INVESTMENT COMPANY INSTITUTE
ICI 1940 2015

1401 H Street, NW, Washington, DC 20005-2148, USA
202-326-5800 www.ici.org

September 24, 2015

Email: e-ORI@dol.gov; e-OED@dol.gov

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

Office of Exemption Determinations
Employee Benefits Security Administration
Attention: D11712
U.S. Department of Labor
200 Constitution Avenue, N.W., Suite 400
Washington, DC 20210

Re: RIN 1210-AB32: Regulatory Impact Analysis; Definition of the Term "Fiduciary"; Conflict of Interest Rule – Retirement Investment Advice/ZRIN 1210-ZA25: Proposed Best Interest Contract Exemption

Dear Madam or Sir:

The Investment Company Institute[1] appreciates the opportunity to supplement our July 21 comment letter regarding the Department of Labor's (the "Department") Regulatory Impact Analysis of its proposed rulemaking regarding the definition of "fiduciary" under the Employee Retirement Income Security Act of 1974 ("ERISA").[2] We also appreciate having had the opportunity to testify about the Regulatory Impact Analysis at the Department's public hearing on its proposed rulemaking.

In this letter, we address three issues—two that arose during our testimony about the Regulatory Impact Analysis and a third issue raised in a Question and Answer that the Department posted about "small savers."[3] This supplemental letter[4] explains why the asset-weighted average return

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

[2] *See* U.S. Department of Labor, Employee Benefits Security Administration, *Fiduciary Investment Advice Regulatory Impact Analysis* (April 14, 2015), available at www.Department.gov/ebsa/pdf/conflictsofinterestria.pdf. The Institute provided previous comment on the Regulatory Impact Analysis in a letter dated July 21, 2015, available at www.ici.org/pdf/15_ici_dol_fiduciary_reg_impact_ltr.pdf.

[3] *See* U.S. Department of Labor, Q&A on Small Savers, available at www.dol.gov/QandAsmallsavers.

for categories of mutual funds, rather than the simple average, is the appropriate measure for assessing the overall experience of investors using broker-sold funds. We then explain how, in our July 21 comment letter regarding the Regulatory Impact Analysis, we adjusted fund returns for risk. We also provide additional detail about why a large share of IRA investors will not be able to get access to fee-based advice under the Department's proposed rules, even if those advisers also manage taxable investable assets on behalf of these households.

I. Why Asset-Weighted Returns Appropriately Measure Investor Experience with Broker-Sold Funds

During the public hearing, a senior Department official asked ICI Senior Economist Sean Collins about ICI's use of asset-weighted relative performance in our comment letter.[5] As Mr. Collins explained during the hearing,[6] we provided the Department with asset-weighted performance and fee data in response to the Regulatory Impact Analysis' statement that "IRA holders receiving conflicted investment advice can expect their investments to underperform by an average of 100 basis points per year over the next 20 years."[7] The Department applied "this performance gap to the current IRA marketplace,"[8] meaning the assets invested in broker-sold funds.[9] These calculations require the use of an asset-weighted average to correctly estimate the total cost to IRA investors of using broker-sold funds. Using a simple average provides undue weight to funds with extremely low (or high) performance, regardless of how little these funds hold in IRA assets.

Our comment letter provided a variety of comparisons challenging the Department's characterization that IRA investors using brokers "underperformed" by 100 basis points a year. We compared performance data for broker-sold share classes relative to their respective Morningstar category returns by computing the relative return for each front-end load share class. We weighted that relative return both by the assets and by the gross sales for that share class, to provide two market-based views of relative performance. As we demonstrated, "investors in front-end load share classes earned returns (net of expenses) that exceeded their Morningstar category return by 27 basis points"[10] on a sales-weighted basis. This is contrary to the Department's assertion that investors are experiencing a "performance gap."

Our comment letter also provided asset-weighted relative returns for retail no-load mutual funds and found that, after adjusting for fees that compensate brokers, the "difference in returns

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[4] The Institute filed a separate supplemental letter on the proposed Conflict of Interest Rule and proposed Best Interest Contract Exemption ("BIC Exemption"), available at www.ici.org/pdf/15_ici_dol_rule_comment.pdf

[5] *See* Public Hearing Transcript (August 11, 2015) at pp. 414-419.

[6] *Id*. at p. 417.

[7] *See* Regulatory Impact Analysis at p. 7.

[8] *Id*. at p. 98.

[9] *Id.* at p. 116.

[10] *See* ICI July 21 comment letter at p. 5.

between front-end load funds and retail no-load funds…[is] 7 basis points on an asset-weighted" basis.[11] The comparison between asset-weighted returns among broker-sold and no-load funds is the comparison that the senior Department official seemed to be seeking at the hearing. The small difference in returns contradicts the Department's claim that investors in broker-sold funds underperform by an average of 100 basis points a year. Our approach of comparing asset-weighted returns for broker-sold funds with those for no-load funds is the same technique found in Bergstresser, Chalmers, and Tufano (2009), which the Department cites in its Regulatory Impact Analysis.[12]

To be quite clear, our analysis demonstrates – using recent real-world data – that the experience of investors in front-end load funds since 2007 is dramatically different from the experience described in the Regulatory Impact Analysis. We find no evidence to support the Department's assertion that there is a "substantial failure of the market."[13]

II. How the ICI Adjusted Fund Returns for Risk

At the hearing, the Department's Chief Economist asked Mr. Collins whether ICI adjusted returns for risk in our analysis of the relative returns of broker-sold funds.[14] In fact, we did so by comparing returns of broker-sold funds with returns of funds in the same Morningstar category. As Mr. Collins pointed out, this is one of the techniques used in several of the papers cited in the Regulatory Impact Analysis. For example, Christoffersen, Evans and Musto (2013) compare performance of broker-sold funds with the performance of other funds in the same Morningstar category.[15] Bergstresser *et al*, also compare returns for broker-sold funds against a benchmark return.

We note that Bergstresser *et al,* also calculate Sharpe ratios,[16] and that the Department's Chief Economist inquired about those measurements.[17] Bergstresser *et al* find that there is no material difference in the Sharpe ratios between broker-sold funds and funds sold without the help of a broker. This finding contradicts the Department's claim of underperformance of broker-sold funds.

III. Why Many IRA Investors Will Lose Access to Advisers Under the Department's Proposal

Our July 21 comment letter pointed to a fundamental flaw in the Department's Regulatory Impact Analysis: the analysis does not measure any harm to IRA investors if the Department adopts the proposed rule. For example, IRA investors would be harmed if they lost access to advice and information that they currently rely on to meet their savings goals.

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[11] *See* ICI July 21 comment letter at p. 21.

[12] *See* Daniel Bergstresser, John Chalmers, and Peter Tufano, "Assessing the Costs and Benefits of Brokers in the Mutual Fund Industry," *Review of Financial Studies* 22, no. 10 (2009): 4129-4156.

[13] *See* Regulatory Impact Analysis at pp. 3, 7, and 211.

[14] *See* Public Hearing Transcript (August 11, 2015) at pp. 396-398.

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

[16] *See* Bergstresser *et al.*, at p. 4145.

[17] *See* Public Hearing Transcript (August 11, 2015) at p. 396.

We said that if the Department does not correct the many flaws with the proposed rules, we expect that significant numbers of investors could lose access to the guidance, products, and services that they currently receive from brokers. The unfortunate result of the Department's rules will be that many retirement investors may be left with no choice but to seek asset-based fee accounts to obtain the investment assistance that they need. Fee-based accounts, however, may not be available to many investors who cannot meet minimum account balance requirements. Currently, fee-based advisers often require minimum account balances of $100,000.[18] We provided data demonstrating that 76 percent of traditional IRA accounts had less than $100,000.[19]

The Department recently published a Q&A on "small savers," which it defines as holders of IRAs with balances of less than $25,000. That Q&A states that "[m]ore than two-thirds of small-IRA owners are wealthy and upper-middle-class households for whom these IRAs generally represent only a single component of a larger financial portfolio . . . These are households that generally own their own homes as well as other types of financial assets such as job-based defined-contribution plans, stocks, and mutual funds."[20] The Department then states that is "unlikely that the financial services industry will walk away from the billions of dollars held in small IRAs."[21]

Using data from the Federal Reserve Board's 2013 Survey of Consumer Finances, which the Department cites,[22] we tested the Department's implied conclusion that most owners of small IRAs could obtain financial advice by combining their IRA balances with other parts of "a larger financial portfolio" to meet fee-based advisers' minimum account balances. We find that among households with IRAs, 64 percent have total household IRA balances (combining traditional and Roth IRAs) of less than $100,000 (*see* figure below). Even after including taxable investable assets that IRA investors could bring to a financial adviser, half of IRA-owning households would not have sufficient assets to meet the typical $100,000 minimum account balance required by fee-based advisers.[23] This finding is not surprising because, except among the very wealthiest households, net worth is largely composed of home equity and job-based retirement assets, neither of which is an investable asset for the purposes of engaging a fee-based adviser. We still conclude that significant numbers of investors will lose access to guidance, products, and services that they currently receive from brokers and will suffer significant harm if the problems with the proposed fiduciary rule are not addressed.

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[18] *See* ICI July 21 comment letter at p. 27.

[19] *See* ICI July 21 comment letter, Figure 9, at p. 28.

[20] *See* DOL Q&A at p. 1.

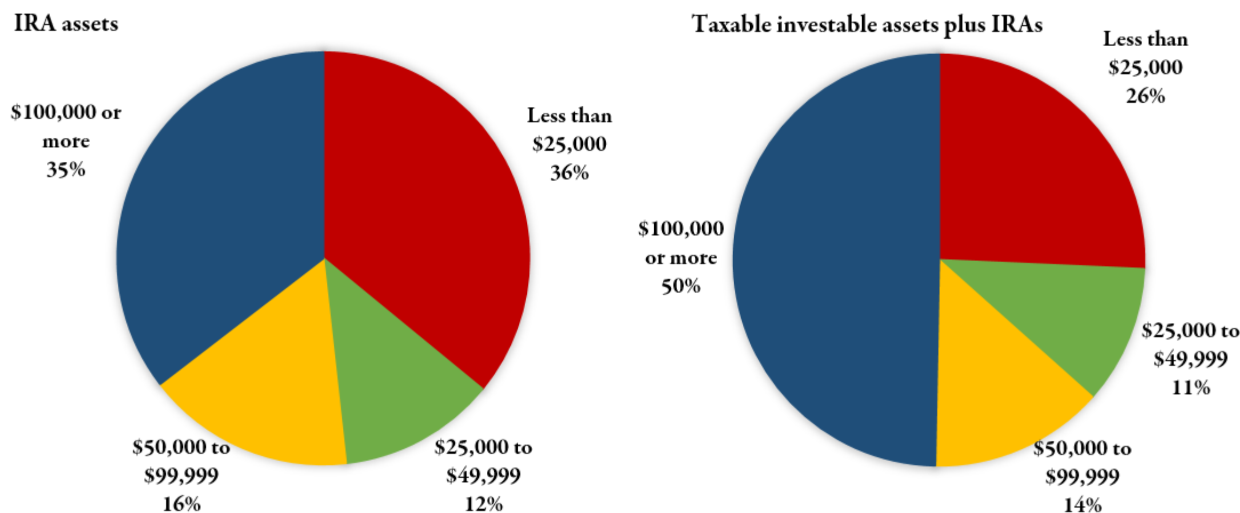
[21] *See* DOL Q&A at p. 3.

[22] *See* DOL Q&A at p. 1.

[23] The data on average account sizes in our comment letter were for individual traditional IRA accounts. The Survey of Consumer Finance data are for all IRAs (traditional and Roth) held within a household.

Household Holdings of IRAs and Taxable Investable Assets by Amount of Assets

Percentage of IRA-owning households, 2013



Note: IRAs include traditional and Roth IRA assets held by the household. Components do not add to 100 percent because of rounding.
Source: Investment Company Institute tabulation of Federal Reserve Board 2013 Survey of Consumer Finances

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

Sincerely,

/s/ Brian Reid

Brian Reid
Chief Economist
Investment Company Institute

/s/ David Blass

David Blass
General Counsel
Investment Company Institute

Cc: Joseph Piacentini
Director, Office of Policy and Research and Chief Economist

U.S. Department of Labor, Employee Benefits Security Administration

G. Christopher Cosby
Office of Policy and Research, Division of Regulatory Policy Analysis
U.S. Department of Labor, Employee Benefits Security Administration