Comment on the Department of Labor Proposal and Regulatory Impact Analysis

July 17, 2015

EXECUTIVE SUMMARY

NERA Economic Consulting has been retained by SIFMA to review and comment on the U.S. Department of Labor's ("DOL") proposed conflict of interest rule and definition of the term "fiduciary" under ERISA (the "proposal"), and associated Regulatory Impact Analysis ("RIA"). The estimates in the above documents form the basis of the Department of Labor's argument that the proposed conflict of interest rule would provide a net "benefit" to the public.

To study these costs associated with the DOL proposal, NERA also collected account-level data from a number of financial institutions in order to construct a representative sample of retirement accounts. Our dataset includes tens of thousands of IRA accounts, observed over a period from 2012 through the first quarter of 2015.

Briefly, our findings are as follows:

- The DOL proposal may effectively make the commission-based brokerage model unworkable for investment accounts covered by ERISA due to the operational complexity and costs of compliance that would be required under the Best Interest Contract Exemption. Using our account-level data, we find that:
    - Some commission-based accounts would become significantly more expensive when converted to a fee-based account under the DOL proposal.
    - Investors can and do select the fee model (commission vs. fee) that best suits their own needs and trading behavior.
    - A large number of accounts do not meet the minimum account balance to qualify for an advisory account.

    - There is no evidence that commission-based accounts underperform fee-based accounts.

- In 2011, the DOL estimated that consumers who invest without professional advice make investment errors that collectively cost them $114 billion per year. Applying the DOL's own logic to the present proposal, combined with the likelihood that a large number of investors will lose access to advice, will result in aggregate costs that may exceed the DOL's own estimates of the benefits of the proposal.
- The RIA produces many different numbers representing different underlying assumptions, resulting in industry cost estimates that vary wildly from about $2 bil./year to $50 bil./year. The range of numbers is so wide it suggests no scientific confidence in their own methodology.
- The academic research cited in the RIA is misapplied.
    - While the academic literature focuses on mutual funds, it is applied more widely to other assets such as variable annuities in order to come up with the asset base of $1.7 trillion in retirement assets.
    - The most frequently cited paper in the RIA takes results from a statistical analysis on certain types of funds and misapplies those results to all funds. This likely exaggerates the importance of the findings cited by the DOL.
    - The academic literature cited in the RIA does not compare the costs and benefits of fiduciary accounts with those of brokerage accounts. Therefore, any findings based on this research are inappropriate as a basis for the DOL proposal.
- Overall the DOL's misapplied use of the academic literature and erroneous conclusions on investor behaviors render their regulatory impact analysis unreliable and incomplete.

Contents

I. COSTS OF IMPEDING THE COMMISSION-BASED INVESTMENT MODEL

The Department of Labor's ("DOL") proposed conflict of interest rule and definition of the term "fiduciary" under ERISA (the "proposal"), and associated Regulatory Impact Analysis ("RIA")[1,2] have led many to conclude that the proposal would effectively make the commission-based brokerage model unworkable for investment accounts covered by ERISA and similar sections of the IRS code due to the operational complexity and costs of compliance that would be required under the Best Interest Contract exemption. In this section, we use account-level data to pursue the question of how this result would affect existing holders of commission-based accounts.

There are at least two immediate consequences to the proposed rule change. The first is that some commission-based accounts would become more expensive, in the sense that average fees would increase, particularly for investors who trade infrequently. Second, advisory or "fee-based" accounts currently have minimum balance requirements. These account balance requirements are in place to ensure that the firm serving the client can at least break even on the operating costs associated with administering advisory accounts. Using account-level data, we can estimate the percentage of consumers currently in commission-based accounts who would not meet the minimum account balance requirements and therefore lose access to professional investment advice under the DOL proposal.

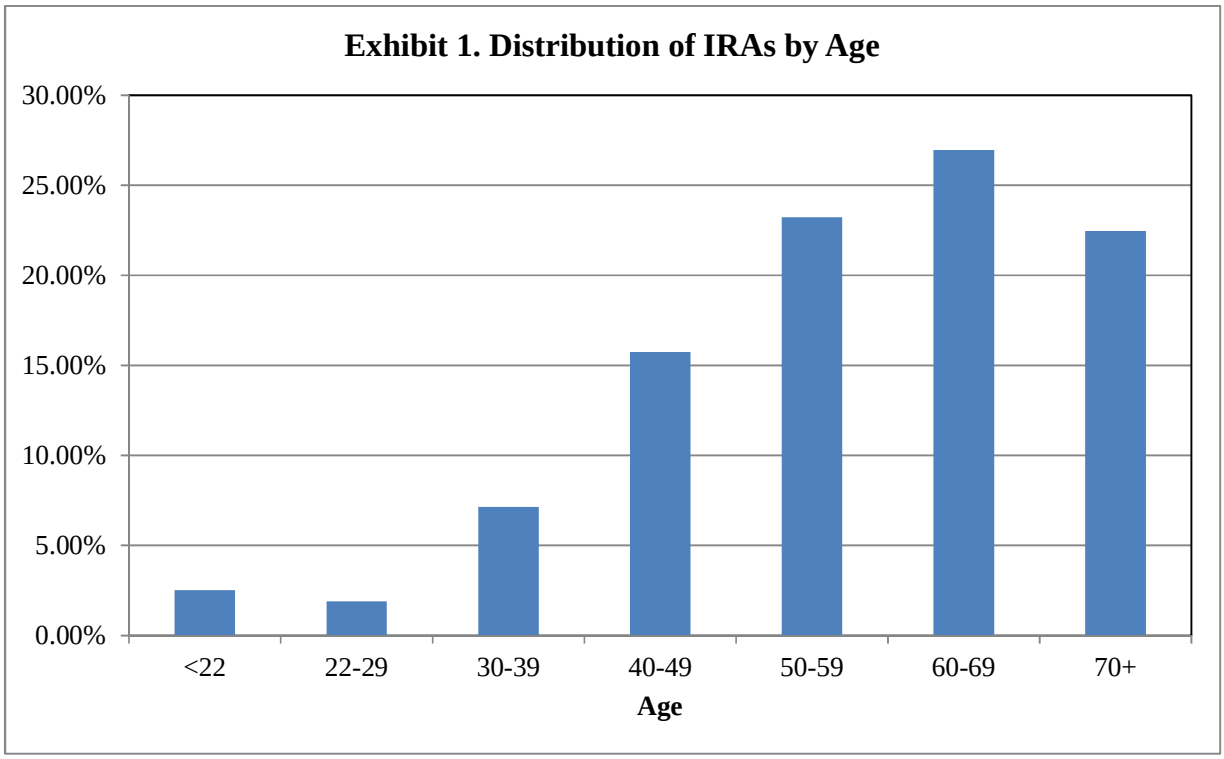
We begin with a discussion and summary of the account-level data that NERA has collected for this study.

A. Summary of Data

The RIA itself recognizes (p. 101) "the absence of comprehensive data" with which to conduct a complete analysis of the proposal. To address that void, we collected account-level

[1] 29 CFR 2509 and 2510, DOL, Definition of the Term "Fiduciary"; Conflict of Interest Rule-- Retirement Investment Advice; Proposed Rule in Federal Register Volume 80, Number 75 (Monday, April 20, 2015), Pages 21927-21960.
[2] "Fiduciary Investment Advice Regulatory Impact Analysis", Department of Labor, Available on-line at www.dol.gov/ebsa/pdf/conflictsofinterestria.pdf.

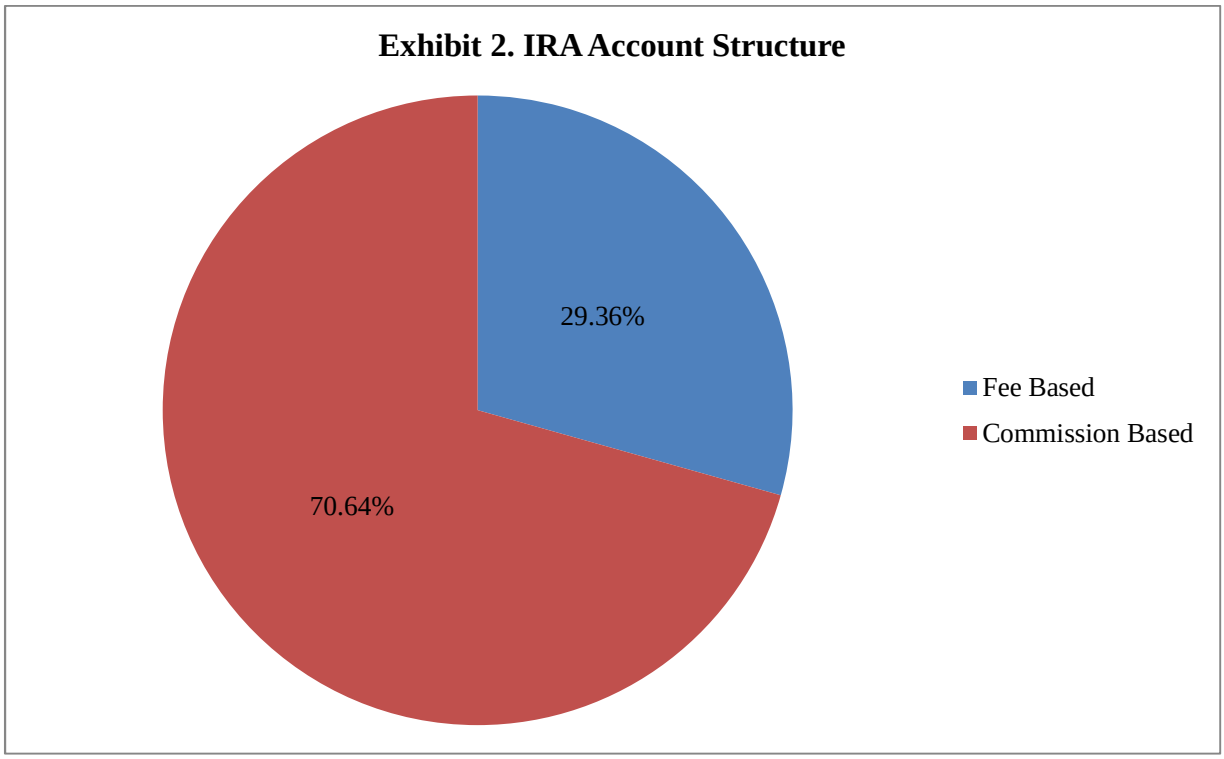
data from a number of financial institutions in order to construct a representative sample of retirement accounts. Our dataset includes over 63,000 IRA accounts, with data ranging from 2012 through the first quarter of 2015. The investors in our dataset are distributed across a wide range of age groups, with the bulk of IRAs held by investors aged 50 or older, as shown in Exhibit 1.



The data we collected from the participating firms contains various types of account-level data fields, including: balances, fees, activity, and positions. In order to conduct an analysis, we merged the data from the various firms into one combined dataset.

Fees

Based on data received from participating firms, we classify IRAs into two broad fee-type categories: fee-based and commission-based accounts. Fee-based accounts are charged a fixed fee as a percentage of assets whereas commission-based accounts are charged fees based on trading and other activity. As shown in Exhibit 2, approximately 70.6 percent of our accounts are commission-based; the rest are fee-based.



Fees include all proceeds paid by the account-holder directly to the firm, such as management fees and trading commissions.[3] They exclude, however, fees paid to third-parties such as mutual fund managers.

The median account balance in our sample is $57,072, with the 25th and 75th percentiles falling at $17,511 and $166,794 respectively.[4] These summary statistics are shown in Table 1 below.

[3] Fees exclude revenue that the firm may receive indirectly from the account-holder, such as markup/markdown revenue or 12b-1 fees. Recognizing that such indirect revenues are not included in our fee data, we construct returns which are net of *all* fees, both direct and indirect. These net returns are presented in section I.E.

[4] In our analyses, we exclude accounts with balances below $1,000.

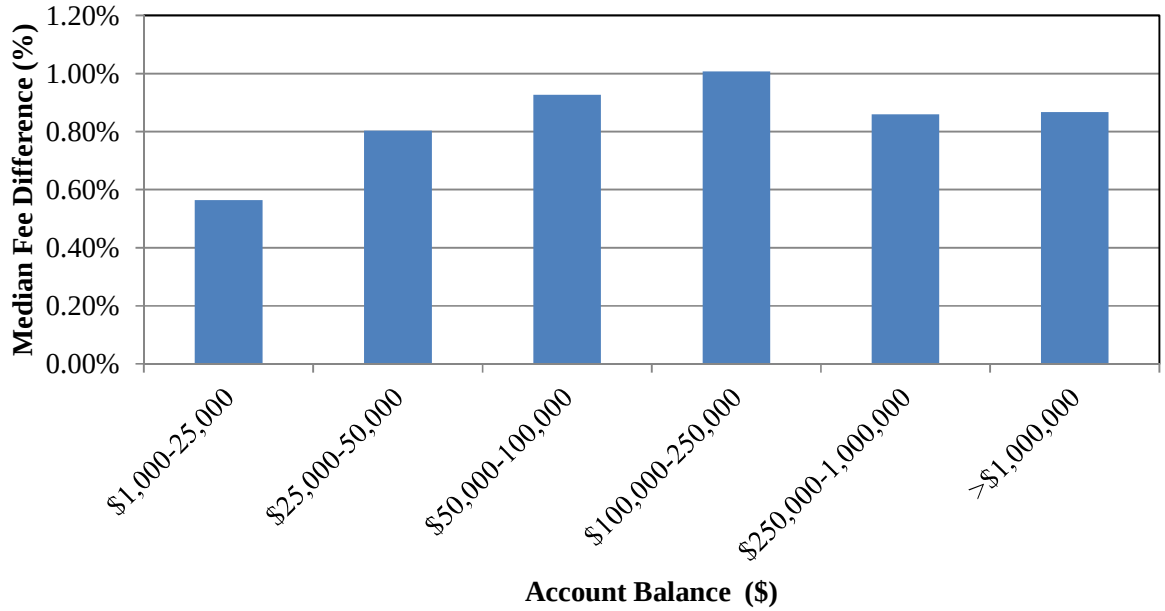
Table 1. Account Balances

	Account Balance ($)
Mean	174,034
Median	57,072
25th Percentile	17,511
75th Percentile	166,794

B. Some Accounts Would Become More Expensive under the DOL Proposal

Our account-level dataset allows us to identify a large number of accounts as having a fee structure which is either fee-based, or commission-based. In Exhibit 3, we present the difference between median fee-based and commission-based account fees, as a percentage of account balance, for various levels of account balance. The chart shows that this difference is always greater than zero; in other words, holders of fee-based accounts pay higher fees, in percentage terms, for all levels of account balance.

Exhibit 3: Fee-Based Accounts Are More Expensive Than Commission-Based Accounts



The differences tend to be in the range of about 57 basis points (bps) for relatively small accounts (those with balances below $25,000) up to about 1 percent for accounts with balances from $100,000 to $250,000. This suggests that investors would pay more if moved to fee-based accounts. Indeed, the magnitude of the increased cost is on par with the 1 percent "cost of conflicted advice" claimed in the White House/CEA memo that preceded the DOL proposal. The numerical results are reported in Table 2, below.

Table 2. Fees by Balance and Account Type

	Median		
Balance Range	**Fee Based**	**Commission Based**	**Difference**
$1,000-25,000	1.24%	0.67%	0.57%
$25,000-50,000	1.16%	0.36%	0.80%
$50,000-100,000	1.20%	0.27%	0.93%
$100,000-250,000	1.25%	0.24%	1.01%
$250,000-1,000,000	1.09%	0.22%	0.86%
Greater than $1,000,000	0.99%	0.12%	0.87%

C. Account-Level Data Suggests that Investors Select the Fee Model that Best Suits Their Own Needs and Trading Behavior

In the data, one of the most striking behavioral distinctions between fee-based and commission-based accounts is that the former tend to trade more frequently. We also calculated investors' aggregate trading activity by looking at both the number and dollar amount of purchases and sales in each account.[5] We measure trading activity in two ways: number of trades and account turnover. Number of trades counts each discrete purchase and sale during the time period. Account turnover takes the minimum of the total dollar amount purchased and the total dollar amount sold as a percentage of the average dollar balance during the year. Summary statistics of trading activity are presented below in Table 3.

[5] Where we could not break out dividends from new investments, trades may include dividend reinvestments.

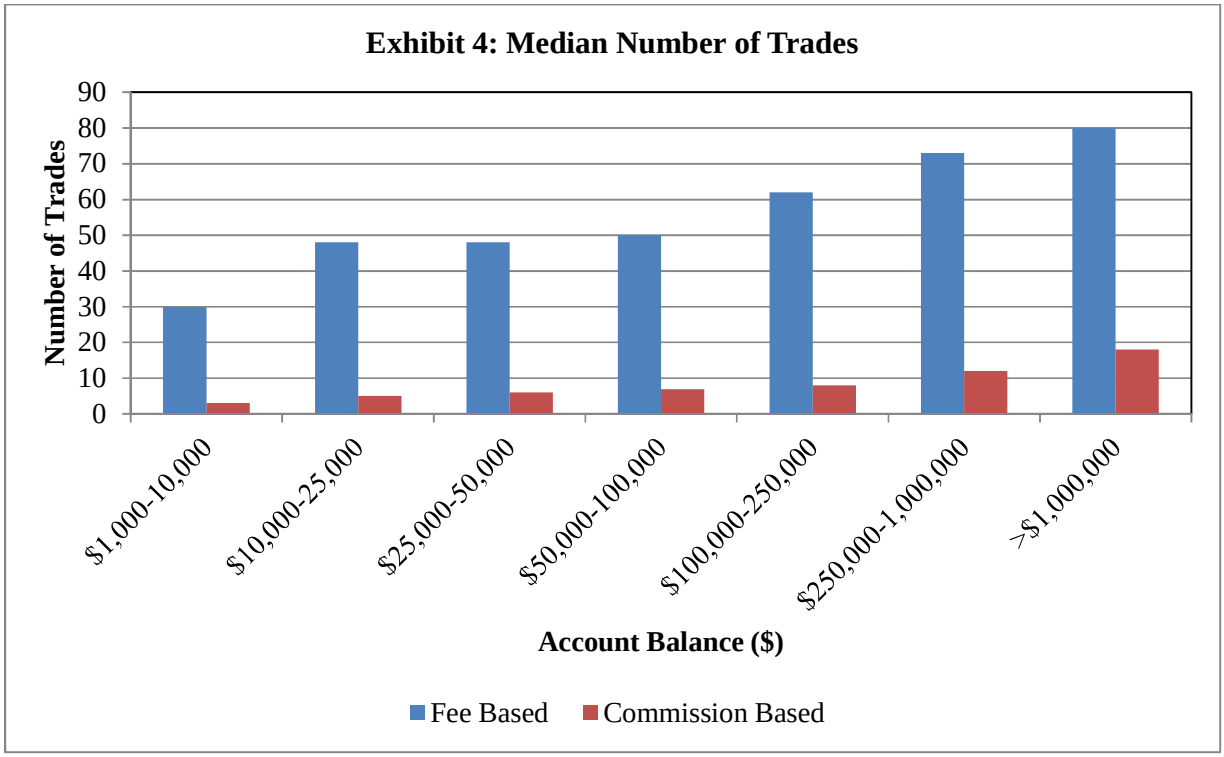
Table 3. Trading Activity

	Number of Trades	Account Turnover
Mean	54	34.11%
Median	16	14.79%
25th Percentile	4	4.84%
75th Percentile	56	39.31%

Exhibit 4 below shows the number of trades, or transaction frequency, of fee-based and commission-based accounts in 2014 for various account balance levels.

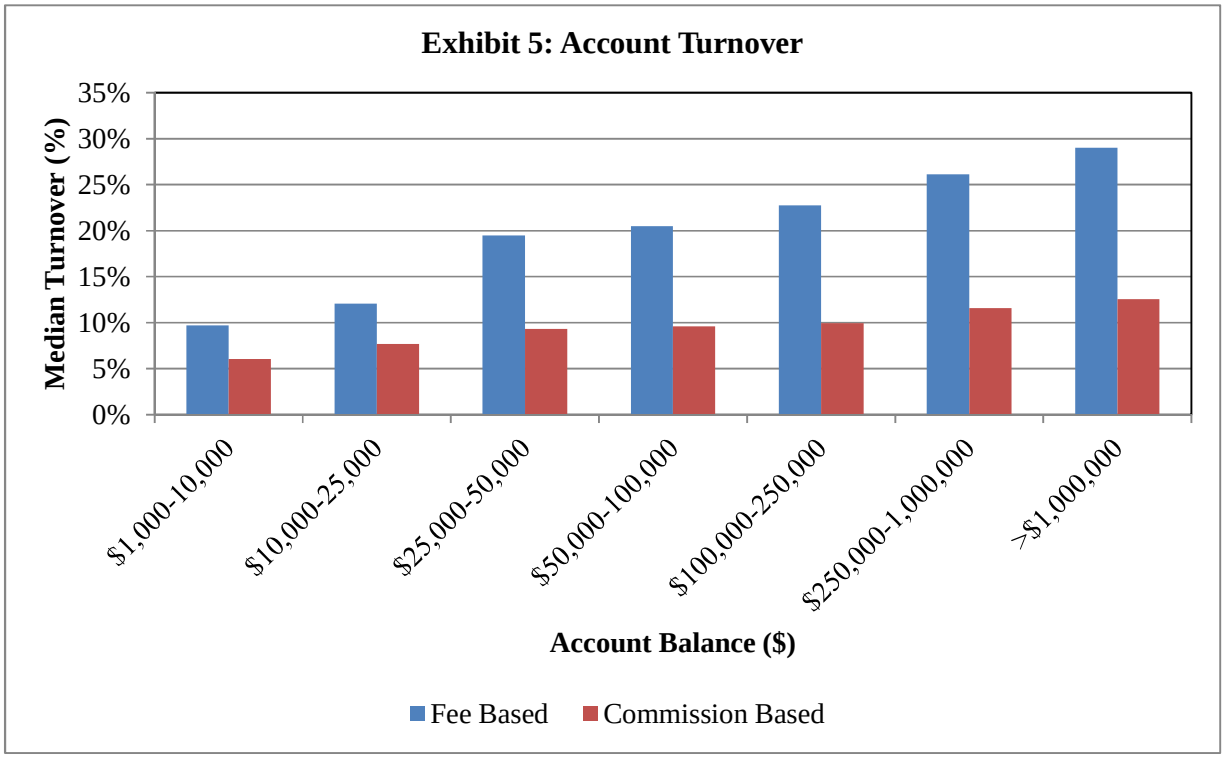
In 2014, the median trade frequency in commission-based accounts was just 6 trades. By comparison, in fee-based accounts the median trade frequency was 57 trades, with larger accounts generally trading more frequently than smaller ones.

Thus, the data are consistent with the idea that investors who expect to trade often rationally choose fee-based accounts whereas those that do not trade often are likely to choose commission-based accounts.



Additionally, it is worth noting that the data does not seem to show "churning," the needless buying and selling of securities. We see the median commission-based account had traded 6 times in 2014. Such trading is more consistent with a buy-and-hold strategy than churning.

The interpretation of the account-level data as being consistent with investors who trade infrequently self-selecting into commission-based accounts is further supported by account turnover. The median dollar-value of transactions, as a fraction of account balance, is show in Exhibit 5 below, for various levels of account balance.



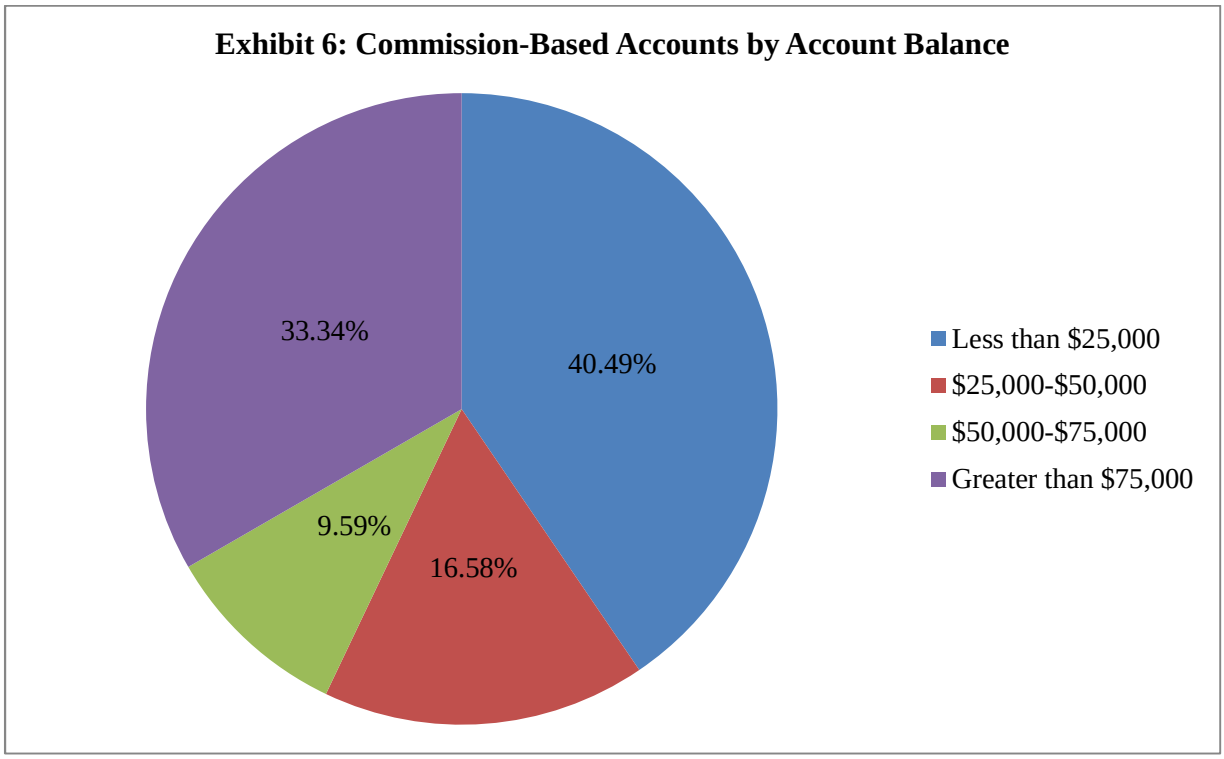
The median commission-based account across all balances only turns over 8.9 percent of its assets annually. For fee-based accounts the median turnover is 22.1 percent.

D. Some Account Balances Are Too Small for RIA Accounts

As mentioned above, a primary concern with the DOL proposal is that it would make commission-based accounts unworkable. If this turns out to be the case, investors will have to move to fee-based accounts or lose access to professional investment advice entirely.
Using our account-level data, we can estimate the number of investors who currently have commission-based accounts with balances below the minimum required account balance for advisory accounts.[6]

The results are shown in Exhibit 6. Using the conservative minimum account balance of $25,000, over 40% of commission-based accounts in our dataset would not be able to open fee-based accounts. Using a $50,000 threshold, over 57% of accounts would not meet minimum balance requirements for a fee-based account. If the effective threshold is $75,000, two-thirds of account holders would be left without any professional investment advice.

Exhibit 6: Commission-Based Accounts by Account Balance



[6] An important limitation in our data is that we have collected account-level data, which may not coincide with household-level data. We may therefore be understating the ability of some households to combine separate IRA accounts held within the same household to achieve the minimum balance requirement. This limitation also likely explains the existence of fee-based accounts smaller than $10,000 in our dataset.

E. Commission-Based Accounts Do Not Underperform

We calculate returns on a quarterly basis by calculating the change in account balance, adjusting for net flows during the quarter.[7] Since fees are deducted from account balances, either directly or indirectly, returns calculated based on account balances are net of fees.

We find that the median annualized return across all accounts in our sample, over the period from June 30, 2012 to March 31, 2015, is 10.3 percent.

In terms of differential fee structures, if investors in commission-based account are subject to the "cost of conflicted advice", then we would expect to see an underperformance in terms of the returns they earn. Indeed, this is explicitly the argument made in the DOL proposal.

Over the time periods for which we have data, commission-based and fee-based accounts exhibit similar performance, when calculated net of fees. The median differences in returns are shown, quarter by quarter, in Table 4. As the data show, the difference in return is sometimes positive and sometimes negative but small in magnitude. Moreover, the difference in returns is not statistically significant.

Table 4. Fee-Based Returns Less Commission-Based Returns

Date Range	Difference in Median Quarterly Return
06/30/12-09/30/12	-0.14%
09/30/12-12/31/12	0.63%
12/31/12-03/31/13	-1.96%
03/31/13-06/30/13	-0.91%
06/30/13-09/30/13	0.62%
09/30/13-12/31/13	-0.08%
12/31/13-03/31/14	-0.44%
03/31/14-06/30/14	-0.18%
06/30/14-09/30/14	-1.04%
09/30/14-12/31/14	0.04%
12/31/14-03/31/15	0.33%
Average	**-0.28%**

[7] Net flows include cash and other transfers to and from the account that are not investment-related (i.e.: withdrawals and contributions). Net flows were constructed to exclude fees, dividends, and interest, to the extent it was possible to identify these payments in the underlying transaction data. To eliminate the potential impact of outliers on our findings, we removed the top and bottom 1 percent of returns from our calculations (where such outliers may reflect the timing of transactions in our data, and not be reflective of actual returns).

Overall, from June 30, 2012 to March 31, 2015, the average difference (where again the difference is the fee-based return minus the commission-based return) is -0.28 percent. Thus, there is no support in this data for the contention that commission-based accounts underperform.[8] An alternative interpretation of the finding that returns are roughly equal across the two fee structures is that investors self-select into account types that are appropriate for them and that this leads to equilibrium.

II. COST OF LOSING ACCESS TO ADVICE

In order to conduct a proper cost-benefit analysis, it is important to consider all of the costs associated the proposed rule. Indeed, the DOL Regulatory Impact Analysis itself states (p.99-100) that:

"A full accounting of a rule's social welfare effects would encompass all of the rule's direct and indirect effects as would be manifest in general market equilibrium. Likewise, that full accounting would consider pure social welfare costs – that is, reductions in economic efficiency – which are not the same as simple compliance costs."

The RIA goes on to recognize that (p. 100): *"The quantitative focus of this analysis, however, is on the proposal's most direct, and directly targeted, effects: gains to retirement investors, and compliance costs to advisers and others."*

But the DOL fails to measure one important cost—the cost of the loss of advice to investors. In this section we partly address this shortcoming by explicitly considering the costs that would be incurred by those consumers who completely lose access to professional investment advice as a result of the DOL proposal.

In prior studies, the DOL itself acknowledged this cost. An October 2011 DOL cost-benefit analysis published in the Federal Register on the "final rule" relating to the provision of investment advice under ERISA included estimates of the costs to consumers of not having access to advice.[9] In that document, the DOL estimated that participant-directed retirement

[8] The sign of the difference might be read to mean that commission-based accounts outperform fee-based accounts in our dataset, but in fact the difference is not statistically different than zero in any of the quarters in our sample period.

[9] 29 CFR 2550, DOL, Investment Advice – Participants and Beneficiaries, Final Rule, October 2011.

savings account holders make investment mistakes in the absence of professional advice valued at an aggregate of "more than $114 billion in 2010" (p.66151).

Moreover, the 2011 DOL cost-benefit analysis estimated the effects of a change in public policy on investors' access to professional investment advice. In particular, the DOL estimated that the enactment of the Pension Protection Act of 2006 (P.L. 109-280, the "PPA") increased access to advice, and hence reduced aggregate investing errors by $7 billion to $18 billion per year. These are extremely large numbers, and hence clearly indicate the DOL's own estimation of the importance to investors of access to professional advice.

A. Estimates of Number of Investors Who Will Lose Access to Advice

As discussed in section I.A above, our account-level data allows us to identify a large number of accounts as having a fee structure which is either fee-based, or commission-based, by account balance. For example, we noted above that 40.49 percent of the accounts that are currently commission-based have balances below $25,000 in our sample.

If the DOL proposal were to make commission-based accounts unworkable for broker-dealers, these accounts could no longer be maintained. Moreover, many commission-based accounts have small balances and so would be below the minimum account balance for advisory accounts. These investors will be left on their own with no access to professional investment advice.

If we were to take at face value the DOL's methodology in the 2011 cost-benefit analysis discussed above, and assume a minimum-balance threshold of $25,000, the new fiduciary standard would cause a loss of access to professional advice for 40.49 percent of commission-based retirement account holders. It would take a relatively small number of such accounts to lose advice for this to result in an aggregate cost that exceeds the $17 billion in purported benefits claimed in the White House/CEA memo.

Moreover, this is based on a conservative estimate of the minimum balance, at only $25,000. Even at this level, the aggregate cost could easily be on par with the DOL's own estimates of the "cost of conflicted advice".

Hence, using the DOL's own approach, the costs of the proposal likely exceed its benefits once we account for other costs such as the cost of compliance.

B. Implications of Losing Access to Advice: Individual Investors Make Systematic Errors When Investing on Their Own

In this section we first review the extensive academic and professional literature on the value to investors of having access to professional investment advice. The discussion begins with a survey of the potential pitfalls faced by many individuals who invest on their own. We then discuss the established literature that documents ways in which the use of professional advisors tends to lead to fewer such investment errors.

Additionally, it is worth noting that below, in section III.D, we discuss an earlier 2011 cost-benefit analysis on the Pension Protection Act of 2006 in which the DOL itself recognized the implications of investors losing access to professional investment advice. The conclusions of that DOL study are similar to the academic findings discussed in this section.

1. The disposition effect and mental heuristics

Ever since the seminal work of Kahneman and Tversky (1979, 1992), it has been widely accepted that individual investors are prone to making systematic mistakes in the way they evaluate and treat investment decisions in the presence of uncertainty.[10] Indeed, Kahneman was awarded the Nobel Prize in Economics for this work in 2002. This research agenda was typically accompanied by experimental data, but not backed up with actual accounts and transactions of individual investors.

In the 1990's, however, Odean (1998) built upon the earlier literature by analyzing the trading records of ten thousand accounts at a large nationwide discount brokerage firm. The dataset he collected covered the period 1987 through 1993.[11] The data includes an account identifier, trade dates, the security traded, a buy-sell indicator, the quantity traded, the commission paid and the principle amount. The study compared the selling price for each stock sold to its average price to determine whether that stock is sold for a gain or loss. One of the primary findings of the paper was that investors demonstrate a strong preference for realizing winners rather than losers. This phenomenon is now widely known as the "disposition effect" for individual investors.

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[10] Kahneman, D and A. Tversky (1979), "Prospect Theory: An Analysis of Decision under Risk," *Econometrica* **47** (2): 263 and Tversky, A and D. Kahneman (1992), "Advances in prospect theory: cumulative representation of uncertainty," *Journal of Risk and Uncertainty* **5** (4): 297–323.

[11] Odean, T. (1998), "Are Investors Reluctant to Realize Their Losses?" *Journal of Finance*, 53, 1775-1798.

Since Odean (1998), the disposition effect has been confirmed by numerous studies. Goetzmann and Massa (2004) construct a variable based on investor trades that acts as a proxy for the representation of disposition-prone investors in the market and test how it relates to stock returns. [12] The authors report a strong negative correlation between the disposition effect and stock returns. Grinblatt and Han (2005) also study the disposition effect, and in particular the tendency of investors to hold on to their losing stocks.[13] They attribute this behavior to prospect theory, or the tendency to under weigh outcomes that are merely probable in comparison to outcomes that are obtained with certainty, and to a psychological phenomenon known as "mental accounting". The authors find that the tendency for households to fully sell winning stocks is weaker for wealthy investors with diversified portfolios of individual stocks.

Franzini (2006) uses a database of mutual funds holdings to construct a measure of reference prices for individual stock and confirms the existence of the disposition effect.[14] Moreover, the author suggests that the disposition effect can induce under-reaction by individual investors to news, leading to return predictability and post-announcement price drift. In particular, bad news travels slowly among stocks trading at large capital losses, in turn leading to a negative price drift, and good news travels slowly among stocks trading at large capital gains.

Nor is this literature limited to academic circles. The Morgan Stanley Consulting Group (2014), for example, studied the various behavior biases that can impair the performance of individual investors in managing their own portfolios.[15] The authors point to "psychological blindspots" that negatively influence investors such as overconfidence, mental accounting, anchoring biases, framing biases and loss aversion. Their research suggests that a financial advisor can mitigate the effects of these problems because they have a clearer understanding of the investment process.

2. Mental heuristics disproportionately affect people with fewer savings

As argued above, the academic literature has documented evidence that individual investors display irrational and costly investing behavior in the form of the disposition effect.

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[12] Goetzmann, W. and M. Massa (2004), "Disposition Matters: Volume, Volatility and Price Impact of Behavioural Bias," *Centre for Economic Policy Research*, Paper No. 4814.
[13] Grinblatt, Mark and Bing Han (2005), "*Prospect theory, mental accounting and momentum," Journal of Financial Economics*, 78, 311-339.
[14] Frazini, Andrea (2006), "The Disposition Effect and Underreaction to News," *The Journal of Finance*, 61, No. 4
[15] Morgan *Stanley Consulting Group*, "The Value of Advice," (2014), available on-line at www.morganstanleyfa.com/public/projectfiles/thevalueofadvice.pdf

Beyond this general observation, there is also a strand of research that shows that these flaws tend to disproportionately affect people with lower levels of wealth.

Grinblatt and Keloharju (2000) employ the central register of shareholdings for Finnish stocks in the Finnish Central Securities Depository (FCSD), a comprehensive data source which covers 97 percent of the total market capitalization of Finnish stocks beginning in 1995.[16] The data set reports institutional holdings and stock trades on a daily basis. The authors find that generally the more sophisticated the investor and the greater the wealth invested in stocks, the less contrarian (buying losing stock and selling winning stock) is the investment strategy. The degree of contrarianism appears to be inversely related to a ranking of the sophistication of investor types.

Dhar and Zhu (2002) analyze the trading records of a major discount brokerage house and confirm the existence of the disposition effect.[17] The paper finds empirical evidence that wealthier and individual investors in professional occupations exhibit less disposition effect. Trading experience also tends to reduce the disposition effect.

Calver, Campbell and Sodini (2009) study a dataset containing the disaggregated wealth of all households in Sweden between 1999 and 2002. The authors find that contrary to rational expectations, households are more likely to fully sell directly held stocks if those stocks have performed well and more likely to exit direct stockholding if their stock portfolios have performed well.[18] This paper examines changes in household behavior over time, specifically decisions to scale up or down the share of risky assets in the total portfolio, to enter or exit risky financial markets, to full sell individual risky assets and to scale up or down the share of individual assets in the risky portfolio. By doing so, the authors develop an adjustment model with different target risky shares across households. The authors find that wealthy, educated investors with better diversified portfolios tend to rebalance more actively. Specifically, the authors point to wealth and portfolio diversification as more relevant than income in predicting the strength of the disposition effect

[16] Grinblatt, Mark and Matti Keloharju (2000), "The investment behavior and performance of various investor types: a study of Finalnd's unique data set" *Journal of Financial Economics*, 55, 43-67.
[17] Dhar, Ravi and Ning Zhu (2002), "Up Close and Personal: An Individual Level Analysis of the Disposition Effect," *Yale ICF Working Paper No. 02-20.*
[18] Calver, Laurent E. and John Y. Campbell and Paolo Sodini (2009), "Fight or Flight?" *The Quarterly Journal of Economics*, 124, 1.

Cerqueira Leal, Rocha Armada and Duque (2010) use a database of 1,496 trading records of individual investors in the Portuguese stock market from January 1, 1999 to December 31, 2002, consisting of initial position, account movements, events and daily closing stock prices.[19] The authors then calculate the "proportions of gains realized and the proportions of losses realized" based on each investor's portfolio for each day of the sampling period. The authors find that less sophisticated investors (defined by average account value, number of shares traded and number of trades) exhibit a stronger disposition effect.

3. Individual investors churn

Aside from the disposition effect described above, another well-known error that is commonly observed in un-advised, self-directed, individual investors is the tendency to trade too often, or "churn". In a seminal paper, Barber and Odean (2000), analyze the returns earned on common stock investment by 66,465 self-directed households. The net return earned by these households underperforms a value-weighted market index by about 9 basis points per month (or 1.1 percent annually).[20] Those that trade the most earn an annual return rate of 11.4 percent, while the market returns 17.9 percent. The poor performance of the average household can be traced to the costs associated with this high level of trading. The authors find a negative correlation between trading frequency and investment returns.

Similarly, Barber, Lee, Liu and Odean (2007) use a complete trading history of all investors in Taiwan, and document that the aggregate portfolio of individual investors suffers an annual penalty of 3.8 percentage points.[21] These losses virtually all come from aggressive trading. In contrast, institutional investors enjoy an annual performance boost of 1.5 percentage points--even after commission and transaction taxes. Foreign institutional investors garner nearly half of the institutional profits. The author points out that investors who are saving to meet long term goals would benefit from effective guidance regarding best investment practices.

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[19] Cerqueira Leal, Cristiana and Manuel J. Rocha Armada, and Joao C. Duque (2010), "Are All Individual Investors Equally Prone to the Disposition Effect All The Time? New Evidence from a Small Market," *Frontiers in Finance and Economics*, 7, No. 2, 38-68.

[20] Barber, M. Brad and Terrance Odean (2000), "Trading is Hazardous to Your Wealth: The Common Stock Investment Performance of Individual Investors" *The Journal of Finance*, 60, No. 2.

[21] Barber, Brad M., Yi-Tsung Lee, Yu-Jane Liu, and Terrance Odean (2007) "Just How Much Do Individual Investors Lose by Trading?" *AFA 2006 Boston Meetings Paper*.

C. Benefits of Financial Advisors

Having established that individual investors are prone to making systematic mistakes in their investing due to behavioral biases, it is natural to ask whether such errors are reduced, on average, by having access to professional advice. The answer, unsurprisingly, tends to be "yes" in the by extensive academic and professional literature.

1. Portfolio allocations that are more diversified and closer to model portfolios

Bluethgen, Gintschel, Hackethal and Mueller (2008) examine a dataset of 12,000 German bank accounts, categorizing bank customers as "advised customers" or "self-directed", and find that financial advice enhances portfolio diversification, and makes investor portfolios more congruent with predefined model portfolios.[22] While the bank in the study derived more revenues from advised clients, the advised clients' portfolios also resembled more closely the optimal portfolios prescribed by financial theory. The authors conclude that financial advisory service has a "significant impact on household investment behavior."

Gerhardt and Hackethal (2009) collect a data set on 65,000 private investors and analyzed the portfolio composition and trading behavior of more than 14,000 persons and note that there are clearly positive effects to working with an advisor.[23] These benefits include: less speculative trading and a more diversified portfolio.

A study commissioned by the Investment Funds Institute of Canada (2010) analyzed a longitudinal database with Canadian households' financial behaviors and attitudes.[24] The study isolated 3200 households and broke the sample into two groups – those who had an advisor in both years and those who did not have an advisor in either year. The authors found that households that received investment advice had substantially higher investable assets that non-advised households, controlling for age and income level. Additionally, investors without advice save less, utilize tax-advantaged savings opportunities less, and invest in securities with less opportunity for future investment growth than their advised counterparts.

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[22] Bluethgen, Ralph, Andreas Gintschel, Andreas Hackethal, and Armin Mueller (2008), "Financial Advice and Individual Investors' Portfolios."
[23] Gerhardt, Ralf and Andreas Hackethal (2009), "The Influence of Financial Advisors on Household portfolios: A study on Private Investors switching to Financial Advice," February 14, 2009.
[24] The Investment Funds Institute of Canada (2010), "The Value of Advice Report," available on-line at www.ific.ca/wp-content/uploads/2010/07/IFIC-Value-of-Advice-Report-2010-July-2010.pdf/4001/

A paper by the Investment Funds Institute of Canada (2012) stresses the importance of the CIRANO 2012 research, as well as citing papers from Australia and the United States.[25] Summarizing the existing literature, the paper notes that research proves that advice has a positive and significant impact on wealth accumulation, leads to better long term investment strategies and benefits the wider macroeconomy.

Kramer (2012) compares portfolios of advised and self-directed Dutch individual investors to investigate whether financial advisers add value to individual investors' portfolios.[26] The author finds that advised portfolios are more diversified and perform better than self-directed portfolios, thus reducing avoidable risk. The author (at least partly) attributes the reduction of idiosyncratic risk observed in advised portfolios to advisory intervention

In a widely-cited paper, Kinniry, Jaconetti, DiJoseph and Zilbering (2014), argue that through suitable asset allocation using broadly diversified funds/ETFs, cost effective implementation, rebalancing, behavioral coaching, asset location, spending strategy, and total-return versus income investing strategies, advisors can potentially add about 3 percent in net returns to investors.[27] For some investors, the value of working with an advisor is peace of mind. The value of an advisor for investors "without the time, willingness, or ability to confidently handle their financial matters" should not be ignored by "the inability to objectively quantify it." The authors argue that value added cannot be analyzed as an annual figure because "the most significant opportunities to add value occur during periods of market duress or euphoria when clients are tempted to abandon their well-thought-out investment plan."

Mardsen, Zick and Mayer (2011) argue that working with an advisor is related to several important financial planning activities including goal setting, calculation of retirement needs, retirement account diversification, use of supplemental retirement accounts, accumulation of emergency funds, positive behavioral responses to the recent economic crisis and retirement confidence.[28]

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[25] The Investment Funds Institute of Canada (2012), "The Value of Advice Report," available on-line at www.ific.ca/wp-content/uploads/2013/02/IFIC-Value-of-Advice-Report-2012.pdf/1650 /

[26] Kramer, Marc M. (2012), "Financial Advice and Individual Investor Portfolio Performance," *Financial Management*, 41, No. 2, 395-428.

[27] Kinniry, Francis M., Jr., Colleen M. Jaconetti, Michael A. DiJoseph, and Yan Zilbering (2014), "Putting a value on your value: Quantifying Vanguard advisor's Alpha," *The Vanguard Group.*

[28] Mardsen, Mitchell, Cathleen D. Zick, and Robert N. Mayer (2011), "The Value of Seeking Financial Advice," *Journal of Family and Economic Issues*, 32, No. 4, 625-643.

Winchester, Huston and Finke (2011) collect data containing 3,022 respondents with at least $50,000 in annual income.[29] These individuals also had equity holdings that they could control or direct during market downturns. The authors used "investor prudence" as the dependent variable and noted whether the individuals rebalanced their portfolio over a market decline. The authors find that investors who use a financial advisor are about one-and-a half times more likely to adhere to long-term investment decisions. Moreover, investors with a written financial plan are almost twice as likely to make optimal long term financial decisions.

2. Advisors help investors stop making investing mistakes

Shapira and Venezia (2001) argue that professionally-managed accounts experienced better roundtrip performance than those administered independently.[30] The authors find that the disposition effect, or the tendency of investors to sell shares whose price has increased, while keeping assets that have dropped in value, is significantly weaker for professional investors. This indicates that professional training and experience reduces judgmental biases, even though it cannot eliminate them. The authors point to this as an advantage in enlisting professional advice.

Maymin and Fisher (2011) used data from a boutique investment management firm, Gertstein Fisher.[31] The data includes all account and household information, client introduction history, notes, and portfolio allocations and performances since 1993. The authors test five predictions by analyzing the contacts actually recorded between clients and the manager in the data set. The authors conclude that the advisor's role in helping investors stay disciplined and on plan in the face of market volatility, including dissuading them from excessive trading, is one that is highly valued by the individual investor.

3. Tax minimization

Horn, Meyer and Hackethal (2009) use transaction data from a German bank from 1999-2008, to study a natural experiment of the introduction of a withholding tax in Germany in order to see how private investors react to changes in taxation.[32] The authors conclude that financial

[29] Winchester, Danielle D., Sandra J. Huston, and Michael S. Finke (2011), "Investor Prudence and the Role of Financial Advice," *Journal of Financial Service*, 65, No. 4, 43-51.
[30] Shapira, Zur and Itzhak Venezia (2001). *Patterns of Behavior of Professionally Managed and Independent Investors*, Journal of Banking and Finance, 25, No. 8, 1573-587.
[31] Maymin, Philip Z. and Gregg S. Fisher (2011), "Preventing Emotional Investing: An Added Value of an Investment Advisor." *The Journal of Wealth Management*, 13, No. 4.
[32] Horn, Lutz, Steffen Meyer and Andreas Hackethal (2009), "Smart Investing and the Role of Financial Advice – Evidence from a natural Experiment Using Data Around a Tax Law Change," Working Paper Series.

advisors help people make smarter investment decisions because of their financial sophistication and experience in tax-related investment decisions.

Martin and Finke (2012) uses both the 2004 and the 2008 waves of the National Longitudinal Survey of Youth to estimate the impact of financial advice on retirement savings and the change in accumulated retirement wealth between 2004-2008.[33] The authors compare the effectiveness of creating one's own retirement plan versus using a professional advisor. The authors find that the use of a comprehensive financial professional overwhelmingly increases the likelihood that households will go through the process of calculating retirement needs. Respondents who rely on an advisor to help plan for retirement are more likely to own tax-advantaged accounts. Authors conclude that planning, with the help of a comprehensive advisor, improves retirement outcomes.

4. Increased savings

Montmarquette and Nathalie (2015) used Ipsos Reid collected data in the form of a 45-question internet survey from 18,333 Canadian Households.[34] The data were filtered to produce a high quality sample of 3,610 households. After splitting up the data into "advised households" and "non-advised households" the authors used econometric modelling in order to isolate the benefits of advisors in the accumulation of wealth.

Econometric results show that participants retaining the services of a financial advisor for more than 15 years have about 174 percent more financial assets (in other words, 2.73 times the level of assets) than non-advised respondents. The authors conclude that a highly plausible explanation for this finding comes from the greater savings and improved asset selection that is associated with having a financial advisor. Those investors who have advice are more likely to trust financial advisors, associate satisfaction with financial advisors and have confidence in financial advisors.

Similarly, in a KPMG Econtech (2009) paper based on the results of a regression analysis from an economy-wide model, the authors conclude that an individual who has a financial planner is estimated to save $2,457 more in a year compared to similar individuals without

[33] Martin, T. K. and Michael S. Finke (2012), "*Planning for Retirement,*" (December 31, 2012), available at SSRN: papers.ssrn.com/sol3/papers.cfm?abstract_id=2195138

[34] Montmarquette and Nathalie Viennot-Briot (2015), "The Value of Advice," Annals of Economics and Finance, 16-1, 69-94. This paper was also published as Montmarquette and Veinnot-Briot (2012), "Econometric Models on the Value of Advice of a Financial Advisor," at the Centre interuniversitaire de recherché en enalyse des des organisations.

financial advisors/planners.[35] Investors with a financial planner have greater savings and investment balances than those who do not.

A study by Standard Life (2012) based on collected data from the UK, reports that the current average pension pot for consumers who have been advised on their retirement planning is £74,554.30, nearly double that of those not seeking advice.[36] Those who have taken advice put nearly a third more a month into their pension plan. On investments, people with an adviser save for longer and contribute more, leading to an average investment value which is over £40,000 higher than the average for those who haven't sought advice.

Lastly, Antunes, Macdonald and Stewart (2014) construct a hypothetical scenario using collected survey data that included age, average savings, average income and the presence of an advisor.[37] After collecting the data, the authors assume that 10 percent of the income of non-advised savers is now saved at the higher rate of those who do receive financial advice in order to capture the increased savings level that is correlated with having an advisor. This paper then applied the percentage difference between this savings rate and the baseline savings rate to the Conference Board of Canada's long term national forecasting model to quantify the economic impact of the increased savings in the long run. On top of positively impacting an investor's savings rate, the presence of an advisor was also shown to boost real GDP, turn consumer expenditures positive and raise the aggregate household savings rate.

5. Economies of scale with respect to the cost of information

In a highly-regarded paper by Stoughton, Wu and Zechner (2010), the authors create a model with three classes of agents: the active portfolio manager, the set of financial advisers and the pool of investors in the economy.[38] The authors first derive an equilibrium assuming that financial advisers are independent and must charge their investors their full costs in order to break even and allow portfolio manager to provide payments to the adviser. Then, the authors run the model to solve for the optimal amount of rebates preferred by the portfolio manager and

[35] "Value Proposition of Financial Advisory Networks" (2009), *KPMG Econtech*. www.fsc.org.au/downloads/uploaded/2009_1105_KPMGEcontech(FinalReport)_7d94.pdf

[36] Standard Life (2012), "Value of Advice Report," available on-line at www.unbiased.co.uk/Value-of-Advice-Report-2012.pdf

[37] Antunes, Pedro, Alicia Macdonald and Matthew Stewart (2014), "Boosting Retirement Readiness and the Economy Through Financial Advice," *The Conference Board of Canada.*

[38] Stoughton, Neal M., Youchang Wu, and Josef Zechner (2010), "Intermediated Investment Management," *Journal of Finance,* 66, No. 3. 947-980.

the impact on management fees, fund sizes and flows. Finally, the paper derives the equilibrium without an adviser and compares all the scenarios. The authors find that financial advisers facilitate the participation of small investors in actively managed portfolios by economizing on information costs.

It is also interesting to note that the DOL itself wrote, in a 2011 cost benefit analysis of the final rule on investment advice under ERISA[39] (p. 66156) that "The Department therefore expects this final rule to produce cost savings by harnessing economies of scale and by reducing compliance burdens." "For example, an adviser employed by an asset manager can share the manager's research instead of buying or producing such research independently."

D. The Cost of Losing Access to Professional Investment Advice

While the 2015 DOL regulatory impact analysis (RIA) ignored the costs of investors losing access to advice, the 2011 SEC staff's 913 study as well as the 2011 DOL cost-benefit analysis, both mentioned above, both discussed the costs of investors not having access to advice.

We note that the DOL's 2010 proposal differs from the current one in some of its details. However, both proposals raise the same troubling implications for current investors in commission-based accounts by increasing the complexity and compliance costs associated with offering that fee structure to customers.

1. Review of the SEC (2011) assessment: costs of imposing a fiduciary standard on brokers

As mentioned above, the SEC staff undertook a study in 2011 designed to evaluate the effectiveness of existing regulatory standards for investment advisers and brokers. The study was mandated under Section 913 of Title IX of the Dodd-Frank Act and analyzed some of the potential costs associated with changes to the current regulatory framework (see p.143-165), including imposition of a fiduciary standard on brokers.

In this section we review the discussion in SEC (2011) regarding the potential costs and expenses to retail customers, and the potential impact on the profitability of their investment

[39] See footnote 10.

decisions, including access to the range of products and services offered by broker-dealers, resulting from imposing on broker-dealers the fiduciary standard associated with the Investment Advisers Act of 1940.

The primary concern mentioned in SEC (2011) is with respect to the cost and availability to retail investors of accounts, products, services, and relationships with broker-dealers, which could inadvertently be eliminated or impeded (for example, through higher costs to brokers being passed on to investors).[40]

In general imposition of a new regulatory standard of conduct on broker-dealers has the potential for additional costs on broker-dealers, which would be passed on to the customers at least in part, according to the standard economic theory of "effective incidence". That theory simply states that it is likely that at least some portion of the regulatory costs imposed by the government is ultimately passed on to the public.[41] In turn, costs passed on to retail investors would have the effect of eroding the profitability of their investments.

The net cost impact on retail customers would likely depend on a complex interplay of various factors, such as investor wealth, investor willingness to pay additional fees, and size of the particular broker-dealers in question as well as the competitive landscape. To take an extreme example, in relation to the UK experience, the FSA found[42] that smaller firms and firms with less revenue were more likely to either exit the market or alter the types of services provided, in response to new government regulations.

The following discussion presents some further detail on specific concerns discussed in SEC (2011).

a. Brokers may deregister and register as investment advisers and, in the process, convert their brokerage accounts into advisory accounts subject to advisory fees.

One concern expressed in SEC (2011) associated with the imposition of a fiduciary standard is the possibility that brokers would convert existing accounts from commission-based

[40] See p. 155-159.

[41] See, for example, Mukherjee, S. (2002), Modern Economic Theory, at p.833.

[42] Oxera, Retail Distribution Review Proposals: Impact on Market Structure and Competition, prepared for the Financial Services Authority, Mar. 2010

accounts to fee-based accounts, in order to respond to new requirements placed on those account. The ultimate cost impact of this would depend on the actual fees and commissions, the relative extent to which the accounts in question had been actively trading, and any increased costs associated with providing advice for a fee.[43]

Additionally, there could also be "fee layering" (whereby fees are charged based both on the value of the assets as well as account fees such as administrative and custodial fees), especially for less actively traded accounts.[44]

An Oliver Wyman/SIFMA 2010 study[45] notes that there are significant cost differences between broker-dealer and advisory accounts, and if a change in the regulatory regime has the effect of pushing more clients toward the higher-cost model then this could be a suboptimal outcome for those investors. They estimate cumulative returns to retail customers with $200,000 in assets would be reduced by $20,000 over the next 20 years in such a scenario.

The 2011 SEC study states on p.162 that: "One possible way that costs could increase is if broker-dealers whose customers want advice and who currently provide the full range of brokerage services…for a single commission (or mark-up) and perhaps minor account level fees, simply converted these accounts to investment adviser status and cease to provide execution services to retail investors who sought advice. If that were the case, custody costs to the retail investors would be higher. Advice costs charged, at least initially upon conversion (and absent the investor researching competitors' prices), would also be higher for those investors who buy and hold, because either an hourly or asset-based fee would likely exceed the current commission or mark-up on a retail trade."

The 2011 SEC study goes on to note: "In sum, to the extent that broker-dealers respond to a new standard by choosing from among a range of business models, such as converting brokerage accounts to advisory accounts, or converting them from commission-based to fee-based accounts, certain costs might be incurred and ultimately passed on to retail investors in the

[43] See p. 155-159.
[44] See p. 172
[45] Oliver Wyman, Securities Industry and Financial Markets Association, Standard of Care Harmonization: Impact Assessment for SEC, Oct. 2010.

form of higher fees or lost access to services and products. Any increase in costs to retail investors detracts from the profitability of their investments."[46]

b. Broker-dealers may unbundle their services and provide them separately through affiliates or third parties.

The SEC (2011) study notes that broker-dealers might choose to unbundle their services and provide some of the component services through third parties.[47] A brokerage relationship involves various component functions: finding customers; providing advice to those customers; executing orders; clearance and settlement services; custodial services; and recordkeeping services, such as trade confirmations and account statements.

SEC (2011) argues that costs to broker-dealers are likely to depend on whether these services were provided by one firm or whether they were divided among affiliates. For example, a broker can self-clear securities transactions or contract with a third-party clearing broker to clear transactions. A broker can act as custodian for securities itself or contract with a third party such as a bank.

Brokers could decide to divide some or all of these functions. As noted in SEC (2011), to the extent broker-dealers may transfer accounts or personnel to affiliates, this may generate additional administrative costs.

2. The DOL (2011) Federal Register Study

While the most recent 2015 DOL RIA did not provide estimates of the cost to investors of losing professional investment advice, an earlier DOL (EBSA) study in 2011, previously cited, did in fact do so. The 2011 DOL *Federal Register* article published the final rule relating to the provision of professional investment advice to plans and beneficiaries of IRAs, under ERISA.

The 2011 DOL publication explicitly argues that participants in participant-directed retirement savings accounts make mistakes. In particular, the study notes (p.66151) that:

[46] See p. 162.

[47] See p. 164, 173.

"such mistakes and consequent losses historically can be attributed at least in part to provisions of the Employee Retirement Income Security Act of 1974 that effectively preclude a variety of arrangements whereby financial professionals might otherwise provide retirement plan participants with expert investment advice. Specifically, these 'prohibited transaction' provisions of section 406 of ERISA and section 4975 of the Internal Revenue Code prohibit fiduciaries from dealing with DC plan or IRA assets in ways that advance their own interests."

The DOL estimates this error rate costs an aggregate of "more than $114 billion in 2010" (p.66151). The study goes on to say (p. 66159) that: "The Department is highly confident in its conclusion that investment errors are common and often large, producing large avoidable losses (including foregone earnings) for participants. It is also confident that participants can reduce errors substantially by obtaining and following good advice. While the precise magnitude of the errors and potential reductions therein are uncertain, there is ample evidence that that magnitude is large."

The DOL then argued that the PPA, by permitting a broader array of investment advice under ERISA, decreased the amount of errors made by investors. For example, the study states (p.66152): "the Department believes this final regulation will provide important benefits to society by extending quality, expert investment advice to more participants, leading them to make fewer investment mistakes. The Department believes that participants, after having received such advice, may pay lower fees and expenses, engage in less excessive or poorly timed trading, more adequately diversify their portfolios and thereby assume less uncompensated risk, achieve a more optimal level of compensated risk, and/or pay less excess taxes."

The DOL estimated that the reduction in investment errors due to the expansion of availability of investment advice would amount to between $7 billion and $18 billion annually, or approximately 6 percent to 16 percent of the $114 billion total in investment errors made per year.[48] At the upper range these numbers are as large as the supposed cost of conflicted advice that the DOL Fiduciary Standard is designed to alleviate.

[48] The DOL stated that it based its estimates on the retirement assets in DC plans and Individual Retirement Accounts reported by the Federal Reserve Board's Flow of Funds Accounts (Mar. 2011), at www.federalreserve.gov/releases/z1/Current/. The study also refers the reader to earlier DOL studies including 74 FR No 164 (Aug. 22, 2008), 74 FR No 12 (Jan. 21, 2009), and 75 FR No 40 (Mar. 2, 2010).

The investment mistakes discussed in the 2011 RIA are grounded in the behavioral finance literature, which we have discussed in detail above. For example, the DOL stated (p. 66153) that "in practice many investors do not optimize their investments, at least not in accordance with generally accepted financial theories. Some investors fail to exhibit clear, fixed and rational preferences for risk and return. Some base their decisions on flawed information or reasoning. For example some investors appear to anchor decisions inappropriately to plan features or to mental accounts or frames, or to rely excessively on past performance measures or peer examples. Some investors suffer from overconfidence, myopia, or simple inertia."

The study then goes on to focus on five types of investment mistakes:

a) *Fees and Expenses.* The DOL stated that it believes that (p. 66153) "there is a strong possibility that at least some participants, especially IRA beneficiaries, pay inefficiently high investment prices." However, it is not clear what empirical evidence the DOL used as its basis for this statement.

b) *Poor Trading Strategies.* The study cited churning, failure to rebalance, attempts to time the market, and chasing past returns as examples of strategies that tend to underperform.

c) *Inadequate Diversification.* The DOL claims that DC plan participants sometimes concentrate their assets excessively in stock of their employer, as well as being under-invested in international equity or debt.

d) *Inappropriate Risk.* The study notes that investors may construct portfolios that are too risky or too safe, given their preferences.

e) *Excess Taxes.* The DOL study mused that some households appear to follow sub-optimal strategies with respect to minimizing taxes, such as not placing taxable bonds in tax-deferred accounts. However, the DOL also stated that (p. 66154) "the Department currently has no basis to estimate the magnitude of excess taxes that might derive from participants' investment mistakes."

Despite the rather lengthy description of the above types of investment errors, the DOL did not use data from actual investor-held accounts to estimate the magnitude of the associated losses. Instead, they made a variety of assumptions, summarized as follows:

1) The DOL assumed that approximately 40 percent of DC plan sponsors provided access to investment advice before the PPA.[49] After enactment of the PPA, they assumed this percentage increased to between 56 and 69 percent.

2) They assumed that about 25 percent of plan participants that are offered advice use the advice (both pre-PPA and post-PPA). For IRAs, they assumed that 33 percent used advice pre-PPA, and between 50 percent and 80 percent post-PPA.[50,51]

3) Investors who received advice make mistakes about half as often as those who are unadvised (they also consider other fractions).

Finally, the above assumptions are combined with the previously mentioned assumption that aggregate investment errors cost consumers about $114 billion per year to arrive at the final estimates of between $7 billion to $18 billion per year from having increased access to professional investment advice.

Taking the DOL's methodology and results at face value, by their own calculations the loss of access to advice, by even a small fraction of investors, would result in investment errors so large as to be of the same magnitude as the problem that the DOL is purportedly trying to solve—the "cost of conflicted advice," by the DOL's own reckoning, is on par with the losses that would be incurred by a government policy that curtails the availability of professional investment advice.

III. THE COST OF CONFLICTED INVESTMENT ADVICE

We begin with a review of the claims of harm associated with purportedly conflicted investment advice, as put forth in White House memo entitled "The Effects of Conflicted Investment Advice on Retirement Savings" ("WH/CEA memo") published in February 2015 and the Department of Labor's (DOL) proposed conflict of interest rule and definition of the term

[49] The DOL attributed these numbers at least partly to surveys including Hewitt Associates LLC, *Survey Findings: Hot Topics in Retirement, 2007* (2007); Profit Sharing/401(k) Council of America, *50th Annual Survey of Profit Sharing and 401(k) Plans* (2007); and Deloitte Development LLC, *Annual 401(k) Benchmarking Survey, 2005/2006 Edition* (2006).
[50] These are based on Employee Benefit Research Institute, *2007 Retirement Confidence Survey, Wave XVII*, Posted Questionnaire (Jan. 2007); Hewitt Associates LLC, *Survey Findings: Hot Topics in Retirement, 2007* (2007); Profit Sharing/401(k) Council of America, *50th Annual Survey of Profit Sharing and 401(k) Plans* (2007); and Deloitte Development LLC, *Annual 401(k) Benchmarking Survey, 2005/2006 Edition* (2006).
[51] It is interesting to note that the DOL assumed that "a large majority of IRA beneficiaries who invest in mutual funds purchase them via such professionals."

"fiduciary" under ERISA (the "proposal"), and associated Regulatory Impact Analysis ("RIA").[52,53]

The estimates in these documents form the basis of the Department of Labor's argument that the proposed conflict of interest rule would "benefit" the public. The Regulatory Impact Analysis in particular purports to quantify these benefits in dollar terms. As shown in detail in the next section, however, the RIA fails to do so. The RIA produces many different numbers representing different underlying assumptions, and results in estimates that vary wildly over an incredible set of values. This range of numbers is so wide as to suggest no scientific confidence in the DOL's methodology. As a result, the estimates in the RIA provide little confidence as to the actual benefits, if any, arising from the DOL's proposal.

A. Estimates of the Benefits of the Proposal Vary Wildly in the RIA

In the WH/CEA memo entitled "The Effects of Conflicted Investment Advice on Retirement Savings" published in February 2015, the authors estimated that a baseline aggregate cost to consumers from purportedly conflicted advice is about $17 billion per year. They calculated this number as one percent times the total number of mutual funds and variable annuities in IRAs. The one-percent factor came from their assessment of an average of estimates produced by various academic papers using differing methodologies and datasets.

However, this number does not appear in the subsequent DOL Regulatory Impact Analysis published two months later in April 2015. Instead, the RIA provides many different numbers, all generated by different sets of assumptions.

Table 5 summarizes the various estimates of the cost of purportedly conflicted advice that appeared in the RIA. A review of the table indicates an astounding range of different estimates. On the low end, there is mention in three separate places in the RIA (p. 8, p. 102, and p. 106) of an estimated cost from $20 billion to $22 billion over a ten year horizon. These numbers appear to come from an analysis that assumes the new DOL rules will eliminate 50 percent of

[52] 29 CFR 2509 and 2510, DOL, Definition of the Term ``Fiduciary"; Conflict of Interest Rule-- Retirement Investment Advice; Proposed Rule in Federal Register Volume 80, Number 75 (Monday, April 20, 2015), Pages 21927-21960.
[53] "Fiduciary Investment Advice Regulatory Impact Analysis", Department of Labor, Available on-line at http://www.dol.gov/ebsa/pdf/conflictsofinterestria.pdf.

underperformance due to front-end-load sharing, and that this is the only effect considered. These numbers equate to between $2 billion to $2.2 billion per year (setting aside discount rates and any growth in the asset base over time), which are about 13 percent of the WH/CEA memo's $17 billion per year estimate.

On the high range, the RIA states on p. 7 and p. 98 that the costs of conflicted advice could be "nearly $1 trillion" over a horizon of 20 years. This is consistent with approximately $50b in costs per year (again, setting aside discount rates, compounding of returns and other dynamic assumptions the DOL may have made). The estimate seems to come from an analysis in which it is assumed that investors lose 200 basis points (two percentage points) of annualized return per year due to "conflicted advice," instead of the 100 bps (one percentage point) assumed in the WH/CEA memo. It is not clear where the 200 bps number comes from. Nor is it clear why this number is so large, given that simply doubling the 100 bps number should approximately double the estimate from $17 billion per year to $34 billion per year. Presumably, the DOL increased the number from $34 billion to $50 billion by apparently compounding returns over time, but the RIA does not specify this in enough detail to be certain.

One reason for the incredible range in aggregate estimates is that the RIA numbers vary in terms of the horizon of interest (some are per year, some cover a 10-year horizon, and some cover a 20-year horizon), assumptions made (e.g., some assume a 100 bps reduction in investment performance, and others assume a 200 bps reduction in performance), and the universe of assets that are considered (e.g., some consider all mutual funds held in individual retirement accounts ("IRAs") while others focus only on front-end load mutual funds, and so forth).

Nevertheless, given the variety to the DOL's own numbers, the "benefit" estimates do not provide a credible foundation on which to base significant changes in policy and regulation. The very wide range in the numbers suggests that the DOL itself does not have a good measure of the dollar magnitude of purportedly conflicted advice that they seek to ameliorate.

This range of numbers is so wide as to provide no scientific confidence in the DOL's own methodology, and is inconsistent with a cost-benefit analysis that is concrete enough to form the basis of a change to federal government policy.

An additional problem with the "benefits" of the proposal, as presented by the DOL, is that the academic literature on which they base their argument does not directly apply to the question of how to best define and implement a fiduciary standard under ERISA.

B. The RIA Misapplies the Academic Literature

In this section, we discuss some important ways in which the RIA misapplies the existing academic literature in an attempt to justify the DOL proposal.

Before discussing the methodological shortcomings, we note that much of the academic literature which is cited by the RIA is based on data which is now dated and may no longer be relevant. Significant changes have occurred in the past several years. Indeed, one of the most salient recent developments is that mutual fund fees have been declining substantially, and that has occurred independently of any explicit government driven interventions.

Over the period 1990-2013, front-end sales loads have declined by nearly 75 percent for equity funds and hybrid funds, and even more than that for bond funds.[54] The ICI argues this decline, at least in part, may reflect the increasing role of mutual funds in helping investors save for retirement. That is, mutual funds now often waive load fees on purchases made through defined contribution plans, such as 401(k) plans.

Additionally, nearly all net new cash flows in recent years have accrued to no-load mutual funds. Net flows to load mutual funds have been negative for all four years of the most recent data.[55]

1. The cited literature focuses on mutual funds, yet the DOL applies the results more widely

The academic research that serves as the basis for conflicted cost-of-advice estimates focuses on the commissions embedded in mutual fund purchases and sales. These are typically front-end loads, although there may be back-end loads and on-going fees such as 12b-1 fees.[56]

[54] See Chapter 5 of the 2014 Investment Company Fact Book, *Mutual Fund Expenses and Fees*, available on-line at http://www.icifactbook.org/fb_ch5.html

[55] *Id*., in Figure 5.10.

Yet the DOL proposal extends far beyond mutual funds. To cite one example, the proposal ends the existing prohibited transaction exemption for variable annuities and states that they would be able to be sold only under existing compensation structures under the Best Interest Contract Exemption. Other assets classes, such as options on stocks, do not appear to be permitted for sale to IRA accounts under any of the proposed exemptions.

There is no justification provided, therefore, as to why the DOL would propose making such radical shifts to the way in which all assets are sold to IRA account holders, given that the academic literature on which the RIA relies so heavily is almost exclusively limited to the mutual fund literature. There is no basis in the academic literature for extrapolating conclusions applicable to mutual funds to other investment products that may not even have front-end sales loads.

2. The research cited in the RIA takes results associated with higher-than-average load funds and misapplies them to all funds.

One of most heavily cited academic papers in the RIA is Christoffersen, Evans and Musto (2013).[57] It is cited dozens of times, and is one of the leading sources of the baseline estimate of 100 bps per year in apparent "cost of conflicted advice" that the DOL claims is suffered by investors in commission-based retirement accounts.

It is therefore important to understand the claims that actually appear in Christoffersen et al. (2013). In particular, their study finds evidence that a subset of funds, those whose front-end loads are higher than other funds with similar characteristics, underperformed the average return of their fund category during the next year. In formulating much of their "cost of conflicted advice" aggregate figures, the DOL then assumes that *all* IRAs invested in front-end load funds

[56] The RIA attempts to portray brokers and investment advisers in the professional IRA market as charging excessive fees to investors, yet it fails to mention one of the most salient developments in recent years – namely, that mutual fund fees have been declining substantially. It is notable that this has occurred independently of any explicit government driven interventions. Investment Company Institute (ICI) expense ratio data for three broad types of mutual funds over the years 2000-2013 indicate, for example, that in 2000 equity mutual fund investors incurred average expense ratios of 99 basis points. By 2013, that number fell to 74 basis points, a decline of 25 percent. The same basic pattern is true for hybrid and bond funds. In terms of front-end sales loads, it is again the case that they have declined substantially over time with no explicit government intervention. Over the period 1990-2013, they have declined by nearly 75% for equity funds and hybrid funds, and even more than that for bond funds. Additionally, nearly all net new cash flows in recent years have accrued to no-load mutual funds. Net flows to load mutual funds have been negative for all four years of the most recent data. See Chapter 5 of the 2014 Investment Company Fact Book, *Mutual Fund Expenses and Fees*, available on-line at http://www.icifactbook.org/fb_ch5.html

[57] Christoffersen, Susan E. K., Richard Evans, and David K. Musto (2013) "What Do Consumers' Fund Flows Maximize? Evidence from Their Brokers' Incentives," *Journal of Finance*, Vol. 68(1), p. 201-235.

suffer the same underperformance, thereby mistakenly applying a result from a subset of load funds to all load funds.

The extrapolation the DOL made is analogous to the following: Suppose we conduct medical research and find that people who consume more salt than average have a lower life expectancy by five years, and we then conclude that eating no salt will increase the life expectancy of everyone by five years. This is a logical fallacy. We have no evidence that people who eat a "normal" amount of salt would benefit from reduced salt intake, and so extrapolating to them is an error in logic.

Again, we emphasize this point because an official cost-benefit analysis needs to be precise and free of logical fallacies. By incorrectly extrapolating from a subset of mutual funds to all mutual funds, the DOL is effectively applying the 100 bps cost number to assets for which it does not apply. Hence, the benefit side of the cost-benefit analysis presented in the RIA is seriously flawed. The result is that it is impossible to conclude whether the benefits of the DOL proposal outweigh the costs.

3. The academic literature cited in the RIA does not compare the costs and benefits of fiduciary accounts with those of brokerage accounts

The academic literature on which the DOL relies, such as Christoffersen, Evans, and Musto (2013), Bergstresser, Chalmers, and Tufano (2009),[58] Del Guercio and Reuter (2014),[59] generally compares the performance of mutual funds with loads (paid as commission to brokers) versus mutual funds sold directly to the public.

None of these academic studies actually compares the performance of accounts with a financial advisor who is a fiduciary to the performance of accounts with a broker or other financial advisor that is not a fiduciary. Hence they are using results that do not address the central question of the proposal. It is absolutely inappropriate to conclude that investors would

[58] Bergstresser, Daniel, John Chalmers, and Peter Tufano (2009), "Assessing the Costs and Benefits of Brokers in the Mutual Fund Industry", The Review of Financial Studies, 22(10), p. 4129-4156.

[59] Del Guercio, Diane and Jonathan Reuter (2014) "Mutual Fund Performance and the Incentive to Generate Alpha", The Journal Of Finance, Vol. 69(4), p. 1673-1704.

be better off under an expanded fiduciary standard on the basis of the academic literature being cited.

The bulk of the literature considers data at the mutual fund level and measures their loads and performance. These can be compared to direct-to-public investments such as a "S&P 500" index fund. The academic research generally has not undertaken a direct way of comparing how investors would fare under a fiduciary standard in relation to a broker-based suitability model or a self-direction model because that analysis requires account-level data from actual investors, rather than aggregate fund-level data.[60]

Absent account-level data, the DOL is drawing fallacious conclusions. Even if it were true that fund loads cause underperformance—which is not proven—there is no reason to conclude that consumers would be better off in fiduciary advised accounts based on the evidence cited by the DOL. Fiduciary advisors do not work for free. They must also be compensated for their work, and in some cases they may be providing a great deal more service than a commission-based non-fiduciary broker and may need even more compensation. If certain investors are forced out of commission-based accounts, they may either lose access to advice entirely, or they may switch to advisory accounts which may charge more, not less. Moreover, this increased expense is likely to be particularly acute for low-balance and low-activity accounts who may pay very low annual fees and loads because their portfolios tend to be static. Hence the DOL proposal is likely to disproportionately hurt low-income Americans.

[60] A small number of academic papers have looked at account-level data, but these are generally limited to extremely small sample sets that are not in any way representative of the spectrum of American consumers. For example, Chalmers and Reuter (2014) collect account level data, but it is limited to faculty and administrators in the Oregon University's optional retirement plan (ORP). See Chalmers, J. and J. Reuter (2014), "What is the Impact of Financial Advisors on Retirement Portfolio Choices and Outcomes?" working paper, University of Oregon.

Table 5
The Cost of Conflicted Advice Estimated by DOL Varies Widely

Entry	Page	Amount	Horizon	Methodology	Notes
(1)	(2)	(3)	(4)	(5)	(6)
Estimates found in *The Effects of Conflicted Investment Advice on Retirement Savings*[1]					
1	2	$17 bil.	per year	100 bps (from academic lit) * $1.7 trillion assets in IRA funds	N/A
Estimates found in *Fiduciary Investment Advice: Regulatory Impact*[2]					
1	7	100 bps	per year	"Careful review" of academic literature	N/A
2	7, 98	$210 bil.	10 years	Applying performance gap (100 bps based on academic lit) to the current IRA marketplace	100 bps figure is the average underperformance associated with conflicts of interest in the mutual funds segment
3	7, 98	$500 bil.	20 years	See above	N/A
4	7, 98	$430 bil.	10 years	Applying performance gap (200 bps based on academic lit) to the current IRA marketplace	200 bps figure is based on academic studies that suggest that the underperformance of broker-sold mutual funds may be even higher than 100 bps, possibly due to loads that are taken off the top and/or poor timing of broker sold investment
5	7, 98	"nearly" $1 tril.	20 years	See above	On pg. 8 the RIA also mentions that adviser conflicts "could cost IRA investors as much as $410 bil. over 10 years and $1 tril. over 20 years. The $410 bil. number seems to come from the 200 bps points, but the RIA is unclear

6	8	$410 bil.	10 years	DOL estimate based on reduction in excessive trading, associated transaction costs, timing errors, improvements in performance of IRA investments other than front-load mutual funds	See above
7	8, 101	$40-44 bil.	10 years	DOL estimate based of assumption that rule will eliminate 100 percent of underperformance due to variable front-end-load sharing	"Baseline scenario" where the 1975 rule remains in place. Loads projected to decrease over time at the same rate as the baseline scenario. Quantifying gains expected to accrue to IRA investments in front-end load mutual funds attributable to variations in load sharing. DOL considers this estimate "conservative". Quantified gains pertain only to 13 percent of all IRA assets that are involved in front-end-load mutual funds
8	8, 101	$88-100 bil.	20 years	See above	See above
9	8, 102, 106	$30-33 bil.	10 years	DOL estimate based of assumption that rule will eliminate 75 percent of underperformance due to variable front-end-load sharing	The Report offers no basis for the selection of 75 percent underperformance
10	8, 102, 106	$20-22 bil.	10 years	DoL estimate based of assumption that rule will eliminate 50 percent of underperformance due to variable front-end-load sharing	The Report offers no basis for the selection of 50 percent underperformance

11	105	$44.1 bil.	10	Loads decrease over time at twice the rate of the baseline scenario. Quantifying gains expected to accrue to IRA investments in front-end load mutual funds attributable to variations in load sharing and increased investment performance for broker-sold mutual funds. The DOL considers this estimate "reasonably high" Quantified gains pertain only to 13 percent of all IRA assets that are involved in front-end-load mutual funds	N/A
12	105	$99.7 bil.	20	See above	N/A
13	105	$65.6 bil.	10	Represents upper limit. Loads paid by investors immediately fall to zero Quantifying gains expected to accrue to IRA investments in front-end load mutual funds attributable to variations in load sharing and increased investment performance for broker-sold mutual funds. The DOL considers this to be an "illustration but does not expect the proposal to result" in this number. Quantified gains pertain only to 13 percent of all IRA assets that are involved in front-end-load mutual funds	N/A
14	105	$135.1 bil.	20	See above	N/A
15	98	$18 bil.	per year	Applying performance gap (100 bps) to the current IRA marketplace	N/A

16	98	$10 bil.	per year	Christoffersen, Evans, and Musto (2013) find that each 100 basis points in load sharing paid to an unaffiliated adviser reduces future returns by 50 bps and 100 bps paid to a captive broker reduces future performance by 15 bps. Authors of the RIA project these results onto the current IRA marketplace	N/A
17	98	$125 bil.	10 years	See above	N/A
18	98	$285 bil.	20 years	See above	N/A
19	98	$26 bil.	per year	Harm to consumers if industry has simply shifted conflicted revenue streams, rather than reducing conflicts	This refers to a hypothetical where the industry shifts away from front-end load mutual funds into other revenue streams with conflicts of interest. Appears to be based off of Christoffersen, Evans, and Musto (2013).
20	98	$300 bil.	10 years	See above	See above
21	98	$700 bil.	20 years	See above	See above
22	101	$80 bil.	10 years	Underperformance seen by focusing only on how load shares paid to brokers affect the size of loads IRA investors holding load funds pay and the returns they achieve	The Report assesses the gains to investors attributable to the rule by specifically quantifying benefits in an area of the IRA market where the conflicts are well measured-namely front-end load mutual funds
23	101	$200 bil.	20 years	See above	See above

Sources:

[1] *The Effects of Conflicted Investment Advice on Retirement Savings.* The White House. February 2015

[2] *Fiduciary Investment Advice: Regulatory Impact Analysis.* The Department of Labor

APPENDIX: THE COST OF COMPLYING WITH THE DOL PROPOSAL

The Regulatory Impact Analysis published by the DOL also reported estimates for the costs of implementing the DOL's new Fiduciary Standard rules. These are essentially limited to compliance costs.

A detailed overview is presented in Table 6. Turning to the top row, compliance costs are estimated to range from range from $240 million to $570 million per year (equivalently, $2.4 billion to $5.7 billion over a 10 year horizon, abstracting from applying discount rates, inflation corrections or other dynamic adjustments).

Perhaps more important than the baseline numbers, however, is the incredibly complex and opaque, ad hoc, methodology and set of assumptions which were used to formulate these estimates.

For example, The DOL's cost estimates for complying with the DOL's proposed fiduciary rule rely on data submitted by SIFMA to the SEC in 2013 (the "SIFMA Data").[61] The SIFMA Data was collected and submitted by SIFMA to the SEC for the purpose of estimating the costs of complying with potential SEC fiduciary rule changes under Dodd-Frank Section 913.[62] Although the DOL states that "*there will be substantive differences between the [DOL]'s new proposal and exemptions and any future SEC regulation that would establish a uniform fiduciary standard…* ", the DOL nevertheless relies on the SIFMA Data as part of the basis for its cost estimates.[63] DOL's stated reason for doing so is that there are *"some similarities between the cost components"* in the SIFMA Data and the costs that would be required to comply with the DOL proposal.

However, the phrase "some similarities" implies there are some differences and the DOL is, by definition, unable to address the compliance costs that may arise due to such differences in the two regulatory regimes in question.

The SIFMA Data estimates the costs of implementing an SEC-established uniform fiduciary standard in two parts. The first was the cost for broker-dealers to develop and maintain

[61] Regulatory Impact Analysis, http://www.dol.gov/ebsa/pdf/conflictsofinterestria.pdf, at pp. 160 – 65.

[62] SIFMA Comment to SEC dated July 5, 2013, http://www.sifma.org/issues/item.aspx?id=8589944317.

[63] Regulatory Impact Analysis at p. 161.

a disclosure form and customer relationship guide, similar to the Form ADV Part 2A that registered investment advisors use today.

The DOL proposal does *not* require a Form ADV Part 2A-type disclosure for broker-dealers, but it would require an extensive range of new disclosure obligations that do not exist today. These include: (i) contractual disclosures under the Best Interests Contract Exemption, (ii) point of sale disclosure, including the total cost of the acquired asset over periods of 1, 5, and 10 years; (iii) annual fee and compensation disclosure; (iv) public website disclosure, including a list of all direct or indirect material compensation; and (v) aggregated data regarding inflows, outflows, holdings, and returns, including the identity and amounts of revenue received, which DOL reserves the right to publicly disclose.

The disclosure estimates in the SIFMA Data are for broker-dealers to adopt an essentially "known quantity" disclosure form that is used by advisors today. The disclosure estimates in the SIFMA Data do not address any of the new disclosure obligations in the DOL proposal. Hence it is erroneous for DOL to use SIFMA's disclosure estimates to approximate the costs of the extensive, new, separate and distinct, disclosures required under the DOL proposal.

The second part of the SIFMA Data is the estimated cost of implementing compliance oversight and training programs to adapt to a new SEC standard. In providing these estimates, SIFMA member firms were asked to make a host of assumptions. None of these assumptions, however, include the new obligations and potential liabilities that the DOL proposal may create, including: (i) new contractual liability under the Best Interest Contract Exemption, including potentially significant individual and class action litigation exposure; (ii) compliance with a new DOL exemption in order to engage in principal transactions; (iii) new restrictions on products that may be offered and sold, and (iv) the costs of creating the new data and information that are subject to the new disclosures outlined above.

In sum, the SIFMA Data applies to estimating the cost of a contemplated SEC fiduciary regime, under specific assumptions that were applied to such a contemplated SEC approach. It is not methodologically appropriate to use the SIFMA Data to estimate the cost of a separate and distinct DOL regime, with separate and distinct requirements, obligations, liabilities, and costs.

The DOL further compounds the apparent inconsistency by relying on the SIFMA Data and then suggesting that "*the SIFMA submission significantly overestimates the costs of the new*

proposal."[64] The DOL thus appears to be relying on inputs into its cost analysis that it does not view as accurate, thereby undermining the reliability of its own methodology.

Lastly, we note that the US Chamber of Commerce submitted a comment letter to the OMB on May 20, 2015 outlining their view that the Department of Labor vastly underestimated the compliance costs associated with the proposed Fiduciary rule.[65] Specifically, the Chamber states (on p. 2) that real costs associated with the information collection requests alone may be "five to ten times greater" than the DOL's estimate of $792 million over ten years. The ten-page letter goes on to detail the various shortcomings and implausible assumptions made by the DOL in their calculations.

While we will not undertake to comment on the OMB letter, it does serve to emphasize the clear shortcoming of the DOL's estimates. Namely, they are not based on a scientific or empirical approach and the resulting estimates may or may not be wildly inaccurate reflections of the true costs. As a result, it would be inappropriate to include them as part of a formal assessment of the costs and benefits of a proposed change in public policy.

[64] Regulatory Impact Analysis at p. 162.

[65] Available on-line at http://www.uschamber.com/sites/default/files/oira_comments.pdf.

Table 6
The Costs of Compliance Are Based on Complex and Opaque Set of Assumptions

Estimates found in *Fiduciary Investment Advice: Regulatory Impact*[1]

Page	Source	Amount	Horizon	Notes
(1)	(2)	(3)	(4)	(5)
157	Department of Labor Estimate	$2.4b-5.7 bil.	10 years	Total compliance cost. Cost mostly reflects the costs incurred by new fiduciary advisers to satisfy relevant PTE conditions
162	SIFMA estimate of average start up cost to develop and implement new, comprehensive supervisory systems, procedures and training	$5 mil.	one year	Estimated costs that would be incurred by broker-dealers
162	SIFMA estimate of annual on-going costs	$2 mil.	annual	
165	DOL estimated start-up cost of compliance for medium firms based on values provided by SIFMA	$663,000	one year	$5 million x (0.133). 0.133 is the estimated ratio of medium firms and large firms' cost based on figures provided for RIAs in the IAA comment letter
165	DOL estimated start-up cost of compliance for small firms based on values provided by SIFMA multiplied by DoL's ratio	$242,000	one year	5 million x (0.048). 0.048 is the estimated ratio of small firms and large firms' cost based on figures provided for RIAs in the IAA comment letter
166	DOL total estimated start-up cost of compliance in the first year	$892 mil.	one year	
165	DOL estimated on-going cost of compliance for medium firms	$265,000	annual	$2 million x 0.133 (the IAA ratio)
165	DOL estimated on-going cost of compliance for small firms	$96,900	annual	$2 million x 0.048 (the IAA ratio)
166	DOL estimated on-going cost of compliance after first year	$357 mil.	annual	
166	Estimated start-up cost of compliance for large firms based on values provided by the IAA	$1 mil.	one year	
166	DOL estimated start-up cost of compliance for medium firms based on values provided by the IAA	$145,000	one year	The DoL took the ratio between the cost SIFMA and IAA provided (.2181) and derived the costs from that ratio referred to as the

				"ADV ratio"
166	DOL estimated start-up cost of compliance for small firms based on values provided by the IAA	$53,000	one year	SIFMA estimates multiplied by ADV ratio
166	DOL total start-up cost of compliance after first year based on IAA	$195 mil.	one year	See above
166	Estimated on-going cost of compliance for large firms based on values provided by the IAA	$436,000	annual	See above
166	Estimated on-going cost of compliance for medium firms based on values provided by the IAA	$58,000	annual	SIFMA estimates multiplied by ADV ratio
166	Estimated on-going cost of compliance for small firms based on values provided by the IAA	$21,000	annual	See above
166	DOL estimated total annual ongoing costs for subsequent years based on IAA	$78 mil.	annual	See above
	Cost of Developing and Maintaining a Disclosure Form and Customer Relationship Guide			
161	SIFMA reported start-up cost for preparing a relationship guide similar to the Form ADV 2A	$2.8 mil.	one year	
161	SIFMA reported "low" start up cost	$1.2 mil.	one year	
161	SIFMA reported "high" start-up cost	$4.6 mil.	one year	
161	SIFMA reported average annual on-going cost	$631,000	annual	
	Costs Incurred by Registered Investment Advisors			
166	DoL Analysis of cost for legal consultation for small firms	$3,840	one year	Hourly rate of $480. 8 hours assumed
166	DoL Analysis of cost for legal consultation for medium firms	$7,680	one year	Hourly rate of $480. 16 hours were assumed.
166	DoL Analysis of cost for legal consultation for large firms	$19,200	one year	Hourly rate of $480. 40 hours were assumed.
167	DoL Analysis of costs of training for a large firm in the first year	$30,000	one year	
167	DoL Analysis of costs of training for a large firm after the first year	$10,000	annual	
167	DoL Analysis of costs of training for a medium firm in the first year	$4,000	one year	

167	DoL Analysis of costs of training for a medium firm after the first year	$1,500	annual	
167	DoL Analysis of costs of training for a small firm in the first year	$1,500	one year	
167	DoL Analysis of costs of training for a small firm after the first year	$1,500	annual	
167	Total cost to evaluate compliance with rule and provide training for a large RIA firm in the first year	$49,200	one year	
167	Total cost to evaluate compliance with rule and provide training for a medium RIA firm in the first year	$11,700	one year	
167	Total cost to evaluate compliance with rule and provide training for a small RIA firm in the first year	$5,300	one year	
167	Total cost to evaluate compliance with rule and provide training for a large RIA firm in the subsequent years	$10,000	annual	
167	Total cost to evaluate compliance with rule and provide training for a medium RIA firm in the subsequent years	$1,500	annual	
167	Total cost to evaluate compliance with rule and provide training for a small RIA firm in the subsequent years	$500	annual	
167	Total Cost for IRA firms in the first year	$110.8 mil,	one year	
167	Total Cost for IRA firms in the subsequent years	$11.9 mil.	annual	

Costs Incurred by Plan Service Providers

168	Start-up cost for a large firm	$49,000	one year	
168	Start-up cost for a medium firm	$12,000	one year	
168	Start-up cost for a small firm	$5,000	one year	
168	Aggregate start-up cost for training employees	$24.1 mil.	one year	
169	On-Going Costs for small firm	$10,000	annual	2,275 small service providers, 437 medium service providers, 142 large service providers
169	On-Going Costs for medium firm	$2,000	annual	
169	On-Going Costs for large firm	$1,000	annual	
169	Aggregate on-going costs for training employees, yearly	$3.2 mil.	annual	

				2,275 small service providers, 427 medium service providers, 142 large service providers
		Additional Costs		
171	Increased insurance premiums for consultants, firms and broker-dealer representatives	premiums for these affected service providers could be expected to increase 10 percent; average insurance premium is $3,000 per representative. Premium increase would be $300 per insured	N/A	DoL estimates that 50% of the cost reflects the expenses and profits of insurance carriers, while the remainder is not a cost but a transfer in the form of compensation paid to those harmed by the insured fiduciary investment adviser
172	one year premium increase for broker dealer representatives	$87 mil.	one year	290,000 broker dealers multiplied by $300
173	Cost of premiums and transfers from firms to plans or IRA investors	$63 mil.	annual	418,00 BD representatives and plan service provider employees could experience a $300 increase. 50% is paid out as compensation and 50% is paid to the insuring firm
174	First year cost for each BD representative converting to RIA status	$5,600	one year	50 hours preparing for Series 65 exam (at $106.06/hour) plus additional costs
174	Total first year cost of BD to RIA conversion	$59.4 mil.	one year	
174	Ten year cost of BD to RIA conversion	$445 mil.	ten years	
177	first year cost for producing and distributing the disclosures and subsequent compliance	$77.4 mil.	one year	
177	on-going cost for subsequent years for producing and distributing disclosures	$29.2 mil.	annual	
177	first year cost of the 6.3 million disclosures required under the new Principal Transactions PTE	$57.4 mil.	one year	
	on-going cost of the 6.3 million disclosures required under the new Principal Transactions PTE	$47.8 mil.	annual	
177	Disclosure requirements required by the amended PTE 86-128	$198,000	annual	
177	Seller's Carve-Out disclosures	$6.2 mil.	annual	Assumes 43,000 disclosures

178	The Platform Provider Carve-Out	$39,000	annual	Assumes 1,800 disclosures
178	The Investment Education Carve-Out	$121,000	annual	Assumes 2,800 disclosures
178	Total exemptions and carve-outs cost in the first year	$141.5 mil.	one year	Assumes 92.4 million additional disclosures
178	Total exemptions and carve-outs cost in the subsequent years	$83.5 mil.	annual	
178	Total exemptions and carve-outs cost in 10 years	$791.8 mil.	10 years	

Mentioned But Not Quantified

175	Increased traffic in Call Centers
176	Cost of creating or updating contracts
176	transitional impacts on the financial sector market
176	impact on asset providers
177	costs for complying with the new and amended PTEs

Sources

[1] *Fiduciary Investment Advice: Regulatory Impact Analysis*. The Department of Labor

Our work in this matter is ongoing and we may update or change our opinions as we continue our review and analysis.