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Submitted Electronically to rule-comments@sec.gov

The Honorable Jay Clayton
Chairman
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

Re: Public Comments from Retail Investors and Other Interested Parties on Standards of Conduct for Investment Advisers and Broker-Dealers

Dear Chairman Clayton:

On behalf of our members, the Insured Retirement Institute ("IRI")[1] appreciates the opportunity to provide these comments in response to the public statement you issued earlier this year (the "Public Statement") regarding the standards of conduct for investment advisers ("IAs") and broker-dealers ("BDs"). IRI and our members commend you for recognizing the importance of this issue and for seeking public input to help the Securities and Exchange Commission (the "Commission" or the "SEC") as it considers possible rulemaking in this space. As we will further elaborate below, IRI and our members have long supported the principle that financial professionals should be required to act in their clients' best interest standard when providing personalized investment advice. We believe the SEC should take the lead in developing this standard, in collaboration with the Department of Labor ("DOL"), the National Association of Insurance Commissioners (the "NAIC"), the Financial Industry Regulatory Authority ("FINRA") and the North American Securities Administrators Association ("NASAA").

[1] IRI is the only national trade association that represents the entire supply chain of the retirement income industry. IRI has more than 500 member companies, including major life insurance companies, broker-dealers, banks, and asset management companies. IRI member companies account for more than 95 percent of annuity assets in the United States, include the top 10 distributors of annuities ranked by assets under management, and are represented by more than 150,000 financial professionals serving over 22.5 million households in communities across the country.

In this letter, we will provide constructive suggestions and recommendations to help the SEC and its fellow regulators formulate a workable and cohesive best interest standard that preserves consumer choice and access to the products and services they need to achieve their financial goals.

Executive Summary

The following is an overview of our comments and recommendations in response to the questions posed in the Public Statement.

A. The Context for IRI's Comments: America's Retirement Income Challenge and the Need for Retirement Income Products

1. Americans today are living longer than ever before. A married couple age 65 has more than a 65 percent chance of one or both spouses living to age 90 and a 35 percent chance of one spouse living to age 95. Meanwhile, access to traditional defined benefit pension plans continues to decline, creating a significant risk that many people will outlive their assets. It is critical that the regulatory environment allows consumers to access products that meet their needs to protect against this increased longevity risk.
2. Annuities are the only products available in the private market that can provide retirees and pre-retirees with a guaranteed source of income to ensure they can enjoy a financially secure and dignified retirement.
3. Consumers who receive assistance from financial professionals save more throughout their working years, make better use of available retirement planning products and strategies, and experience better returns on their investments, and therefore are better prepared for retirement than those who do not have access to retirement planning advice. Financial professionals have been shown to help consumers earn 1.59 percent in additional annual returns, which over time leads to 22.8 percent more income in retirement.

B. IRI's Guiding Principles for Development of a Workable Best Interest Standard

Foundational Principles – Best Interest Standard and Choice

1. Financial professionals should be held to a best interest standard when providing personalized investment advice to retail clients.
    a. The vast majority of financial professionals already act in their clients' best interest.
    b. The standard should not require financial professionals to completely disregard their own interests or recommend only the "best" or "cheapest" product.

   c. The standard should only apply to recommendations that would reasonably be viewed as a call to take action and are sufficiently individualized.

   d. The standard should not impair the ability of firms and financial professionals to market, advertise and sell their products.

   e. The standard should be applied in a manner that is in the best interest of each unique individual investor.

2. Investors are generally capable of looking out for their own interests and should have freedom of access to shop the financial services marketplace for retirement income guarantees.

   a. The Commission should preserve access to annuities and other valuable financial products and services by rejecting the DOL's paternalistic view of individuals.

   b. A competitive product marketplace is clearly in the best interests of retirement investors.

3. Investors should have the right to choose their own financial professional; Regulations should not favor or disfavor financial professionals based on the nature of their compensation (commission or fee) or the scope of their product offerings (proprietary products or limited product shelf).

<u>Procedural Principles – Coordination with Other Regulators</u>

4. The DOL Rule is causing consumers to lose access to valuable retirement products and services, and therefore should not serve as the starting point for rulemaking by the Commission.

   a. A recent survey of IRI's insurance company and distributor members, along with similar research conducted by other organizations, demonstrates the DOL rule is already harming consumers.

5. The Commission should collaborate with the DOL, FINRA, and the state insurance and securities regulators to develop a clear and consistent best interest standard.

<u>Substantive Principles – Conflicts, Disclosure, Grandfathering, Innovation and Enforcement</u>

6. A workable best interest standard must include a workable approach to conflicts of interest and disclosure.

   a. Conflicts should be eliminated when reasonably possibly (without requiring levelized compensation; Unavoidable conflicts should be managed through mitigation and disclosure.

b. Disclosures should help investors understand what they are paying AND what they are getting for their money.

c. The Commission should only propose new disclosure requirements if it identifies a gap in existing disclosure requirements.

d. The Commission should adopt a rule to allow use of a summary prospectus for variable annuities to help investors better understand these products.

7. The Commission should provide true grandfathering; any new standard of conduct should not retroactively apply to pre-existing accounts or transactions.

8. The Commission should provide a flexible regulatory environment to facilitate and encourage innovation, but should not pick winners and losers.

9. The best interest standard should not be interpreted or enforced through private litigation; regulators should control interpretation of the standard, and enforcement should be handled through regulatory actions or arbitration.

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The Context for IRI's Comments: America's Retirement Income Challenge and the Need for Retirement Income Products

With unprecedented growth in the number of retired Americans, the nation's retirement system is at a crossroads, and policymakers in Washington have clearly taken notice. Numerous retirement-focused bills have been introduced in Congress over the past several years, and federal regulators have been working to make guaranteed lifetime income products more widely available. IRI and our members believe the standards of conduct applicable to financial professionals must be carefully crafted to preserve access to the products and services Americans need to achieve financial security in retirement.

Longevity Risk *– Americans today are living longer than ever before, while access to traditional defined benefit pension plans continues to decline, creating a significant risk that many people will outlive their assets. It is critical that the regulatory environment allows consumers to access products that meet their need to protect against this increased longevity risk.*

Americans today are at risk of outliving their assets. This longevity risk has never been greater. The rapid and continuing shift away from defined benefit plan designs in favor of a defined contribution plan model, increasing life expectancies, and rising health care costs are combining to exert significant pressures on individual consumers, in particular middle-income Americans, seeking a financially secure retirement. These challenges simply did not exist in earlier generations.

At their peak in 1985, over 114,000 private-sector defined benefit plans were in place,[2] but by 2012, less than 26,000 of these defined benefit plans remained.[3] Only 19 percent of private-sector workers had access to a defined benefit plan in 2014.[4]

Individuals today are living longer than in past generations. The population of older Americans continues to increase at a faster rate than the overall population. For example, between 2000 and 2010, the number of Americans aged 85 to 94 grew by 29.9 percent; by comparison the entire U.S. population increased by 9.7 percent during that timeframe.[5] Moreover, according the Society of Actuaries, a married couple age 65 has more than a 65 percent chance of one or both spouses living to age 90 and a 35 percent chance of one spouse living to age 95.[6]

As a result of these trends, today more than 30 million Baby Boomers are “at risk” for inadequate retirement income; that is, a lack of sufficient guaranteed lifetime income.[7] Just as concerning, nearly half (45 percent) of Generation Xers (ages 36-45) are “at risk” for inadequate retirement income.[8] Alarmingly, only 40 percent of Americans 30 to 49 years of age have tried to determine how much they need to save by the time they retire.[9] Meanwhile, nearly one-third of Baby Boomers cite having adequate retirement assets as a top concern, while over three-quarters said they will work for income in retirement, meaning true retirement may not be feasible for this cohort.[10] This reality underscores the critical importance of a regulatory environment that allows consumers to access products that meet their need to protect against longevity risk.

Guaranteeing Lifetime Income with Insured Retirement Products – *Annuities are the only products available in the private market that can provide retirees and pre-retirees with a guaranteed source of income to ensure they can enjoy a financially secure and dignified retirement.*

Outside of Social Security and private pensions, annuities are the sole source of guaranteed lifetime income during retirement. Only insurance companies and their distribution partners

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[2] Pension Benefit Guaranty Corporation. *Trends in Defined Benefit Pension Plans.*

[3] Pension Benefit Guaranty Corporation. *Pension Benefit Guaranty Corporation Annual Report 2012.*

[4] Bureau of Labor Statistics. *National Compensation Survey: Employee Benefits in the United States, March 2014.*

[5] United State Census Bureau. *The Older Population 2010*.

[6] Society of Actuaries. *SOA 2012 Individual Annuitant Mortality tables.*

[7] Employee Benefit Research Institute. *EBRI Notes: Retirement Income Adequacy for Boomers and Gen-Xers: Evidence from the 2012 EBRI Retirement Security Projection Model.*

[8] *Ibid.*

[9] Insured Retirement Institute. *Baby Boomers and Generations Xers: Are They on Track to Reach Their Retirement Goals?*

[10] Insured Retirement Institute. *Boomer Expectations for Retirement 2013*.

can provide these products. With proper planning and use, annuities can provide retirees with guaranteed lifetime income and the security of knowing that they will not outlive their savings. Boomers who own insured retirement products, including all types of annuities, have a higher confidence in their overall retirement expectations, with nine out of 10 believing they are doing a good job preparing financially for retirement.[11] Compared to non-annuity owners, Baby Boomers who own annuities are more likely – by more than a two-to-one ratio –to be among those who are most confident in living comfortably throughout all their retirement years.[12] Baby Boomer annuity owners also are more likely to engage in positive retirement planning behaviors than Baby Boomer non-annuity owners, with 68 percent having calculated a retirement goal and 63 percent having consulted with a financial professional.[13]

Annuities appeal to Americans of all income levels and consumers who do not have access to other retirement savings vehicles. In fact, annuity owners are overwhelmingly middle-income. Seven in 10 annuity owners have annual household incomes of less than $100,000. The standards of conduct for financial professionals should not unreasonably limit consumer access to annuity products at precisely the point in time when these products are most vitally needed.

Benefits of Working With a Financial Professional *– Consumers who receive assistance from financial professionals save more throughout their working years, make better use of available retirement planning products and strategies, and experience better returns on their investments, and therefore are better prepared for retirement than those who do not have access to a financial professional.*

Financial professionals play a critical role in helping consumers understand the wide variety of annuity products available in the market and how best to utilize them to prepare for retirement. Studies have shown that Americans accumulate more savings when working with a financial professional, saving twice the amount over a seven- to 14-year period.[14] Working with a financial professional has a positive influence on retirement planning behaviors including: increased usage of tax-advantaged savings vehicles, improved asset allocation, greater portfolio diversification and less-speculative investing.[15] Financial professionals have also been shown to help consumers earn 1.59 percent in additional annual returns, which over time leads to 22.8

[11] Insured Retirement Institute. *Boomer Expectations for Retirement 2011*.

[12] Insured Retirement Institute. *Survey of Americans Aged 51 to 67*.

[13] Insured Retirement Institute: *Tax Policy and Boomer Retirement Saving Behaviors.*

[14] Claude Montmarquette, Nathalie Viennot-Briot. Centre for Interuniversity Research and Analysis on Organizations (CIRANO). *Econometric Models on the Value of Advice of a Financial Advisor*. http://www.cirano.qc.ca/pdf/publication/2012RP-17.pdf.

[15] *Ibid.*

percent more income in retirement.[16] Moreover, financial professionals help their clients overcome the emotional aspects of investing, which can add one percent to two percent in net annual returns.[17]

It is also significant to note the particular benefits of retirement planning advice for women and minorities. Women are more than twice as likely to be confident in their outlook on retirement when they work with a financial professional.[18] African Americans are nearly three times more likely to save in an IRA and four times more likely to have an annuity when working with a financial professional.[19] Similarly, nearly 90 percent of Hispanic Americans contribute to a retirement plan when working with a professional, compared to only 54 percent working on their own.[20]

In sum, consumers who receive assistance from financial professionals save more throughout their working years, make better use of available retirement planning products and strategies, and experience better returns on their investments, and therefore are better prepared for retirement than those who do not have access to retirement planning advice.

Guiding Principles for Development of a Workable Best Interest Standard

IRI and its members believe financial professionals should act in the best interest of their clients when providing personalized investment recommendations. Moreover, IRI members are fully committed to compliance with all applicable laws and regulations. Over the course of nearly twenty months since the final DOL Rule[21] was issued, IRI members have undertaken wide-ranging efforts to prepare for implementation. Let there be no confusion, though: this support for "a best interest standard" and this commitment to legal and regulatory compliance should not be interpreted as support for the approach taken in the DOL Rule.

As we will explain further below, we and other commenters have raised and continue to have serious concerns about the DOL Rule and its harmful impact on retirement savers. For example, the best interest standard articulated by the DOL appears to require a complete disregard for

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[16] Morningstar. *Alpha, Beta, and Now…Gamma*. http://corporate.morningstar.com/ib/documents/PublishedResearch/AlphaBetaandNowGamma.pdf.

[17] Vanguard Research. *Putting a Value on Your Value: Quantifying Vanguard Advisor's Alpha*. http://www.vanguard.com/pdf/ISGQVAA.pdf.

[18] Prudential Financial, Inc. *Financial Experience & Behaviors Among Women: 2014-2015 Prudential Research Study*. http://www.prudential.com/media/managed/wm/media/Pru_Women_Study_2014.pdf.

[19] Prudential Financial. *The African American Financial Experience*. http://www.prudential.com/media/managed/aa/AAStudy.pdf.

[20] Prudential Financial. *Hispanic Americans On the Road to Retirement*. http://www.prudential.com/media/managed/Hispanic_Retirement_FINAL_3-19-08.pdf.

[21] As used in this letter, the term "DOL Rule" means, collectively, the final regulation defining the term "fiduciary" (the "Fiduciary Definition Regulation") under the Employee Retirement Income Security Act of 1974, as amended ("ERISA"), the Best Interest Contract Exemption (the "BIC Exemption"), and the amendments to prohibited transaction exemption 84-24 (the "Amended PTE 84-24") issued by the DOL on April 8, 2016.

the business and economic reality that firms and financial professionals have to generate enough revenue to cover their costs and earn a reasonable profit in order to stay in business. We are particularly concerned about how this requirement will be applied in the context of proprietary annuity distribution models, which provide consumers with invaluable and irreplaceable sources of knowledge about annuity products and how annuities can be used to provide guaranteed lifetime income to retirees.

Put simply, the DOL Rule is already depriving consumers of access to guaranteed lifetime income products and the professional assistance needed to knowledgeably acquire and use those products. This outcome clearly runs counter to the best interests of American working men and women.

As the Commission undertakes its own effort to formulate a regulatory proposal to impose a best interest standard of conduct on all financial professionals, IRI respectfully recommends that the Commission adhere to the following guiding principles as it works to develop a standard that will provide meaningful and effective investor protections without depriving Americans of access to valuable financial products and services.

<u>Foundational Principles – Best Interest Standard and Choice</u>

1. ***Financial Professionals Should be Held to a Best Interest Standard When Providing Personalized Investment Advice to Retail Clients.***

   As noted above, IRI supports the application of a best interest standard when a financial professional provides personalized investment advice or recommendations to their clients. IRI believes the vast majority of financial professionals already act in the best interest of their clients, and recent IRI research found that nearly all consumers agree.[22]

   <u>*The standard should not require financial professionals to completely disregard their own interests or recommend only the "best" or "cheapest" product.*</u>

   The standard must be carefully crafted, however, to avoid any implication that acting in clients' best interest requires that financial professionals must completely disregard their own interests in order to recommend the "best product" (which can only be determined with any degree of certainty with the benefit of hindsight years or decades after the recommendation is made) or the cheapest product (which would prevent recommendations of higher-cost products that provide guarantees or other features many consumers want and need).

[22] Insured Retirement Institute. *January 2014 Survey of Americans aged 51-67*.

We note, for your reference, that the NAIC has released draft revisions to its Suitability in Annuity Transactions Model Regulation[23] for public comment. The draft revisions include the following definition of "best interest":

> "(1) "Best interest" means, at the time the annuity is issued, acting with reasonable diligence, care, skill and prudence in a manner that puts the interest of the consumer first and foremost.
>
> (2) "Best interest" does not mean a resulting recommendation is the least expensive annuity product, or the annuity product with the highest stated interest rate or income payout rate, available in the marketplace at the time of the annuity transaction. "Best interest" also does not mean the recommendation is the single "best" annuity product available in the marketplace at the time of the annuity transaction, but based on the insurance producer's judgment acting with reasonable diligence, care, skill and prudence, the producer believes the recommendation is in the best interest of the consumer"

IRI and our members are still reviewing the NAIC's draft revisions, including this definition, and will be providing written detailed comments to the NAIC by their comment deadline of January 22, 2018. We will provide a copy of our comment letter to the Commission following submission to the NAIC.

The standard should only apply to recommendations that would reasonably be viewed as a call to take action and are sufficiently individualized.

Similarly, it is important that the Commission establish clear and appropriate triggers for application of the standard. In our view, the standard should only apply when a financial professional makes a recommendation that (a) based on its content, context, and presentation, would reasonably be viewed as a call to take action or to refrain from taking action[24] and (b) is sufficiently individualized as to form a reasonable basis for reliance by the investor as a source of unbiased and impartial advice.

The standard should not impair the ability of firms and financial professionals to market, advertise and sell their products.

There is a broad spectrum of financial marketing and sales activities where no reasonable expectation can exist that a financial professional has been engaged by a client to act as an

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[23] Available at http://www.naic.org/cmte_a_aswg.htm.

[24] This would be consistent with FINRA guidance concerning the distinction between recommendations and non-recommendations, which focuses on whether there has been a communication that could be viewed as a "call to action" that might reasonably influence an investor to trade a particular security or group of securities. *See* NASD Notice to Members 01-23.

unbiased and impartial source of recommendations under a legal obligation to disregard its own interests as a seller of investment products or asset management services. [25] Advertising and marketing to existing and potential clients is vital to the functioning of the financial marketplace. Without these kinds of communications, investors might never become aware of or learn about products and services that may be a fit for their needs. By the same token, providers and distributors of annuities and other financial services products require the freedom to utilize specifically directed marketing communications to identify consumers with a potential interest in purchasing those products.

The federal securities laws have long recognized the distinctions between sales and advice, and between episodic advice and continuous advice, and we believe any new standard of conduct should similarly recognize these important distinctions. In our view, the regulatory requirements *vis-à-vis* conflicts of interest should reflect the nature of the activity to which they apply. Put another way, reasonable steps to mitigate potential conflicts of interest would be more extensive for a financial professional engaged in providing advice as compared to a financial professional who is merely selling. Similarly, a financial professional who is providing episodic advice should not be expected to exert the same efforts to mitigate conflicts as a financial professional who has an ongoing relationship with a client.

Based on the foregoing, we urge the Commission to avoid impairing the ability of buyers and sellers to find each other in the marketplace or to enter into arms'-length transactions by applying a best interest standard to advertising, marketing or sales activities. The standard should apply only when there is a relationship of trust between the investor and the financial professional and a reasonable expectation by the investor that the financial professional is acting in the investor's best interest.

The standard should be applied in a manner that is in the best interest of each unique individual investor.

A rigid, one-size-fits-all approach will not serve investors or financial professionals as well as a standard under which financial professionals can appropriately consider all relevant factors when choosing investments to recommend. Some important examples of the factors that should be taken into account are the investors' needs and goals, financial situation, age/life stage (e.g., young professional, mid-career, pre-retiree, retiree, etc…), and applicable risk factors (e.g., market risk, inflation risk, longevity risk, long-term care and health risk, etc…).

[25] See the July 2015 Letter for a list of examples of the types of activities commonly engaged in by annuity providers and financial professionals that we believe should not be considered "advice."

2. ***Investors Are Generally Capable of Looking Out For Their Own Interests and Should Have Freedom of Access to Shop the Financial Services Marketplace for Retirement Income Guarantees.***

IRI believes it is in the best interests of all Americans to have the freedom to shop the financial marketplace for annuity products and to procure a source of secure retirement income. Annuity products, by virtue of the guaranteed lifetime income and other guarantees they provide, are uniquely suited to provide the financial safety and security sought by many retirees. As a result of dramatic declines in defined benefit plan coverage, coupled with the fact that very few defined contribution plans provide lifetime income forms of distribution, individual annuity purchases through IRAs are, on a *de facto* basis, the primary means, other than Social Security, through which retirees procure guaranteed retirement income.[26]

IRI strongly supports recent Congressional and federal regulatory efforts to facilitate retirement savers' access to and use of guaranteed lifetime income products. [27] In particular, we note that Congress and the DOL have separately considered proposals in recent years to require that defined contribution account balances be expressed not only as a lump sum amount, but also as a retirement income stream. This would help transform the way Americans think about the adequacy of their accumulated retirement savings to replace pre-retirement monthly income flows.[28] For this initiative to succeed, however, workers must have the ability to act on the new information they receive. In other words, learning about the importance of retirement income guarantees will make no difference if workers cannot purchase products capable of meeting their guaranteed income needs in the private marketplace.

The Commission should preserve access to annuities and other valuable financial products and services by rejecting the DOL's paternalistic view of individuals.

To ensure this freedom of access, we believe the Commission should take a different approach than the DOL Rule. Under the DOL Rule, individual access to annuity products and

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[26] An independent study conducted for the DOL in 2011 reported that only about 1 percent of defined contribution plans offer a deferred annuity. By contrast almost all defined contribution plans offer the option of a lump sum distribution upon job separation, which may be rolled over into an IRA and used to purchase an annuity. The same study noted that although only about 6.1 percent of workers who retire with a defined contribution plan convert their account balance into an annuity "substantial additional annuitization takes place after retirement through conversions of IRAs, often in the form of a deferred annuity." *Annuities in the Context of Defined Contribution Plans, A Study for the U.S. Department of Labor, Employee Benefits Security Administration,* Michael J. Brien, PhD and Constantijn W.A. Panis, PhD, November, 2011.

[27] *See* Request for Information Regarding Lifetime Income Options for Participants and Beneficiaries in Retirement Plans, 75 Fed. Reg. 5253 (Feb. 2, 2010).

[28] Advance Notice of Proposed Rulemaking, *Pension Benefit Statements,* 78 Fed. Reg. 26727 (May 8, 2013).

other valuable financial products and services is severely constrained based on the assumption that, "as a rule," individual workers are too uninformed to look out for their own interests.[29] The DOL's view was made evident in the preamble to its 2015 proposal. The counterparty carve-out (sometimes referred to as a seller's exception) included in that proposal would not have extended to transactions involving retail investors, including small plans, IRA owners, and plan participants and beneficiaries.[30] While the final DOL Rule recast that carve-out as an exclusion for communications with independent fiduciaries with financial expertise and revised the specific parameters of the carve-out, the DOL clearly continued to believe that, "as a rule," consumers are incapable of looking out for their own best interests when engaging in arm's length bargaining with financial service providers.

IRI emphatically disagrees with the DOL's assessment of American consumers; rather, we believe the vast majority of investors are capable of looking after their own affairs. The DOL's determination is inconsistent with the position taken by Congress in enacting ERISA § 404(c) and with the views expressed by President Trump[31] and Secretary of Labor Alexander Acosta.[32] The DOL failed to adequately support its conclusion that all individuals and small 401(k) plan fiduciaries are so lacking in financial sophistication as to be incapable of independent thought and choice. As a result, the DOL Rule effectively forces consumers to do business with a fiduciary whether or not a fiduciary is wanted or needed.

A competitive product marketplace is clearly in the best interests of retirement investors.

Marketplace competition between and among manufacturers and other investment providers, and between and among affiliated and unaffiliated distributors, fosters innovations and efficiencies that advance consumer interests. The approach taken in the DOL Rule is built upon a "value of services" compensation model, effectively ignoring the intrinsic value consumers derive from insurance guarantees of safety and security. This would stifle marketplace competition and product innovation.

The Commission should instead develop a rule that (a) allows individuals the opportunity to shop the financial services marketplace for the investment arrangements that best fit their needs; (b) accounts for the benefits and costs associated with the guarantees provided by

[29] 80 Fed. Reg. 21942.
[30] 80 Fed. Reg. 21941.
[31] Fiduciary Duty Rule, Memorandum for the Secretary of Labor, 82 Fed. Reg. 9675 (February 7, 2017) ("One of the priorities of my Administration is to empower Americans to make their own financial decisions.")
[32] Acosta, Alexander, Wall Street Journal, *Deregulators Must Follow the Law, So Regulators Will Too* (May 22, 2017), available at https://www.wsj.com/articles/deregulators-must-follow-the-law-so-regulators-will-too-1495494029 ("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.")

annuity products; and (c) does not inadvertently cut off access to guaranteed income products for most Americans at the exact moment in history when ready access is most urgently needed.

3. ***Investors Should Have the Right to Choose Their Own Financial Professional; Regulations Should Not Favor or Disfavor Financial Professionals Based on the Nature of Their Compensation (Commission or Fee) or the Scope of Their Product Offerings (Proprietary Products or Limited Product Shelf).***

   IRI believes in a best interest standard that gives investors the freedom to choose who they receive advice from, whose products their financial professional may offer (i.e., affiliated or unaffiliated), how their financial professional is compensated, and how their retirement savings are invested. In particular, consumers should not be denied access to financial professionals who have acquired in-depth knowledge and expertise by concentrating or dedicating their practices to the products of a single company or a select group of companies. The proprietary distribution model, which emphasizes training and expertise, is vital to a healthy marketplace and therefore must be preserved.

   In the current regulatory framework, for example, 86 percent of Baby Boomers say they are better prepared for retirement as a result of their financial professional's help, validating existing distribution models.[33] The DOL Rule includes a bias that favors unlimited product choice over expertise. This bias poses a threat to proprietary annuity distribution models.

<u>**Procedural Principles – Coordination with Other Regulators**</u>

4. ***The DOL Rule is Causing Consumers to Lose Access to Valuable Retirement Products and Services, and Therefore Should Not Serve as the Starting Point for Rulemaking by the Commission.***

   IRI and our members do not believe the DOL Rule appropriately balances the interests of consumers in receiving broad-based investment advice. Throughout the DOL's rulemaking process, we and many other interested parties repeatedly cautioned the DOL about the significant adverse impacts we believed were likely to result from adoption of the DOL Rule. Most significantly, we expressed serious reservations about the likelihood that the DOL Rule would deprive low- and middle-income consumers of access to the wide range of products and services they need to help them achieve a financially secure retirement.

   Sadly, we now have significant evidence that our fears have been realized. IRI conducted a survey of a representative sampling of IRI's insurance company and distributor members

[33] Insured Retirement Institute. *Boomer Expectations for Retirement 2015*.

from July 18 to July 31, 2017 (the "IRI Member Survey"). Through this survey, our members reported the following:

- More than 60 percent of the distribution firms that participated in the IRI Member Survey have, are planning to, or are considering exiting or de-emphasizing target markets such as small IRA holders and small retirement plan sponsors.
- Many firms are still assessing the extent to which existing clients will lose access to their financial professional as a result of the DOL Rule. However, a number of our distributor members reported that approximately 155,000 of their clients have already been 'orphaned,' and a number of our insurer members told us that both the financial professional and the firm have dissociated from the accounts of hundreds of their annuity contract owners. Far more accounts are expected to be impacted if and when implementation of the DOL Rule proceeds.
- Half of the insurance companies responding to the IRI Member Survey reported that some of their distribution partners have dropped the insurer's products from their shelf due to product restrictions and other decisions made as part of their efforts to implement the DOL Rule. As a result of these changes to distributors' product shelves, some of our largest insurer members reported an expected decline in revenue in the hundreds of millions of dollars.
- Nearly 60 percent of the insurance companies that participated in the IRI Member Survey expect that fee-based annuities manufactured in response to the DOL Rule will result in higher overall fees to the consumer.
- To date, implementation costs for our largest distributor members have ranged from $13 million to more than $40 million, with remaining expected costs ranging from $10 million to more than $25 million. Our largest insurance company members reported expenditures to date ranging from $10 million to more than $30 million, and expected future costs ranging from $5.5 million to $15 million.

In addition to our own survey, a number of other groups conducted their own research and found evidence that the DOL Rule is depriving consumers of access to retirement products and services. One such group, the Independent Insurance Agents & Brokers of America, surveyed its members in July 2017 and found that 38 percent of respondents (primarily small and medium sized "Main Street" firms) have already stopped or are planning to stop selling and servicing products impacted by the fiduciary rule (primarily annuities) on or before January 1, 2018.[34]

[34] Comment letter submitted by the Independent Insurance Agents & Brokers of America, Inc. (August 3, 2017)

IRI and other commenters also provided extensive new data and information to the DOL in connection with its review of the Fiduciary Rule pursuant to the Presidential Memorandum. A compilation of this new data and information is attached to this letter as Appendix A. The following are some of the more noteworthy and troubling findings described in that compilation:

- A survey of financial professionals finds 71 percent will stop providing advice to at least some of their current small accounts due to the risk and increased costs of the DOL Rule.
- Other surveys found that 35 percent of financial professionals will stop serving accounts under $25,000, and 25 percent will raise their client minimum account thresholds.
- A major mutual fund provider reported that the number of orphaned accounts on its books tripled in the first quarter of 2017 due to the DOL Rule. These small accounts averaged $21,000. It further estimated that roughly 15 percent of its accounts would be orphaned following full implementation of the DOL Rule.
- A survey of insurance service providers shows 70 percent already have or are considering exiting the market for small balance IRAs and small plans, and half are preparing to raise minimum account requirements for IRAs.
- Lack of access to advice hurts retirement savers—a study shows that investors starting with $25,000 who receive advice save nearly three times more than their non-advised peers. This is due not only to investment recommendations, but to personal assistance in developing better retirement saving habits and other positive financial behaviors.
- Many comments explained that a wide array of financial service providers are responding to the Rule's new litigation risks by limiting the investment types and products they will recommend.

5. ***The Commission Should Collaborate With the DOL, FINRA, and the State Insurance and Securities Regulators in Developing a Best Interest Standard.***

IRI and our members believe it is essential that the Commission engage in a constructive dialogue with the DOLas well as the NAIC, FINRA, and NASAA. The NAIC and the state insurance departments have valuable expertise in regulating financial professionals who sell insurance products, and have recently formed a working group to consider possible revisions to the NAIC Suitability in Annuity Transactions Model Regulation (the "NAIC

Model"), including possible incorporation of a best interest standard into the NAIC Model.[35] FINRA, NASAA and the state securities regulators should also be part of these discussions, as their experience in regulating financial professionals who sell securities products would also be helpful as a supplement to the Commission's own expertise in that space. We are encouraged by the sentiments recently expressed by Chairman Clayton, Secretary of Labor Alexander Acosta and the NAIC acknowledging the need for coordinatation among the Commission, the DOL, and the NAIC, and we urge the regulators to follow through on those comments.

As the prudential regulators for the securities and insurance industries, the SEC and the state insurance departments should lead this effort. They have the the ability to adopt the most broadly applicable rules, and have robust examination and enforcement tools at their disposal to effectively ensure compliance or penalize violators for non-compliance.

We believe the goal of this collaboration should be to reach general agreement on appropriate standards of conduct and regulatory requirements to be adopted by the Commission, the DOL and the state insurance departments. Unlike the DOL Rule, which applies only to recommendations made with respect to retirement assets, this approach would establish consistent and clear standards of conduct for recommendations made by all licensed financial professionals with respect to any securities or insurance product.

Substantive Principles – Conflicts, Disclosure, Grandfathering, Innovation and Enforcement

6. *A Workable Best Interest Standard Must Include a Workable Approach to Conflicts of Interest and Disclosure.*

One of the most significant and challenging issues facing the Commission in developing a best interest standard is determining how to treat conflicts of interest. SEC and DOL officials have frequently pointed out the distinctions between their statutory structures, with the federal securities laws taking a more disclosure-based approach to conflicts, while ERISA starts from the premise that conflicts should be prohibited. This distinction highlights the flaw in setting standards of conduct for financial professionals under ERISA. While it is reasonable to expect retirement plan sponsors or other plan fiduciaries to completely eliminate potential conflicts, requiring financial professionals to completely disregard their own interest in earning compensation is inappropriate, overly burdensome, and frustrates the goal of increasing access to and utilization of guaranteed lifetime income products. Compensation, whether in the form of a fee or a commission, will always present a possible

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[35] See comment letter submitted by the National Association of Insurance Commissioners (August 7, 2017) (describing the extensive system of state insurance regulation applicable to annuity products and sales practices) (the "NAIC Comment Letter").

conflict of interest. Only a financial professional acting in a *pro bono* capacity can fully eliminate all potential conflicts.

Conflicts should be eliminated when reasonably possibly (without requiring levelized compensation; Unavoidable conflicts should be managed through mitigation and disclosure.

As such, the Commission must identify an alternative approach that will effectively protect investors without making it impossible to obtain much-needed advice. IRI respectfully suggests that the Commission take a three-pronged approach, under which financial professionals would be required to: (1) eliminate potential conflicts when reasonably possible, (2) take reasonable steps to mitigate potential conflicts that cannot be eliminated, and (3) provide simple, straightforward and meaningful disclosure of those remaining conflicts and the steps taken to mitigate them.[36] To avoid the unintended consequences seen under the DOL Rule, the first prong should be carefully structured to avoid any implication that firms and financial professionals must or should move to levelized compensation structures. As we explained in detail in our past comment letters to the DOL, such structures are appropriate for some investors, but there are also many who benefit greatly from the option to work with a financial professional on a commission basis. The Commission should take steps to preserve both options.

Disclosures should help investors understand what they are paying AND what they are getting for their money.

The structure of the disclosure prong will be critical to the workability of this approach. We believe the disclosure requirements should be streamlined to focus investors' attention on the most important information including, for example, general information about how

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[36] For your reference, we note that the NAIC's draft revisions to the Suitability Model includes the following definition of "material conflicts of interest":

> (1) "Material conflict of interest" means a financial interest of an insurance producer, or the insurer where no producer is involved, that a reasonable person would expect to affect the impartiality of the recommendation.
> © 2017 National Association of Insurance Commissioners 3
> (2) "Material conflict of interest" includes financial incentives or rewards offered to or received by an insurance producer, or a direct interest or ownership in an insurer by an insurance producer or an immediate family member of an insurance producer.

As noted above, IRI and our members are still reviewing the NAIC's draft revisions, including this definition, and will be providing written comments to the NAIC by January 22, 2018. We will provide a copy of our comments to the Commission following submission to the NAIC.

much they will pay[37] and what they will get for their money.[38] This approach would be far better than the exceedingly and needlessly complex disclosure requirements imposed under the DOL Rule, which have been driving plan sponsors to focus almost exclusively on fees.[39] In our view, this myopic focus on fees is inconsistent with the goal of ensuring that financial professionals are acting in their clients' best interest. To achieve this goal, the Commission should require that fee disclosures always be presented in the context of the benefits and services being purchased. Without this context, it is impossible for a financial professional to fully and fairly compare products in order to determine which product should be recommended for a particular client.

The Commission should only propose new disclosure requirements if it identifies a gap in existing disclosure requirements.

In the comment letters we submitted to the DOL on July 21, 2015[40] and September 24, 2015,[41] we provided detailed recommendations to help the DOL develop a more effective, efficient and appropriate disclosure regime. Those recommendations relied on the extensive disclosures already being provided to clients under existing regulations.[42] We continue to believe regulators should leverage those existing disclosures rather than simply piling more information in front of investors without meaningfully enhancing their ability to make informed investment decisions. We therefore respectfully encourage the Commission to propose new disclosure requirements only to the extent of any gaps in the existing disclosure regime.

[37] In many cases, the actual cost to a particular investor will not be knowable at the time of the transaction because those amounts will be calculated based on a number of different factors. As such, this disclosure requirement should not require that such information be presented in dollars; rather, it should permit general disclosure (e.g., the formula for calculation of a particular fee).

[38] *See, e.g.,* Advisory Council on Employee Welfare and Pension Benefit Plans (usually referred to as the ERISA Advisory Council), *Successful Plan Communications for Various Population Segments* (November 2013) ("individuals are overwhelmed by too much information and would benefit from streamlined communication").

[39] Cerulli Associates, The Cerulli Report – U.S. Retirement Markets 2016: Preparing for a New World Post---Conflict of Interest Rule.

[40] Comment letter submitted by the Insured Retirement Institute (July 21, 2015), available at https://www.dol.gov/sites/default/files/ebsa/laws-and-regulations/rules-and-regulations/public-comments/1210-AB32-2/00626.pdf (the "July 2015 Letter").

[41] Comment letter submitted by the Insured Retirement Institute (September 24, 2015), available at https://www.dol.gov/sites/default/files/ebsa/laws-and-regulations/rules-and-regulations/public-comments/1210-AB32-2/03062.pdf. (the "September 2015 Letter").

[42] *See, e.g.,* Comment letter submitted by SEC Commissioner Michael S. Piwowar (July 25, 2017) (discussing and emphasizing the effectiveness of the SEC's disclosure-based regime).

*The Commission should adopt a rule to allow use of a summary prospectus for variable annuities to help investors better understand these products.*

On a related topic, we note that Commission staff has been working for several years to develop a summary prospectus rule for variable annuities, similar to the summary prospectus rule adopted by the Commission in 2009 for mutual funds. In support of this effort, IRI developed and provided the SEC with a proof-of-concept sample variable annuity summary prospectus. Consistent with the views expressed by all five SEC commissioners in a series of meetings held in late 2014, the SEC staff continues to strongly support IRI's proposal. This effort has also had the support of former Chairman Mary Schapiro, as well as former Director David Grim of the Division of Investment Management and all of his predecessors. The variable annuity summary prospectus was also endorsed by the SEC's Office of the Investor Advocate its annual report to Congress in June 2017, and by the Treasury Department in a report it submitted to President Trump in October 2017.

In sum, we believe a variable annuity summary prospectus rule would improve consumers' understanding of their investment choices through more streamlined disclosures, and therefore would be consistent with the goals of the Commission's standard of conduct rulemaking effort. As such, we respectfully urge the Commission to issue a variable annuity summary prospectus rule as soon as practicable.

7. *The Commission Should Provide True Grandfathering; Any New Standard of Conduct Should Not Retroactively Apply to Pre-Existing Accounts or Transactions.*

In the interest of fairness, and to ensure clarity and avoid confusion, we respectfully recommend that the Commission include a clear grandfathering provision in any rule proposal. In our view, when a client opens an account with a financial professional or executes a transaction, they do so with the understanding that the laws and rules then in place will govern that account or transaction. Retroactively imposing a new set of rules has the potential to create significant confusion in the context of pre-existing accounts and transactions, and could harm the advisor and/or the client if those new rules frustrate the intent of the account or transaction.

The DOL Rule purports to provide grandfathering, but it does so on a strictly transactional basis that does not comport with the way financial professionals and clients typically interact. In the real world, firms and financial professionals generally try to avoid compartmentalizing different aspects of their client relationships. It would be administratively burdensome to put one part of an account or transaction into one bucket (e.g., assets acquired on or prior to June 9, 2017) and another part of the same account or transaction into a separate bucket (e.g., assets acquired after June 9, 2017). More importantly, we expect many clients would be confused and frustrated by such arrangements.

Put another way, the "grandfathering" provision in the DOL Rule would effectively require firms and financial professionals to ignore the ongoing needs of their clients in order to take advantage of the relief provided by the DOL. This would be contrary to the overall goal of requiring firms and financial professionals to always act in the best interest of their clients. It would also run afoul of FINRA's regulatory expectations that financial professionals should periodically check back with clients to see if their needs or objectives have changed and if their holdings remain appropriate.

To avoid these adverse consequences, we respectfully recommend that the Commission make clear that any changes to the applicable standards of conduct would apply only to accounts and transactions entered into after those changes take effect, and would not apply to future advice regarding any assets acquired prior to that date.

In addition, we believe the Commission should clearly state that the standard of conduct would not apply to transactions that are not the result of a recommendation or solicitation. In such instances, neither the firm nor the financial professional are engaging in conduct that results in the transaction, and therefore, there is no conduct to which the standard could be applied.

8. *The Commission Should Provide a Flexible Regulatory Environment to Facilitate and Encourage Innovation, But Should Not Pick Winners and Losers.*

In the Request for Information issued by the DOL on July 6, 2017 (the "DOL RFI"), the DOL asked for public comments on a possible new prohibited transaction exemption designed to encourage innovation as the industry works to comply with the DOL Rule. While we share the DOL's interest in encouraging innovation, we believe this approach would essentially amount to the DOL picking winners and losers. In our view, this would actually discourage innovation rather than encouraging it, as many product manufacturers would naturally seek to develop products that would qualify for this preferred treatment, and many financial professionals would only recommend those products even if other products would actually be in a particular client's best interest (a result that would clearly be at odds with the overarching goal of the DOL Rule). We believe innovation should be driven by consumer need and other marketplace forces, not by the need to conform to regulatory requirements.

Fee-based annuities are one example of the type of innovation regulators should seek to encourage. These products, which do not embed compensation to the financial professional in the form of an up-front or trail commission, would provide value for some investors but might be inappropriate for others. Fees for the annuity itself are lower, but total compensation and costs to consumers will depend on various factors, including the length of ownership and specific fee structure. Fee-based products may be appropriate for some consumers, but commission-based products may be more appropriate and less expensive for others, depending on their arrangement with their financial professional and their approach to retirement savings. According to the 2017 IRI Member Survey, nearly six in 10 insurers believe fee-based products will ultimately result in higher total costs to consumers than commissionable products.

We believe the best way for regulators to encourage innovation is to create a flexible regulatory environment that can easily adapt to new ideas. A system built on a series of narrowly tailored rules will require additional regulatory action in order for new innovations to test the market. By contrast, a broad, principles-based approach consistent with the guiding principles outlined in this letter will give industry the opportunity to experiment with new ideas to meet evolving consumer needs and desires. Regulators can retain the ability to rein in new innovations if necessary to protect consumers, but regulations should not be designed to prevent such products from coming to market in the first place.

9. ***The Best Interest Standard Should Not be Interpreted or Enforced Through Private Litigation; Regulators Should Control Interpretation of the Standard, and Enforcement Should be Handled Through Regulatory Actions or Arbitration.***

Given that the DOL lacks authority to enforce the DOL Rule in the IRA space, the BIC Exemption requires financial institutions to enter into contracts that expose them to liability in class action lawsuits. The preamble to the BIC Exemption acknowledges that financial institutions will have no choice but to submit to the terms of its exemptions. That was the DOL's objective, since, as it stated in the preamble to the BIC Exemption, "banning all commissions, transaction-based payments, and other forms of conflicted payments" (which would otherwise occur under the Rule) "could have serious adverse unintended consequences."

The DOL also made clear that it intended to subcontract to the class action bar enforcement of the new regulatory scheme that it lacks the power to enforce itself. Former Assistant Secretary of Labor Phyllis Borzi acknowledged this, saying "Back in the day, when people wanted to make changes, they passed legislation," but the DOL Rule changes "the way that social change and legal change and financial change is accomplished through congressional action to two different avenues for making changes: The main one being regulation and the second one being litigation." Borzi further explained that the BIC Exemption "deputiz[es]" consumers to bring "state contract actions" because the DOL lacked direct statutory authority over IRAs.

This inappropriate utilization of private litigation as the primary enforcement mechanism for the DOL Rule would expose the financial services industry to a significant risk of increased litigation. This risk is attributable not to actual violations of the best interest standard but to the uncertainty around the requirements of the DOL Rule and the BIC Exemption.

Outsourcing enforcement to the plaintiffs bar in the manner contemplated by the DOL Rule would also result in outsourcing interpretation to state courts. In the context of the DOL Rule, this would be contrary to congressional intent as reflected in ERISA § 514(a). Perhaps more troubling and problematic, relying on state courts to interpret a federal regulation is likely to result in inconsistent interpretations, which would be particularly problematic for businesses and individuals who operate in multiple states. Moreover, it would be reasonable to expect that some state court interpretations of a particular rule would be inconsistent with or contrary to the intent of the regulator that adopted the rule.

As noted above, the Commission and the state insurance departments have robust examination and enforcement tools at their disposal to effectively ensure compliance or penalize violators for non-compliance. These tools are described in detail in the comment letters we submitted to the DOL on July 21, 2015 and September 24, 2015,[43] which we hereby incorporate by reference into this letter. These regulatory regimes have proven highly effective at addressing consumer protection concerns. This is clear from an examination of complaint data from both FINRA and the NAIC. According to FINRA, just 115 cases involving variable annuities were brought in 2016, representing only 3 percent of all cases (3,635 in total). Similarly, the NAIC reports that just 185 annuity suitability complaints were filed with the states in 2016, representing only 1.8 percent of all complaints in the "Life & Annuity" category (9,970 total). [44]

By contrast, recent experience demonstrates that outsourcing enforcement to the plaintiffs' bar is not an effective way to protect consumers. From 2009 to 2016, plaintiffs in lawsuits alleging breaches of ERISA fiduciary duties received just $116 on average.[45] In fact, the real beneficiaries of these cases were the plaintiffs' attorneys, who collected roughly $204 million for themselves.[46]

In February 2017, Morningstar, Inc. conducted a study of the litigation risk created by the contract and warranty requirements and found that class action lawsuits under the DOL

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[43] See the July 2015 Letter and the September 2015 Letter.

[44] National Association of Insurance Commissioners, *Closed Confirmed Consumer Complaints by Coverage Type,* (July 24, 2017), available at https://eapps.naic.org/documents/cis_aggregate_complaints_by_coverage_types.pdf.

[45] DC Dimensions, Summer 2016, ''Fiduciary Benchmarks: Protect Yourself at All Time,'' by Tom Kmak, https://us.dimensional.com/-/media/Dimensional/Documents/US/Auxiliary/Defined-Contribution/Summer-2016/02-Fiduciary-Benchmarks-Protect-Yourself-at-All-Times.pdf

[46] Id.

Rule[47] will cost the industry between $70 million and $150 million each year. In the near term, these costs could be several times higher "as firms try to figure out how to determine, demonstrate, and document best interest." Ultimately, significant portions of this litigation expense will likely be passed along to retirement savers in the form of increased costs for products and services.

Retirement savers are also being harmed as a result of this litigation risk in other important ways. For example, a recent Cerulli study found that 55 percent of plan sponsors view litigation risk as a very important consideration when making decisions for their plans.[48] The same study found that "improving participant outcomes" ranked only slightly higher at 63 percent.[49] This fear of litigation is driving many plan fiduciaries to focus on easily quantifiable factors such as the fees associated with particular products or services to the exclusion of other important considerations such as the value of those products or services and their appropriateness for the plan's particular participant population. In our view, this approach is incompatible with the best interest standard, which we believe requires fiduciaries to take a more holistic view of different products and services before making a recommendation to a client.

During the rulemaking process, IRI and numerous other commenters expressed serious concerns about these costs,[50] as well as the risks inherent in deferring interpretation and enforcement of the Fiduciary Rule to fifty different state courts across the country.[51] The DOL simply disregarded these extensive comments, assigning no cost estimate to class action litigation in the Regulatory Impact Analysis. We respectfully urge the Commission to consider all relevant factors when assessing possible enforcement mechanisms for a best interest proposal, including the direct and indirect costs associated with enforcement through private litigation. We believe a full and fair cost-benefit analysis would clearly show that regulatory actions and arbitration are the most appropriate enforcement mechanisms.

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[47] We note that the DOL has recently conceded that the BIC Exemption's prohibition on class action waivers in pre-dispute arbitration agreements violates federal law and should be vacated. While we applaud and appreciate this decision, it is important to note that broker-dealers and their registered representatives are subject to FINRA rules that prohibit class action waivers, and therefore will continue to face significant class action litigation risk as long as the BIC Exemption contract requirement remains in place.

[48] Cerulli Associates, The Cerulli Report – U.S. Retirement Markets 2016: Preparing for a New World Post---Conflict of Interest Rule.

[49] Id.

[50] Commenters have also provided extensive new data and information to the DOL in connection with its review of the Fiduciary Rule pursuant to the Presidential Memorandum issued on February 3, 2017. A compilation of this new data and information is attached to this letter as Appendix A.

[51] Allowing state courts to interpret ERISA fiduciary standards is also contrary to congressional intent as reflected in ERISA §514(a).

Conclusion

In an age when saving and preparing for retirement is squarely on the shoulders of individuals, financial professionals will have an important part in helping their clients develop retirement plans and grow their savings. The DOL Rule is already limiting consumer choice and depriving lower- and middle-income consumers from accessing affordable assistance with retirement planning. We believe the guiding principles and proposals outlined in this letter will enable the Commission to establish a best interest standard while preserving Americans' access to retirement planning products and services.

If you have questions about anything in this letter, or if we can be of any further assistance in connection with this important regulatory effort, please feel free to contact me or Lee Covington, IRI's Senior Vice President and General Counsel.

Sincerely,

Catherine J. Weatherford
President & CEO
Insured Retirement Institute

Cc: The Honorable Michael S. Piwowar, Commissioner
The Honorable Kara M. Stein, Commissioner
Dalia Blass, Director, Division of Investment Management
William Hinman, Director, Division of Corporation Finance
Brett Redfearn, Director, Division of Trading and Markets

Appendix A

NEW DATA SHOWS DOL FIDUCIARY RULE HARMING SMALL RETIREMENT SAVERS

Comments Also Highlight Procedural and Analytical Flaws in Rulemaking Process

Executive Summary

As ordered by President Trump, the Department of Labor requested new information about the economic effects of the fiduciary rule. This new data, based on actual experience rather than academic guesswork, shows that the Department's original predictions were wrong. The facts show that the Department significantly underestimated the negative effects of the rule, particularly in reducing access to advice and retirement products for small retirement savers and small businesses.

Specifically:

- A survey of advisors finds 71 percent will stop providing advice to at least some of their current small accounts due to the risk and increased costs of the rule.
- Other surveys found that 35 percent of advisors will stop serving accounts under $25,000, and 25 percent will raise their client minimum account thresholds.
- A major mutual fund provider reported that the number of orphaned accounts on its books (accounts no longer serviced by an advisor, leaving investors on their own) tripled in the first quarter of 2017 due to the fiduciary rule. These small accounts averaged $21,000. It further estimated that roughly 15 percent of its accounts would be orphaned following full implementation of the rule.
- A survey of insurance service providers shows 70 percent already have or are considering exiting the market for small balance IRAs and small plans, and half are preparing to raise minimum account requirements for IRAs.
- Lack of access to advice hurts retirement savers—a study shows that investors starting with $25,000 who receive advice save nearly three times more than their non-advised peers. This is due not only to investment recommendations, but to personal assistance in developing better retirement saving habits and other positive financial behaviors.
- Many comments explained that a wide array of financial service providers are responding to the Rule's new litigation risks by limiting the investment types and products they will recommend.

The information also highlighted critical procedural and analytical flaws in the Department's original analysis, including its reliance on old data, inadequate consideration of alternatives, not taking into account the benefits advisors provide while focusing on aspect of costs, and underestimating the impact on small businesses.

As this data shows, the Trump Administration should further delay the applicability date of the rule while it completes its full review to avoid harming the very people the rule is intended to help.

New Information: Loss of Consumer Access to Retirement Advice

- According to a 2016 study, Americans who work with a financial professional save more than Americans who do not, including saving twice as much over a seven- to 14-year period.[1] (IRI, Davis & Harman, FSR and Chamber)
- A 2016 study by CoreData found that 71 percent of financial professionals will disengage from at least some retirement savers because of the fiduciary rule, 64 percent think the fiduciary rule will have a large negative impact on their mass-market clients (i.e., investors with less than $300,000 in net investable assets), and 39 percent think that financial advice will become too expensive for most retirement savers. On average, these financial professionals estimate they will no longer work with 25 percent of their mass-market clients, creating an advice gap for low-balance investors.[2] (IRI, Davis & Harman, ABA, Market Synergy, SIFMA, ACLI)
- A 2016 study by A.T. Kearney found that by 2020, broker-dealer firms (including wirehouses, independents, and dually-registered broker-dealer/registered investment advisers) will collectively stop serving the majority of the $400 billion currently held in low-balance retirement accounts. [3] (IRI, Davis & Harman, FSI)
- In a 2017 survey of IRI member firms, 70 percent of respondents either already have or are considering exiting smaller markets such as lower balance IRAs and small employer based plans, and nearly half already have or are considering raising IRA account minimums. [4] (IRI)
- A 2017 survey by the National Association of Insurance and Financial Advisors ("NAIFA") found that nearly 90 percent of financial professionals believe consumers will pay more for professional advice services, 75 percent have seen or expect to see increases in minimum account balances for the clients they serve, and 91 percent have already experienced or expect to experience restrictions of product offerings to their clients. [5] (IRI, NAIFA)
- Nearly every financial institution that has disclosed its plans publicly will be changing products and services available to retirement investors, restricting choices, and changing pricing.[6] (SIFMA)
- According to a recent SIFMA survey of 25 financial firms that would be impacted by the Rule, more than half of the firms were considering moving IRA brokerage clients to call center services only, several firms were considering moving clients to a self-directed structure, and nearly three quarters of the responding firms said their plans would not permit small accounts to have advisory accounts. (SIFMA)
- Over 50 percent of respondents to the SIFMA survey anticipated offering only advisor services to a subset of their current IRA brokerage customers. 92 percent of responding firms stated that their Rule compliance plans could limit or restrict products for retirement investors, and over 75 percent of the respondents stated their Rule compliance plans could restrict or restrict services available to retirement investors. (SIFMA)
- One report notes that 35 percent of advisers surveyed "will move away from low-balance accounts" (*i.e.*, less than $25,000 in assets).[7] And "nearly one in four advisers said that they will likely increase

their current client minimums as a result of the fiduciary rule, focusing their attention on higher-net worth clients and more profitable relationships."[8] (FSR)

- In many cases, our members have been informed by their intermediary partners that they will no longer service certain account holders in light of the rule. These so-called "orphaned" account holders already number in the hundreds of thousands (and industry participants indicate that the numbers will climb substantially as implementation efforts proceed) and will be left without access to advice. Many will be forced to pay more for advice as they lose access to commission-based arrangements (ICI)
- One large mutual fund provider reports that its number of orphaned accounts nearly doubled in the first three months of 2017, and that the average account balance in these orphan accounts is just $21,000. Further, it projects that ultimately 16 percent of the accounts it services will be orphaned this year because of the fiduciary rule. Extrapolating this prediction suggests that at least 1.6 million small retirement savers have already lost access to investment assistance since January 2017, and an additional 1.6 million are likely to lose access after the rule becomes applicable. (Chamber, ICI)
- According to an informal survey of ICI members in 2017, 31 out of 32 mutual fund companies reported either having received orphaned accounts or receiving notices regarding some volume of accounts that will become orphaned. The average account balance of those accounts where an intermediary has resigned is $17,138. The expectation is that the number of orphaned accounts likely will run into the hundreds of thousands. (ICI)
- The National Conference of Insurance Legislators ("NCOIL") adopted a resolution stating that "the rule will prevent consumer access to crucial retirement education and services, ultimately harming the very people it seeks to aid." (Market Synergy)
- According to a February 2017 survey of more than 1,000 investors conducted by J.D. Power, more than half (59 percent) who pay commissions now say they either "probably will not" (40 percent) or "definitely will not" (19 percent) be willing to stay with their current firm if it meant being forced to move to fee-based retirement accounts. (Market Synergy)
- The American Action Forum estimates that anywhere from 2.3 million to 14.7 million consumers will face significant changes to their retirement and financial advice. The Rule has caused several large companies to leave the market or scale back sales, affecting an estimated 92,000 advisors and at least 2.3 million consumers. "[A] conservative estimate of 25 to 35 for each of the 92,000 affected advisers still yields 2.3 million to 3.2 million consumers with significant changes to their retirement and financial advice."[9] (ICI)
- A 2017 report indicates that the rule will result in additional charges to retirement investors of approximately $800 per account or over $46 billion in aggregate.[10] (FSR, FSI, NAIFA)
- Based on a minimum balance requirement of $30,000, the Rule could force 28 million Americans out of managed retirement accounts; based on a minimum balance of just $5,000, over 13 million would lose access to managed retirement accounts.[11] (SIFMA, NAIFA, FSI)

- Many advisors plan to exit the business entirely. In a blind online poll of 459 advisors conducted by Fidelity Clearing & Custody Solutions from August 18-26, 2016, 10 percent of advisors reported they are planning to leave or retire from the field earlier than expected because of the rule, and another 18 percent said they are "reconsidering their careers as advisors.[12]
- "For example, effective April 10, 2017, specific distribution partners of Pacific Life will scale back the retirement products they offer, limiting competition and choice. Advisors plan to be more selective of the new investors they choose to service which will limit access to retirement information and personalized advice for many. In addition, distributors continue to identify and eliminate clients with small to modest account balances in anticipation of the added compliance costs and heightened litigation risks generated by compliance with the new rule. As a result, a significant number of existing investors could lose access to an advisor to talk to, answer questions, and who can help encourage them to save more and remain invested over time."[13]
- "According the 2016 Global Survey of Financial Advisors published by Natixis Global Asset Management, more than three-quarters of advisors surveyed believe increased regulations could lead to higher costs for their clients. The rule is specifically mentioned as being one of the primary drivers of increased regulatory costs. More alarming to small businesses, 38 percent of respondents said they were likely to "disengage from smaller clients." Because retirement plans sponsored by small businesses often pale in comparison to larger corporate retirement plans in terms of assets invested, small businesses face a greater likelihood of being dropped by their financial advisors."[14]
- "It is estimated the rule could disqualify up to 7 million IRA holders from investment advice and reduce the number of IRAs opened annually by between 300,000 and 400,000."[15]
- "According to Cerulli, two-thirds (66 percent) of advisors believe that small investors will have less access to professional financial advice as a result of the rule. And, according to a recent report by CoreData Research, 71 percent of surveyed U.S. advisors plan to disengage from "mass market" investors because of the DOL rule and these advisors estimate they will no longer service 25 percent of their current clients – creating a potential "advice gap" for low balance investors." [16]
- Due to the requirements of BICE "Ladenburg will be forced to preclude some lower cost investment options that may be appropriate for some clients and reduce available product offerings to only those that pay the same level compensation (even if that compensation is higher) to the Financial Institution. This will likely cause a broad reduction across multiple product categories and, in some categories, may reduce available products from over 100 to less than 10."[17]

<u>New Information: Loss of Consumer Access to Retirement Products</u>

- Some distribution firms and financial professionals have already significantly scaled back their use of commission-based products such as variable annuities because of concerns about the potential implications of the fiduciary rule on recommendations of such products. In fact, despite the existence of a rising stock market, which has always led to increased sales of variable annuities, sales declined by 21.6 percent from $130.4 billion in 2015 to $102.1 billion in 2016.[18] (IRI)

- Adverse effects on annuities have already occurred. “The variable annuity industry took a beating in 2016, with several of the top sellers inking losses upwards of 25 percent on the year and some exceeding 40 percent. The Department of Labor's fiduciary rule, issued in its final form last spring, played a big role in the industry's bruising, observers said.”[19] (Davis & Harman, IRI)
- Advisors recognize that moving away from certain products will be part of the adjustment process to the new normal established by the fiduciary rule. About a third (32 percent) believe shifting away from certain products, such as annuities and non-traded REITs, is one of the biggest challenges posed by the fiduciary rule.[20] (SIFMA, Davis & Harman)
- In 2015, variable annuities represented 56 percent of IRA annuity sales and 46 percent of 2016 IRA annuity sales. LIMRA projects that variable annuity purchases will decrease another 20-25 percent in 2017 if the rule goes into effect. Several factors contributed to declining variable annuity sales, primarily the BICE and other components of the rule. LIMRA also projects that sales of indexed annuities will drop by similar levels because of the rule.[21] (SIFMA)
- For IRA purchases, sales declined 22 percent in 2016 compared to the prior year.[22] The ambiguous regulatory structure of the rule is expected to result in additional decreases in purchases of variable annuities, which represents a significant amount of IRA annuity purchases. (SIFMA)
- More than 80 percent of respondents to the 2017 IRI survey have already introduced, plan to introduce, or are considering introducing fee-based variable annuities. However, those products are unlikely to be widely available in the near-term and may not be appropriate for all retirement savers, including some for whom a traditional commission-based variable annuity would be more economical, less costly, and likely in their best interest. [23] (IRI)
- Several large intermediaries have already announced a variety of changes to service offerings, including firms no longer offering mutual funds in IRA brokerage accounts; others offering no IRA brokerage accounts at all; firms reducing web-based educational tools; and firms raising account minimums for advisory fees.[24] (ICI)
- Recent media reports have highlighted the decisions being made by some firms to change their service models and product availability, including (a) moving clients to fee-based accounts, (b) eliminating commission-based IRAs; (c) raising investment minimums for commission-based IRAs; (d) eliminating variable annuity products; and (e) excluding certain products from commission-based IRAs (*e.g.*, annuities, mutual funds, and exchange-traded funds).[25] (FSR)
- Many firms have already determined the BIC Exemption is unworkable for certain products, and the substantial threat of unwarranted litigation cannot be justified for certain accounts or that the BIC exemption in its entirety is simply too burdensome.[26] (ICI)
- Many companies will be inclined to reduce the universe of available investments to effectively mitigate potential conflicts of interest arising from different compensation amounts and cost structures, which the company does not control. Likewise, investment choice will be limited to ensure that financial institutions can comply with the numerous initial and ongoing disclosure requirements applicable to BICE. The technology and operational capabilities necessary to meet

these disclosure obligations inevitably will cause us and others to offer fewer products to control the costs of these efforts.[27]

- "Firms have restricted product offerings to certain clients, thereby limiting consumer choice, and have abandoned traditional, lower-cost compensation arrangements for advisors (e.g., commissions, rather than high upfront management fees that small and first- time savers cannot afford) to avoid the cost of complying with the BIC Exemption and mitigate the threat of costly class action lawsuits."[28]
- "AAF found that three major companies have already left part of the brokerage business, and an additional six are drawing down their business or switching to a fee-based arrangement, depriving more consumers of investment advice."[29]
- "Over the 12-month period ending on September 30, 2016, industrywide sales of variable annuities with guarantees declined 24 percent."[30]
- "The National Economic Research Association estimates more than 57 percent of current retirement savings account holders will be forced out of their current plan by this rule. Economists from the Brookings Institution estimated the consumer loss could be $80 billion – twice as much as was projected by the Department of Labor – and a report from economic consulting firm Oliver Wyman concluded the rule could raise the price of financial advice by nearly 200 percent."[31]
- "According to the Insured Retirement Institute, 2016 sales of all annuities declined 7.6 percent from 2015, and 2016 sales of variable annuities, which under the rule will fall under the complicated BICE regulations, fell 21.65 percent from 2015. Fourth quarter 2016 fixed indexed annuity sales declined 7 percent from third quarter 2016 sales. For 2017, the LIMRA Secure Retirement Institute projects that total sales of US individual annuity sales will drop 10 percent to 15 percent, while sales of variable and indexed annuities will drop as much as 20 percent to 25 percent."[32]
- "Most notably, 91 percent of respondents [to a recent survey of NAIFA members] have already experienced or expect to experience restrictions on product offerings to their clients, nearly 90 percent believe consumers will pay more for professional advice services, and 75 percent have seen or expect to see increases in minimum account balances for the clients they serve."[33]
- "In fact, nearly half of NAIFA's members (46 percent) already have experienced a restriction of product offerings to their clients, and another 45 percent anticipate that such restrictions are forthcoming. More specifically, 68 percent of our members have been told that they cannot recommend certain mutual fund classes to clients, and over 70 percent say they cannot recommend certain annuities."[34]
- Due to BICE's requirements "KMS will be forced to preclude some lower cost investment options that may be appropriate for some clients and reduce available product offerings to only those that pay the same level compensation (even if that compensation is higher) to the Financial Institution. This will likely cause a broad reduction across multiple product categories and, in some categories, may reduce available products from over 100 to less than 10."[35]

- The Oxford Economics report warned that the DOL has “dramatically underestimated” the cost to comply with the new rule and that smaller firms would find it difficult to stay in business. The Oxford Economics study estimates the fiduciary rule will result in startup costs ranging from $1.1 million to $16.3 million per firm, depending on firm size. The study also found that because of the cost burdens, firms will shift their business model towards fee-based advising and create a minimum balance for client accounts. These account minimums will effectively force smaller investors into self-advised or robo-advice accounts. As compliance costs rise, fees for investors and account minimums rise, causing middle and lower class investors to be priced out of professional investment advice. The impact of being priced out of professional investment advice will have a permanent, long-term impact on investor’s retirement savings.”[36]

New Information: Value of Advice

- Reuter updates previous analyses based on data from 1994-2004 with newer data from 2004 – 2012. He finds a statistically significant decline in the apparent underperformance in earnings of commission broker sold, actively-managed mutual funds compared to actively-managed direct-sold funds. Instead of the 110 basis point disparity reported by Del Guericio and Reuter in their 2014 paper on which the Department relied for its regulatory impact analysis, Reuter reports that over the 2004-2014 period the disparity declined to 64 basis points. This decline suggests that the putative benefits estimated by the Department for the fiduciary rule and the predicted costs of delaying its implementation are grossly overvalued.[37] (Chamber, ABA, SIFMA, FSI)
- Studies show that unadvised households tend to hold fewer equities than advised households. The likelihood of owning any stocks or stock-based mutual funds increases by 67 percent with the use of an advisor and the proportion dedicated to stock positions increases by 39 percent. Academic work clearly shows that asset allocation, not mutual fund selection, explains, on average, 100 percent of performance. If the rule results in a reduction of equity allocations by only 15 percent, the ICI estimated that would result in a performance decline of 50-100 bps per year, on average, or $95 billion and $189 billion over the next 10 years and between $202 billion and $404 billion over the next 20 years. (ICI, SIFMA)
- New economic studies estimate that investors could lose $109 billion over 10 years because of the rule’s implementation. This would amount to $780 million per month in losses to investors. A 60-day delay would thus save investors $402 million in lost returns over 60 days. A 180-day delay would save more than $1.2 billion. Even a 60-day delay would amount to $414 million in lost returns saved for investors over the first year if the rule ultimately goes forward as now structured and $542 million over a 10-year period (at a three percent discount rate). These lost returns far exceed the Department’s estimated $104 million losses in the form of foregone gains— gains that, as shown above, are widely overstated. (SIFMA, ICI)
- Kinniry, et al., found that having a financial professional can make up to a 300 basis point difference in annual compound returns. They found that the greatest contributing factor of assistance, amounting to 150 basis points in annual compound rate of return, was the “behavioural coaching” element of the interactions between a customer and a financial professional.[38] (Chamber, FSR)

- A paper casts doubt on the social benefits of the Department's promotion of passive index fund investing. The paper shows that despite the apparent advantages to some individual investors, widespread and growing adoption of the strategy could distort capital markets in ways that could slow overall economic growth. The author shows how inclusion of a stock in an index fund may artificially raise its internal cost of capital calculations and discourage otherwise profitable investment decisions. He also illustrates how an index fund investor may be exposed to unforeseen risk of loss.[39] (Chamber)
- A report finds that many retirement savers are adverse to assistance from call centers or robots. The personal connection with a financial professional is important for educating and motivating savings behavior.[40] (Chamber)
- Research from Vanguard shows that human contact from advisors helps investors to stay invested in the market for the long-term, instead of trying to time the market.[41] (ICI, FSI)
- "Studies indicate that households that have worked with a financial advisor over a 15-year period "have about 290 percent more financial assets than non-advised households," even though half of these households had less than $25,000 in savings when they initially began to work with an advisor. "The discipline imposed by a financial advisor on households' financial behavior and increased savings of advised households are key to improving asset values of households relative to comparable households without an advisor." Indeed, some studies find that "behavioral coaching can add 1 percent to 2 percent in net return."[42]

New Information: Increased Litigation

- The increased litigation stemming from the inappropriate use of the private right of action in enforcing the BIC Exemption will result in $70 and $150 million in costs to the industry each year.[43] (IRI, Chamber, FSI)
- Data shows that class action lawsuits like the type that would flow from the rule provide almost no benefit to the class members of the action, but rather just help their lawyers.[44] (Chamber, ICI, FSR, Market Synergy)
- Companies interviewed by the Chamber suggest insurance costs could exceed two to three times the cost estimated by the Department. Some respondents to Chamber interviews cited numbers as high as $10,000 per professional per year for Errors and Omissions coverage. 23 percent of NAIFA members have already seen an increase in E&A premiums, while 60 percent anticipate such an increase. (Chamber, NAIFA)
- The expanded incentive for class action litigation results in defendants settling with an extremely litigious plaintiffs' bar instead of spending years tied up in discovery. A survey of lawsuits filed against fiduciaries in recent years demonstrates how plaintiffs use these settlements to fund future lawsuits.[45] (ARA, ICI)
- Many advisors are fearful of litigation, as the CoreData survey found that "Advisors are also in a heightened state of readiness for a potential rise in lawsuits related to the fiduciary rule. Nearly two in 10 advisors (18 percent) believe preparing for potential litigation will be one of the biggest

challenges they must overcome. And 12 percent think the need to invest in appropriate technologies to aid compliance and implementation constitutes a major challenge."[46] (SIFMA, Davis & Harman)

- A recent SIFMA survey of 25 financial firms that would be impacted by the Rule found that more than 60 percent of the responding firms stated that they anticipated some or all of the costs resulting from the potential increase in litigation and liability insurance to be passed on to clients. (SIFMA)
- In 2016, nearly 4,000 FINRA arbitration cases were filed by consumers alleging broker-dealer wrongdoing (only 158 of those cases were decided in favor of the consumer)-meaning that broker-dealers spent a lot of time and money defending these cases.[47]
- A SIFMA survey indicated "…more than 60 percent of the responding firms stated that they anticipate that some or all of the costs resulting from the potential increase in litigation and liability insurance may be passed on to clients."
- "An equity analyst from Morningstar stated that annual litigation costs will be $70MM-$150MM per year."[48]
- "A February 2017 study prepared by the Lockton Companies indicated that the costs to get through a motion to dismiss range from $500,000-$750,000. Beyond that, discovery costs alone can reach between $2.5 million and $5 million."[49]
- "Participants are not the primary beneficiaries of these awards, as a Fiduciary Benchmarks survey conducted in 2016 concluded that out of $698 million awarded, attorneys received $204 million and the average participant award was $116."[50]

<u>New Information: Compliance Costs</u>

- The Securities Industry and Financial Markets Association estimates that annual compliance costs will range from $240 million to $570 million over the next ten years.[51] (SIFMA)
- Small broker-dealers face the greatest financial risk under the rule, forcing potential consolidation of broker-dealers.[52] (SIFMA, FSI, FSR)
- One recent study by the American Action Forum found reported compliance costs of at least $106 million in 2016, representing up-front costs from just four companies. [53] (Market Synergy)
- The rule presents many compliance and operational hurdles for advisors to overcome. As expected, advisors are preparing for an increase in paperwork. A majority (57 percent) believe increased paperwork stemming from reporting and disclosure requirements will be one of the top three challenges of the fiduciary rule**.** Compliance training is a concern for more than a quarter (28 percent) of advisors.[54] (SIFMA, Davis & Harman)
- The DOL's RIA grossly underestimated the cost of the rule. FSI members have already incurred costs of $189 million to implement the Rule and estimate they will spend an additional $205 million when the Rule's implementation resumes on June 9. This puts the start-up costs for the regulations at 20 times higher than the DOL's updated RIA's estimate. The total implementation costs for FSI

members are estimated to be $394 million, while annual operating expenses are estimated at $230 million. Management and compliance planning make up 20 percent of current costs. If FSI members' experience is extrapolated across the entire broker-dealer industry, FSI estimates that the 10-year cost of the Rule will be $14.2 billion, three times higher than the DOL had estimated.[55] (FSI)

- "The costs that will be incurred to comply will most likely force smaller firms to consolidate or close their doors. In other words, lost jobs. A Morningstar quote for their technology solution which would assist with compliance procedures was $1,014,540 annually. We don't have $1,000,000 of net income annually. How would we pay for this? Other solutions quoted in the several hundred thousand dollar range, again annually. We have already spent over $300,000 in legal costs and staff hours trying to develop our compliance procedures. We won't survive."[56]
- "The proposed rule has already substantially increased our compliance costs. We estimate compliance costs have increased 450 percent as a result of this rule."[57]
- "Our research has found that almost all retail investors will see their costs increased by 73 to 196 percent due to a mass shift toward fee-based accounts. Further, firms providing investment advice will see an average of $21.5 million in initial compliance costs and $5.1 million in annual maintenance costs. Even worse, up to 7 million Individual Retirement Accounts (IRAs) would fail to qualify for an advisory account due to the balance too low to be sustainable for the advisor. In the shorter term, we found that the fiduciary rule, as written, will result in over $1500 of duplicative fees charged per household retirement account."[58]
- "AAF also found reported compliance costs of more than $106 million in 2016, representing up-front compliance costs of just four companies."[59]
- "Industry estimates show that the rule will cost $5 billion to implement and $1 billion annually to maintain."[60]
- "Implementing the DOL's new fiduciary rule for retirement accounts will cost the brokerage industry $11 billion in revenue over the next four years, according to a recent study from A.T. Kearney, a consultant."[61]
- "The Oxford Report estimated that the rule would result in startup costs ranging from $1.1 million to $16.3 million per [Individual broker dealer] firm, depending on firm size."[62]
- "To date, Advisors Excel has spent in excess of $1 million in preparation for the rule. Across the financial industry, compliance estimates range from Ameriprise spending in excess of $11 million in the first part of 2016, to an estimate by the Securities Industry and Financial Markets Association ("SIFMA") indicating start-up costs for large and medium broker- dealers would total $4.7 billion with on-going costs of $1.1 billion."[63]
- A new report showed that to comply with the Fiduciary Rule, Primerica believes it will spend between $4 million and $5 million every year, and Ameriprise Financial has already spent $11 million on DOL-related compliance activities as of September 2016.[64] (FSI)

Procedural Flaws

- An inquiry initiated by Senator Ron Johnson (R-Wisconsin) in 2015 found the Department "was predetermined to regulate the industry and sought evidence to justify its preferred action." In other words, the Department first concluded that it wanted to change the rules governing investment advice fiduciaries, and then sought to justify that conclusion. (IRI, Davis & Harman)
- The Department failed to consider how the rule would likely create an "advice gap" for low- to middle-income families. The Department dismissed concerns of loss of access, and instead found "little evidence" that "financial advisers improve retirement savings." However, this conclusion is contradicted by the Department's own assessment in a prior rulemaking that investment mistakes cost investors approximately $114 billion per year, that access to financial assistance reduced the cost of those mistakes by $15 billion per year, and that increased access to financial assistance would enable them to save billions more. (IRI)
- The Department chose to ignore evidence regarding the impact of similar rules established in other jurisdictions. Most notably, following the United Kingdom's move to a fee-based compensation model, the U.K. regulator issued a report in March 2016 confirming that retirement savers – particularly those with lower incomes – were adversely affected and acknowledged that its "high standard of advice is primarily accessible and affordable only for the more affluent in society."[65] Rather than taking advantage of the opportunity to learn from mistakes made by other countries, the Department simply denied the existence of an "advice gap" in the U.K. and dismissed the possibility that a similar "advice gap" would develop in the U.S. under the fiduciary rule. (IRI, Chamber, ICI and Davis & Harman)
- Under Executive Order 12866[66] and related guidance issued by OMB,[67] consideration of viable alternatives is a fundamental element of federal agency rulemaking. However, the lack of consideration given to all relevant costs of the fiduciary rule prevented the Department from properly evaluating less burdensome alternatives that would have greatly reduced the costs of the fiduciary rule, harmonized the Department's regulatory regime with that of the SEC and, because they would have applied only to relationships in which the client has no reasonable expectation of fiduciary status, would not have caused any meaningful consumer harm. However, as a result of the Department's flawed process, it arbitrarily rejected these and other alternatives. (IRI)
- According to the Johnson Report discussed above, the Department failed to adequately consider comments from expert regulators and professional staffers from the SEC, OIRA and the Treasury Department expressing concerns and offering recommendations regarding the rule. (IRI, Davis & Harman)
- "Further, the Department of Labor underestimated the impact of the rule on small and independent businesses by insufficiently fulfilling its obligations under the Regulatory Flexibility Act (RFA). The RFA requires agencies to consider the impact of their regulatory proposals on small entities, to analyze effective alternatives that minimize small entity impacts, and to make their analyses available for public comment. It is the role of the U.S. Small business Administration's Office of Advocacy to advance the views, concerns, and interests of small business before Congress, the White House, federal agencies, federal courts, and state policy makers. The Office of Advocacy is the government's expert on the RFA. In this role, the Office of Advocacy comments to federal agencies

regarding the impact of proposed regulations on small business and provides feedback on agency analyses of the regulatory impact. Under the RFA, an agency is required to examine whether its proposed rule will have a significant economic impact on a substantial number of small entities. If the agency determines that its proposed rule will have such an impact, it is required to prepare an initial regulatory flexibility analysis (IRFA). The IRFA must meet several requirements spelled out by section 603 of the RFA, including what small businesses are expected to be directly impacted, the major cost factors, and consideration of all significant regulatory alternatives. The RFA requires agencies to publish the IRFA, or a summary, in the Federal Register at the same time it publishes the proposed rulemaking. In its public comment letter to the Department of labor of July 17, 2015, the Office of Advocacy wrote that it had found the IRFA for the rule deficient."[68]

Analytical Flaws

- According to a February 2017 analysis by the American Action Forum, it is unclear how CEA found that $1.7 trillion of IRA assets involved conflicts of interest. Total affected IRA assets are significantly less. Retirement account assets were $7.3 trillion in 2013, 86.2 percent of which, by the CEA's own definition, were not "conflicted." That leaves less than $1 trillion in so-called "conflicted" assets. And even that amount is too large because it represents total "conflicted" assets across all retirement accounts, while the CEA's analysis was limited to IRA assets only. Total "conflicted" IRA assets are some amount less than $1 trillion. Also, as the CEA stated, the $1.7 trillion figure is some combination of front-load funds and variable annuity in IRAs. By including the annuity market, the CEA increased total affected assets by approximately $600 billion, or about 50 percent. (Market Synergy, ACLI, SIFMA)
- The Final RIA is deficient because the regulation is built on two false premises: all commission-based sales are conflicted, and all fee-only advice is always unconflicted and serves retirement savers' best interest. Neither premise is correct, and neither is supported by the final RIA. (ACLI)
- The Department's Regulatory Impact Analysis only briefly addressed the impact the rule would have on jobs, noting the rule could have "some social costs." [69] (IRI, Davis & Harman)
- In projecting the costs of the rule, the Department did not give due consideration to the costs of the rule specifically applied to annuity manufacturers and distributors, despite several studies made available to the Department demonstrating the costs.[70] (IRI)
- The Regulatory Impact Analysis overstated the benefits of the fiduciary rule, underestimated the fiduciary rule's direct and indirect costs to the financial services industry and retirement savers, and, as described above, failed to give meaningful consideration to the costs to retirement savers from lost access to retirement assistance (including assistance with guaranteed lifetime income products such as annuities) and the transaction-based fee model as well as the costs of class action lawsuits arising from the BIC Exemption. The record shows those costs total tens of billions of dollars. (IRI, ICI)
- The Department relied on flawed and problematic factors and data in their Regulatory Impact Analysis projections. Specifically, the Department admitted to basing savers' projected financial gains on research regarding "only one" issue: the purported "conflict that arises from variation in

the share of front-end-loads that advisers receive when selling different mutual funds that charge such loads to IRA investors." This research provides no basis for regulating products—such as annuities—that may not invest in mutual funds at all, and was not even a proper assessment of mutual fund performance. (IRI, ICI, FSR, FSI)

- Additionally, in estimating that the average mutual fund sold by brokers underperformed its benchmark, the Department improperly used performance data on certain unrepresentative funds to draw conclusions about the entire mutual fund market. The Department compounded this error by relying on data for the period 1993 through 2009 (a cherry-picked sample encompassing the entire global financial crisis and nearly none of the recovery) and basing its underperformance estimate not on actual holding periods, or even over a full market cycle, but rather on the single year in which funds were purchased. A series of comment letters from the Investment Company refuted this data, finding the rule could cost investors $109 billion in additional fees.[71] (IRI, ICI, ACLI, SIFMA, NAIFA)
- Vanderbilt Professor and former SEC Chief Economist Dr. Craig Lewis noted the research relied on by the Department did not analyze the performance of mutual funds held in annuities, relied on old data not reflecting the current marketplace, and the author of one of the key studies later revised his work to show the "cost" of conflicts was about 1/6th of the amount originally estimated.[72] (Chamber, ABA, SIFMA)
- The Department was far too optimistic in relying on "robo advisers" to alleviate the potential loss of access to retirement advice for small savers. The Chamber of Commerce is currently unaware of any "robo advisor" that recommends annuity products to generate retirement income, despite the clear need for those products. (Chamber, ICI)
- The Department seemingly concludes that "robo advisors" and low-expense passive investment options are the best course of action for retirement investors, while ignoring the reality that there is no "one size fits all" investment strategy and even if some investors would benefit from this development, others would be harmed. The Department failed to address this potential impact in their Regulatory Impact Analysis. (Chamber, FSI)
- DOL failed to acknowledge that annuities are governed by a distinct, customized, and comprehensive regulatory framework that was enhanced in 2010 to account for annuities' unique features. The dated mutual fund studies relied upon by the Department, which focus primarily on investment performance in the historical period 1991 to 2005, do not measure the efficacy of targeted and more rigorous annuity-specific rules. (ACLI)
- "DOL's cost analysis is flawed on two accounts. First, DOL states that the fiduciary rule will save retirement savers $17 billion a year. It came to this conclusion by taking a uniform 1 percent off of the total amount of assets in IRAs in the United States. From a statistical standpoint, DOL failed to take into account the asset-weighted performance of funds. Craig Lewis of Vanderbilt's Owen School of Business provides an example of how this skews an analysis: "[A] non-asset weighted study examining nine funds each with $1 million invested yielding a 1 percent return and one fund with $10 million invested yielding a 10 percent return would show an average return of 1.8 percent. But

an asset-weighted study looking at the same 10 funds would show an average return of 5.7 percent. By ignoring which funds investors actually invest in, the report fails to achieve its stated objective of measuring the market-wide impact of conflicted advice in retirement accounts." Second, DOL vastly underestimated the costs of compliance with the fiduciary rule. DOL estimated total startup compliance costs at $5 billion and ongoing costs of $1.5 billion. Even if true, these would make the fiduciary rule one of the most expensive regulations in history, but the costs are much higher than DOL's original estimates. AAF found that the fiduciary rule would cost $31.5 billion in total costs and $2 billion in annual burdens, making it the most expensive rule of 2016 and the second most expensive non-EPA rule since 2005."[73]

- "Among other things, the updated analysis should account for the following: (1) the Department should acknowledge that the data comprising most of the studies relied on by CEA are from the late 1990s and early 2000s, when there was scant overlap in the marketing and sale of broker-sold funds versus no-load funds. The competitive landscape now is markedly different, with 90 percent of front-load mutual funds also having no-load shares. (2) The author of one of the academic studies cited by CEA, Jonathan Reuter, issued an updated analysis that looked at more recent mutual fund performance (from 2003 to 2012) and concluded that broker-sold funds underperform no-load funds by an average of 18 basis points, significantly narrower than the 100-basis point difference cited by CEA. This means that CEA greatly overestimates with its projected $17 billion figure. (3) A survey of financial advisors by CoreData Research that was conducted after the fiduciary rule was finalized (October 2016) found that 71 percent plan to disengage from some mass-market investors due to the fiduciary rule. On average, these advisors further estimate that they will no longer service 25 percent of their mass-market clients, creating a significant likely advice gap for low-balance investors."[74]

- "The Department commented in its original release of the proposed rule that the "research has shown that disclaimers are ineffective in alerting retail investors to the potential costs imposed by conflicts of interest," yet the Department has constructed a rule that does just that. The rule as written adds dozens of pages of disclaimers and disclosures for consumers to review in addition to the ones imposed by state insurance regulation."[75]

- "First, the Department's premise that investors will gain from the rule is incorrect. Instead, investors will incur substantial quantitative and qualitative losses. The rule has the potential to increase consumer costs by $46.6 billion, or $813 annually per account, in addition to the $1,500 in duplicative fees for retirement savers that have already paid a fee on their commission-based accounts. The RIA's assessment of the "Small Saver Market" is woefully inadequate. For example, the RIA spends a mere 14 pages of 376 assessing the very market segment the rule purports to protect."[76]

- "Separately, the Investment Company Institute has pointed out that new economic studies estimate that investors could in fact lose $109 billion over 10 years because of the rule's implementation."[77]

- "For example, a Vanguard study from last September shows that having a financial professional's assistance can increase compound annual returns by 300 basis points, fully half of which is due not to investment selection, but to teaching better saving habits and other behavioral changes. Another paper discusses factors the Department did not consider in its analysis, showing the effects a financial professional has in encouraging increased savings and financial discipline. These studies show that the Department underestimated the costs and overestimated the gains of the rule for individual retirement investors—when these investors lose access to financial professionals, regardless of how they are paid, they lose valuable financial assistance causing real harm."[78]

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[11] Id.

[12] Comment Letter submitted by the National Association of Insurance and Financial Advisors (March 10, 2017),

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[13] Comment Letter submitted by Pacific Life (March 16, 2017).

[14] Comment Letter submitted by The National Federation of Independent Business (March 16, 2017).

[15] Comment Letter submitted by Americans for Tax Reform (March 17, 2017).

[16] Comment Letter submitted by Lincoln Financial Group, citing various sources (March 17, 2017).

[17] Comment Letter submitted by Landenburg Thalmann Financial Services Inc. (March 17, 2017).

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