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September 21, 2015

RE: **RIN 1210-AB32; Conflicts of Interest Rule**
ZRIN 1210-ZA25; Proposed Class Exemption

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

To Whom It May Concern:

We are writing this letter to respond to the questions raised by Mr. Piacentini from the Department at its recent hearings on the Department's proposed fiduciary rule about our study of the Department's proposal.

First, he responded to our critique of the Department's reliance on a single "experimental" study to back its rejection of a simplified though strengthened disclosure requirement by pointing to the Department's citation of a study by the RAND Corporation for the SEC. That study, performed by Hung et al. (2008), purportedly found that people do not understand "what kind of financial adviser they have and what the obligations of those advisors are."

It is odd to us, however, that Department's Regulatory Impact Analysis (RIA) only briefly mentions this report with regard to the efficacy of disclosures in passing (one sentence on page 174), but gives substantial treatment in both the introductory summary and later in the body of the RIA to the "experimental" study by Loewenstein, Cain and Sah (2011). (The RAND study is cited other times for propositions unrelated to the efficacy of disclosures.) If the RAND study were so important on this point, why relegate it to a single line?

Perhaps the reason for this unusual treatment is that the RAND study says nothing about the value of the efficacy of simplified disclosure. The RAND study merely claims that representatives of brokerage firms believe that "investors rarely read these disclosures" *as they are currently presented*. This is not an argument against developing a newer, simplified, improved disclosure written in plain English in big bold letters at the front of offering documents that investors cannot miss.

Given the current vacuum of adequate disclosure from the Department's perspective, it is understandable why the RIA instead focused on the Lowenstein, et al. study, which at least purports to examine the value of disclosure generally (but again, not the precise recommendation we offered). Nonetheless, as we highlighted in our own study, the Lowenstein, et al. study is based on no *real world evidence*, and so can provide no reliable empirical basis for the Department's rejection of toughened, simplified disclosure – a step without the risks and the compliance costs of its own proposal. The disclosure alternative we recommend ought to be given a chance before more controversial, riskier and costlier ideas such as the Department's fiduciary proposal are more seriously considered, taking into account *all of its potential costs and benefits*, which the Department failed to do, as we documented in our study.

Which brings us to the Department's second critique of our study – that our translation of the purported benefits of the proposal was somehow defective because we calculated a ten year average, 25 basis points, rather than a "weighted average," which the questioner claims "would have made more sense because the effects are actually different over those 10 years."

We do not understand what to make of this suggestion, since the Department itself assumes that the benefits of its proposed rule are phased in linearly over a ten year period. Under these circumstances, what weights would the Department have recommended we use instead?

Even if we had applied different, and presumably, higher weights to the benefits in some years rather than others, it is not clear – without having a clear basis for applying those weights – whether our calculated ten-year average of 25 basis points would have been higher or lower than this figure. Regardless of the outcome, even adding a few basis points to our estimate of the benefits of the Department's would have made no difference to our net results, which showed that at a minimum, the RIA's analysis had left out a conservative 44 basis points of costs that its proposed rule would generate by depriving investors of the value of advice relating to staying in the market during its ups and downs (avoiding market timing) and portfolio rebalancing. No amount of reweighting of the Department's benefit numbers would offset these omitted costs (which as we showed in our report understated the full cost of the proposed rule).

Third, Mr. Piacentini criticizes our use of Vanguard's study of the value of financial advice regarding market timing, which relies on the relative investment performance of target date funds, as a proxy for good financial advice, relative to the performance of index funds. Our response to this is two-fold.

Most important, the question implicitly concedes what we reported in our study: that the RIA itself contains no estimate of the value of financial advisers encouraging their clients, especially those with limited investment portfolios, not to engage in market timing. The RIA's cost-benefit analysis ignores the value of this advice, which we argued was a critically important omission.

We attempted to correct that omission by using the only study that came close to estimating this value, and that was the 2014 Vanguard study, which found that the average investor who exchanged money between funds or into other funds fared 150 basis points worse than those who did not. Vanguard used the performance of target date funds as a proxy for the value of the kind of advice that would discourage such attempts at market timing, and we adopted this convention in our work. But then, as outlined in our report, we heavily discounted the Vanguard estimate to take account of self-directed investment accounts, and added an additional conservative discount to this adjusted figure to arrive at 27 basis points of value added. Even then, we found that the value of avoiding market timing afforded by advisers, *by itself*, outweighed the average annual benefit of Labor's proposed rule.

We wish we could have found and used additional studies of the market timing effect, and we would have made use of them had we done so. The key point for Labor's proposal, however, is that the Department made no attempt to come up with its own estimate of this effect, which is clearly important in the sometimes turbulent investment world. That the Department failed to take *any account* of the costs investors, especially small investors, would suffer by no longer having access to someone to call and talk to in times of market stress, and thus being exposed to making the fundamental mistake of trying to time the market, is a critical omission in the RIA – and one that can easily reverse the results of the cost-benefit analysis of the Department's proposed rule.

Mr. Piacentini's fourth criticism is that Vanguard's estimate of the value of portfolio rebalancing reflects some "double counting" because such rebalancing is already reflected in the performance of target date funds. In fact, Vanguard's 2014 study makes very clear that its market timing and portfolio rebalancing estimates are different, and the methods used to derive those estimates are also very different. This fourth criticism is therefore misplaced. In any event, we discounted Vanguard's estimated benefit (35 basis points) to allow for the possibility that not all brokers providers this kind of advice.

We appreciate the opportunity to clarify the record relating to our study.

Sincerely,

Robert Litan
Senior Consultant

Hal Singer
Principal