primarily supporting efforts in the following ways:

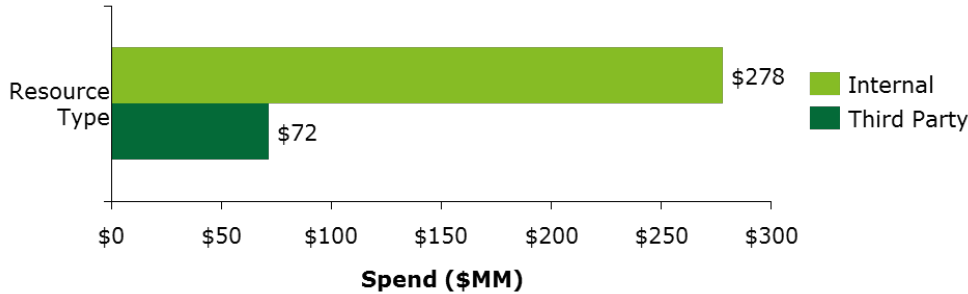
Staffing source	Primary Roles
<b>1) New or Reallocated FTEs</b>	<ul style="list-style-type: none"> <li>• Surveillance</li> <li>• Supervision</li> <li>• Compliance</li> </ul>
<b>2) Third-parties</b>	<ul style="list-style-type: none"> <li>• Rule understanding</li> <li>• Legal Strategy</li> <li>• Business strategy</li> <li>• Project/program management</li> <li>• Technology initiatives</li> </ul>

**4.2.1 Study participants spent approximately \$350 million on human capital needs to ready for June 9<sup>th</sup>**

To support the human capital needs of Rule decisions, study participants have spent a total of nearly \$350 million to date. This number is primarily driven by the onboarding of FTEs and reallocation of existing employee resourcing toward surveillance, supervision and compliance roles, including those needed to support an adherence to the Impartial Conduct Standards and enhanced rollover processes.



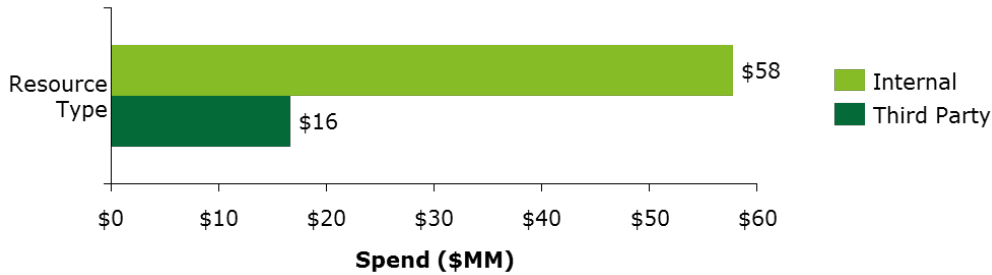
**Figure 4.2: Breakdown of human capital spend to-date as of June 9, 2017**



**4.2.2 Human capital spending related to the Rule is expected to continue through 2017 and ongoing annual costs are expected to be significant**

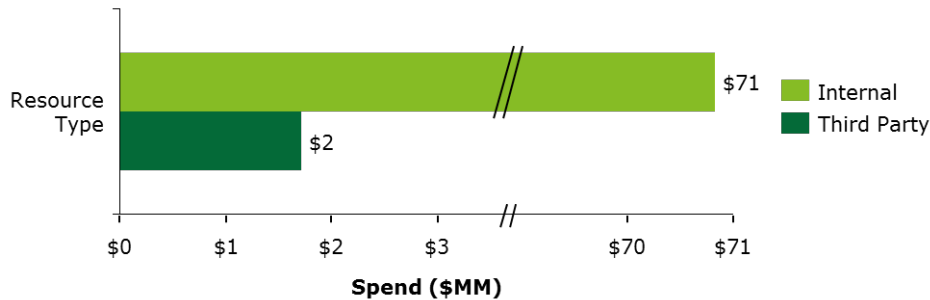
Internal resources are expected to continue to drive human capital spending through the remainder of 2017, making up over three quarters of the estimated \$74 million total additional spend by study participants. This number is primarily driven by the onboarding of FTEs and reallocation of existing employee resourcing toward surveillance, supervision and compliance roles, including those needed to support an adherence to the Impartial Conduct Standards and enhanced rollover processes.

**Figure 4.3: Breakdown of estimated additional human capital spend through January 1, 2018**



Estimated ongoing annual costs associated with human capital needs totaled almost \$73 million, with study participants' annual estimates ranging from \$75 thousand to \$14 million.

**Figure 4.4: Breakdown of estimated ongoing, annual human capital spend**



### 4.3 Significant disruption has resulted from process changes

Processes to support financial institutions' responses to the Rule also led to noticeable operational impacts by study participants. Specifically, financial institutions noted large operational impacts from new or enhanced processes related to:

- Rollover recommendations
- Product due diligence
- Financial institution and advisor compensation evaluation

#### 4.3.1 Rollover Recommendation Processes

Due to the Rule's revised definition of investment advice, certain rollover recommendations are now subject to the Impartial Conduct Standards. As a result of this change, 100% of study participants indicated that significant efforts were expended to evaluate their rollover processes and if rollover advice would be allowed going forward.

Financial institutions continuing to allow rollover recommendations have spent significant time and effort developing how a recommendation would be documented and evaluated against the Impartial Conduct Standards. The most common process change identified was substantially enhancing documentation requirements relating to rollover recommendations, particularly around existing plan costs and services. While some study participants invested in technologies to aid in the rollover recommendation process, most indicated that new processes are highly manual and accomplished via forms populated through conversations with and documentation received from retirement investors. All financial institutions indicated the lack of easily accessible and reliable plan data, such as 404a-5 fee disclosures, has significantly disrupted the rollover process. The necessity of manual processes and lack of easily accessible data has the potential to increase financial institutions' operational risk.

In addition to enhanced documentation processes, certain study participants changed their review and approval process for rollover recommendations. Some financial institutions set up teams, staffed with FTEs dedicated solely to the review and approval of rollover recommendations. In addition to costs associated with the development of new processes and, in certain circumstances, the hiring of FTEs, all respondents indicated that the most substantial impact of the change in rollover processes has been the increase in time and effort required to deliver rollover advice to retirement investors.

### *Education-only Processes*

Those financial institutions, which elected to prohibit or significantly limit rollover recommendations and serve in an education-only capacity, also implemented policy and process changes including updates to retirement investor onboarding and documentation. The primary impact noted by financial institutions electing to operate in an education-only capacity for rollovers was the substantial training efforts undertaken to ensure advisors understand what is and is not allowed under the model. In addition to the training requirements, study participants that previously allowed rollover recommendations but now operate in an education-only capacity indicated that the process change has been a significant disruption for their advisors and retirement investors, who had become accustomed to delivering and receiving rollover advice.

#### **4.3.2 Product Due Diligence Process Changes**

In order to support the changes to product offerings discussed earlier, almost all study participants indicated that their due diligence processes were changed or enhanced. Due diligence process changes include:

- New or enhanced internal research for certain products
- New or enhanced vendor research for certain products

In a number of instances, financial institutions made changes to both internal and vendor research support for their due diligence processes. Impacts resulting from changes to due diligence processes include increased costs for additional FTEs and vendor contracts, as well as changes in product offerings due to the results of new due diligence processes. As discussed in Section 3, "Impact to Investors," mutual fund product shelves were most affected by new due diligence processes. During interviews, some financial institutions indicated the removal of over a thousand funds from their platforms as a result of their new processes.

#### **4.3.3 Changes to Compensation Processes**

Beyond rollover advice and due diligence process changes, 76% of study participants implemented updates or revisions to their firm and advisor compensation evaluation processes. All study participants indicated that they plan to implement new or additional process changes if the Rule remains as is for January 1, 2018.

### *Advisor Compensation*

The most common change indicated or anticipated is leveling compensation arrangements to both the financial institution and to advisors. The primary operational impacts resulting from these new processes were:

- Resource time and efforts to carry out the evaluation
- Resource time and efforts to implement changes

### *Third Party Compensation & Revenue Share*

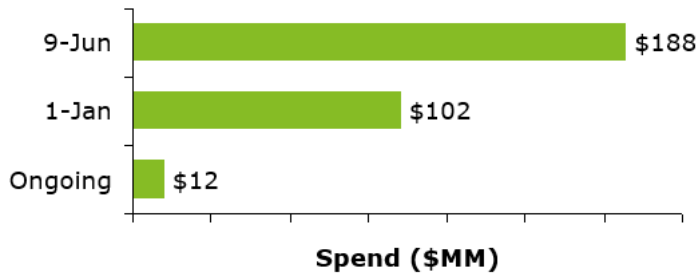
Specific operational impacts arose from renegotiating selling partner agreements (i.e., revenue sharing) and compensation features (e.g., commission percentages, payout options) with product manufacturers. As with

changes in due diligence processes, the change in compensation evaluation processes has led certain financial institutions to reduce their product offerings due to product manufacturers being unable or unwilling to conform to the new compensation criteria.

#### 4.4 Technology efforts to support people and process change has led to significant costs

Study participants' technology operations were significantly impacted by Rule decisions. To support their people and process changes, financial institutions have spent heavily on technology initiatives. Total technology spend through June 9, 2017 by study participants was in excess of \$185 million, with spending expected to continue through January 1, 2018 and on an ongoing annual basis.

**Figure 4.5: Financial Institutions' technology expenditures to support Rule decisions**



The average technology spend through June 9, 2017 among study participants was \$12 million, with estimated average additional spend through January 1, 2018 of \$6.5 million and average ongoing annual technology costs of roughly \$1 million.

Respondents indicated that technology to support the following Rule responses have been the primary drivers of technology impact:

- Rollover processes
- Principal trading controls
- Disclosure requirements, including website

# 5. Impact of Rule Uncertainty to Investors and Financial Institutions

Uncertainty with the future of the Rule has caused study participants to postpone their Rule response activities leading to additional potential firm and investor impacts.

Uncertainty in the January 1, 2018 Rule requirements has resulted in study participants delaying:

- Finalizing product and service changes
- Implementing technology solutions
- Adjusting compensation received from third parties and paid to their advisors

Study participants have indicated that they plan to make additional product and service changes as they get more clarity around the Rule, specifically around:

- Additional mutual fund share class changes
- Reduction in variable annuity availability
- Resignation of directly held mutual funds
- Limitation on additional asset classes
- Further client segmentation (e.g., loss of advice, movements into other platforms)
- Launch of new platforms (e.g., robo-advice, call-center, self-directed)

One consistent theme noted was that due to the uncertainty of the Rule, though study participants were actively exploring T shares, Clean shares, or modified A shares, almost none had moved forward with implementation on their advised brokerage platform. A few financial institutions adopted lower cost fund options on self-direct brokerage and/or advisory platforms, but not on their advised brokerage platform. Future adoption of T shares, Clean shares, and modified A shares is unclear but has the potential to substantially impact the makeup of mutual funds offered by financial institutions to retirement investors.

Delays in finalizing these decisions may lead to retirement investors purchasing products that may no longer be offered following future clarity on the Rule.

Further rollout and implementation of new share classes, limitation of additional asset classes, compensation changes, and further client segmentation all are disruptive to the client experience, and many of the study participants are awaiting final clarity on the Rule before moving forward with some of these activities.

Study participants have postponed certain additional investments in technology to avoid investment in capabilities that may not be needed in the future if the Rule changes. Study participants would prefer to allocate the funds to other projects and would also reduce impacts to retirement investors in the event that the Rule requirement changes. Therefore, while many financial institutions have taken a “wait and see” approach before moving forward with technology activities, the “wait and see” period is quickly ending. Technology development activities are generally locked down due to technology freezes surrounding calendar year-end, meaning that many respondents are nearing a “drop dead” date to begin development, in order to ensure they are fully prepared for a January 1<sup>st</sup> compliance date.

Financial institutions indicated that if Rule clarity is not received soon, study participants might have to start making Rule response decisions in advance of such clarity, which may lead to increased firm investment and additional disruptions to retirement investors’ access to products and services.

## 6. Key Takeaways

The DOL Fiduciary Rule has had significant impact across the retirement advice industry and was widely reported as an extremely disruptive regulation by study participants. Many financial institutions reported making business decisions, such as restricting their brokerage offerings and accelerating their momentum to a primarily fee-based business model, which has resulted in limiting choice for retirement investors. These business decisions have been made in a very uncertain operating and regulatory environment given the Rule delay from April 10<sup>th</sup> to June 9, 2017, changes in requirements for the first applicability date, and the potential for further Rule changes or delays. The business model changes has also resulted in a bifurcated experience for retirement investors who hold both retirement and non-retirement assets within the same financial institution. Financial institutions are quickly approaching what they call “drop dead” dates to begin making substantial investments into people, process, and technology, which in the end, may be unnecessary if the Rule is delayed or rescinded.

The impacts across the industry on retirement investors and financial institutions vary widely and the key takeaways from the study are summarized below:

- **Each study participant approached the Rule differently depending on their business objectives, rule interpretation, and risk appetite, resulting in wide range of responses around service and product offerings across the industry.**
- **Although there has been substantial change to services and products in advance of June 9<sup>th</sup>, many financial institutions have indicated there is more change coming should the current version of the Rule go into full effect.**
- **Retirement investors who wish to retain access to advice may have to choose to move to a fee-based model, which changes the service relationship and may result in an increase in average fees paid per year or choose to move to a new financial institution.**
- **Significant investment has been made to date and is planned for the future. This investment has been higher due to increased costs associated with stopping and restarting certain projects due to the changing nature of the Rule.**



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