

February 22, 2016

The Honorable Howard Shelanski
Administrator
Office of Information and Regulatory Affairs
Office of Management and Budget
725 17th Street NW
Washington, DC 20503

Dear Mr. Shelanski:

On behalf of the Investment Company Institute,¹ I am writing to reiterate our deep concerns about the Department of Labor's ("Department") Regulatory Impact Analysis ("RIA") supporting the Department's final regulation redefining who is a "fiduciary" of an employee benefit plan under the Employee Retirement Security Income Act of 1974 ("ERISA") or an individual retirement account ("IRA") under section 4975 of the Internal Revenue Code of 1986 ("Code"), as a result of giving investment advice to a plan or its participants or beneficiaries, or an IRA or IRA owner.

We understand that the Department has submitted the final regulation to the Office of Information and Regulatory Affairs ("OIRA") for review. As explained in more detail below, we are concerned that the RIA, unless it includes significant new data and analysis to support the Department's claims, will not justify the massive overhaul of the retirement marketplace that the rule as proposed would impose. We also request the opportunity to meet with you to share our research and data in greater detail as OIRA reviews the final regulation's impact on American retirement savers and the retirement system as a whole.²

¹ The Investment Company Institute (ICI) is a leading, global association of regulated funds, including mutual funds, exchange-traded funds (ETFs), closed-end funds, and unit investment trusts (UITs) in the United States, and similar funds offered to investors in jurisdictions worldwide. ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of funds, their shareholders, directors, and advisers. ICI's U.S. fund members manage total assets of \$17.6 trillion and serve more than 90 million U.S. shareholders.

² The Institute serves as a source for statistical data on the investment company industry and conducts public policy research on fund industry trends, shareholder characteristics, the industry's role in U.S. and international financial markets, and the retirement market. For example, the Institute publishes reports focusing on the overall U.S. retirement market, fees and expenses, and the behavior of defined contribution plan participants and IRA investors. In its research on mutual fund investors, IRA owners, and 401(k) plan participants, the Institute conducts periodic household surveys that connect directly with investors. Institute data is not only referenced in the RIA for the proposed regulation, but also in several studies relied upon therein.

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As you know, there is wide concern about the impact that an expanded fiduciary definition will have on the ability of American workers to obtain the guidance, products, and services they need to adequately prepare for their retirements through retirement plans and IRAs. This concern has heightened the importance of a comprehensive regulatory impact analysis of the final regulation, focused on showing that any restriction on access to guidance, products, and services resulting from the regulation's significant regulatory expansion is justified. It is that showing that is the core of the concern underlying this letter.

ICI submitted a comment letter³ to the Department on the RIA in connection with the proposed regulation ("RIA Letter") that described in detail the flaws in the analysis underlying the RIA. The RIA for the proposed regulation did not demonstrate that there is a "substantial market failure"⁴ in the provision of advice to IRA investors in the broker market. In the absence of significant changes to the proposal, we explained that the final rule could impose billions of dollars of net harm to IRA investors, particularly those with small balances.⁵ We further noted that these conclusions significantly undermine the validity of the RIA supporting the proposed regulation and suggested that the Department, in issuing the proposed fiduciary rule, acted in a manner that is inconsistent with the requirements of Executive Order 12866. We are concerned that the RIA supporting the final regulation will be based on the same flawed analysis. For your convenience, we have outlined our concerns below.

Claims that retirement savers currently are suffering \$17 billion a year in harm are just wrong. The White House Council of Economic Advisers (CEA) and Department leadership frequently claim that

³ Available at https://www.ici.org/pdf/15_ici_dol_fiduciary_reg_impact_ltr.pdf. The Institute's supplemental letter on the Regulatory Impact Analysis is available at www.ici.org/pdf/15_ici_dol_ria_comment.pdf.

⁴ In the RIA for the proposed regulation, the Department asserted that there is a "substantial failure of the market for retirement advice." DOL, *Fiduciary Investment Advice Regulatory Impact Analysis* (Apr. 14, 2015), at p. 7, available at www.dol.gov/ebsa/pdf/conflictsofinterestria.pdf.

⁵ We have provided the Department detailed comment letters on the proposed rule defining the term "fiduciary," and the proposed exemptions in connection with that definition, which advanced numerous constructive suggestions for improving the proposal. See Letter from David Blass and David Abbey, ICI, regarding the proposed fiduciary rule (July 21, 2015), available at www.ici.org/pdf/15_ici_dol_fiduciary_def_ltr.pdf; Letter from David Blass and David Abbey, ICI, regarding the proposed best interest contract exemption (July 21, 2015), available at www.ici.org/pdf/15_ici_dol_fiduciary_best_interest_ltr.pdf; and Letter from Paul Schott Stevens, ICI, to Thomas E. Perez, Secretary, U.S. Department of Labor (July 21, 2015) available at www.ici.org/pdf/15_ici_dol_fiduciary_overview_ltr.pdf. The Institute's supplemental letter on the proposed Conflict of Interest Rule and proposed Best Interest Contract Exemption is available at www.ici.org/pdf/15_ici_dol_rule_comment.pdf.

“conflicted advice costs Americans about \$17 billion in foregone retirement earnings each year.”⁶ The claim is refuted by the data, and constant repetition does not make it any truer. We find that the Department’s proposal, if adopted, will result in net losses to investors of \$109 billion over 10 years.⁷

The Department’s claims that broker-sold funds “underperform” are not supported by the very academic studies on which it relies. The Department relies on several academic studies to support its claims that investors are harmed by their use of brokers. None of these academic studies actually compares the key element that would be necessary for these studies to provide support for the RIA. Notably, they do *not* compare outcomes of investing with a financial adviser that is a fiduciary to the outcomes of investing with a broker or other financial adviser that is not a fiduciary. These studies also rely on outdated data that fail to reflect fundamental changes in the market for broker-sold funds in the past 10 years. Finally, the Regulatory Impact Analysis misapplies the findings of a key study, leading to a vast overstatement of the rules’ potential benefits.⁸

Investors’ actual experience with broker-sold funds contradicts the Department’s claims. Publicly available data demonstrate that, contrary to the Department’s claims, investors who own funds that are sold with front-end loads during the years 2007 to 2013 actually have concentrated their assets in funds that outperform—not underperform—other comparable funds. On a sales-weighted basis, investors buying front-end load shares in those years outperformed the average for share classes in the same Morningstar category by 27 basis points.⁹ Similarly, publicly available data show that investors concentrate their purchases in front-end load share classes with lower expense ratios and pay brokers lower-than-average loads—further contradicting the Department’s claims of harm to retirement savers.¹⁰

⁶ See Jason Furman & Betsey Stevenson, Council of Economic Advisors, *The Effects of Conflicted Investment Advice on Retirement Savings*, (Feb. 2015), p. 21. The CEA white paper is available at https://www.whitehouse.gov/sites/default/files/docs/cea_coi_report_final.pdf. The Department also asserts that there is an \$18 billion cost to IRA mutual fund investors. RIA at p. 98.

⁷ See RIA Letter, Appendix, p. A-3.

⁸ In our letter to the Department, we discuss each of the academic studies cited by the Department and explain why they do not support these statements. See RIA Letter, at pp. 11–15.

⁹ See RIA Letter, Figure 4 and accompanying text, at pp. 20–21.

¹⁰ See RIA Letter, Figure 6 and accompanying text, at pp. 22–23. In addition, sales of front-end load share classes are skewed toward those with below-average expense ratios—further contradicting the notion that brokers systemically are not acting in the best interests of their clients. See RIA Letter, Figure 7 and accompanying text, at pp. 23–25.

The Regulatory Impact Analysis ignores the cost of investment advice. The total annual cost for the services provided by brokers and their firms to investors in front-end load funds is about 50 basis points a year. But retirement savers likely will pay more in a fee-based account.¹¹ A recent study finds that fee-based accounts—the most likely alternative to brokerage accounts—cost investors 111 basis points per year on average, in addition to fund expenses.¹²

The Regulatory Impact Analysis fails to account for the societal harm of investors losing access to advice and guidance. Fee-based accounts may not be available to low- and middle-income individual retirement account (IRA) investors who cannot meet minimum account balance requirements (frequently, \$100,000). Over time, investors who no longer have access to advice are likely to experience lower returns because of poor asset allocation and market timing, or because they incur tax penalties by taking early withdrawals.¹³

The Regulatory Impact Analysis fails to meet the minimum standards applicable to agency rulemaking.¹⁴ The Department's meager attention to the potential harm to investors resulting from its rule proposal is surprising given the proposal's likely impact on retirement savers.¹⁵

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¹¹ See RIA Letter, Figure 8 and accompanying text, at pp. 25–26.

¹² See Cerulli Associates, Inc., *Cerulli Report RIA [Registered Investment Advisor] Marketplace 2014* at p. 20. The average asset-based fee includes high-net worth accounts, which typically are charged lower asset-based fees. Accounts of average or smaller size may pay higher fees.

¹³ We have calculated that it is possible that the net loss from the proposal, if adopted, could impose annual losses to investors amounting to nearly \$19 billion a year within 10 years. See RIA Letter, Figure 11 and accompanying text at pp. 27–30.

¹⁴ Executive Order 12866 (see 58 Fed. Reg. 51735 (October 4, 1993)), as reaffirmed by the Administration in January 2011, pursuant to Executive Order 13563 (see 76 Fed. Reg. 3821 (January 21, 2011)), is well understood to govern the rulemaking process. The Department states in the preamble to the Proposed Fiduciary Rule that the Office of Management and Budget has determined that the proposed rule is economically significant within the meaning of section 3(f)(1) of Executive Order 12866, because it likely would have an effect on the economy of \$100 million in at least one year. See Fiduciary Rule Notice at 21951. As the Proposed Fiduciary Rule is a “significant” regulatory action, the Department is required to include, within its RIA: (i) an assessment, including the underlying analysis, of the benefits anticipated from the regulatory action; (ii) an assessment, including the underlying analysis, of the costs anticipated from the regulatory action; and (iii) an assessment, including the underlying analysis, of costs and benefits of potentially effective and reasonably feasible alternatives to the planned regulation, and an explanation why the planned regulatory action is preferable to the identified potential alternatives. See Executive Order 12866, section 6(a)(3)(C).

¹⁵ See RIA Letter at pp. 30–32.

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As outlined above, the deficiencies in the RIA for the proposed regulation call into question the Department's ability to provide remotely adequate policy or even legal justification for the sweeping changes it has proposed to the definition of fiduciary. Simply put, there is little in the academic papers cited in the RIA, or in the extensive data readily available to the Department, to substantiate the conclusion that underperformance of funds sold through brokers costs Americans about \$17 billion a year or any other number. This is telling, especially in light of our data showing that IRA investors actually concentrate assets into lower-cost mutual funds. Unless the RIA for the final regulation includes significant new data and compelling analysis addressing the flaws in the Department's initial RIA, or the rule is changed considerably from the proposed rule, we believe that the RIA for the final regulation will continue to fail to justify the changes in a manner that is consistent with the requirements of Executive Order 12866.

We would greatly appreciate the opportunity to share our research and discuss the issues identified above in greater detail as OIRA performs its crucial responsibilities associated with the final regulation. We look forward to hearing from you soon.

Sincerely,

A handwritten signature in blue ink, appearing to read "Paul Schott Stevens". The signature is fluid and cursive, with a large initial "P" and "S".

Paul Schott Stevens
President & CEO
Investment Company Institute