

## COMMENT LETTER

March 17, 2017

# ICI Submits Comment Letter Supporting Proposed Delay of DOL Fiduciary Rule Applicability Date (pdf)

March 17, 2017 Submitted Electronically Office of Regulations and Interpretations Employee Benefits Security Administration Room N-5655 Attention: Fiduciary Rule Examination U.S. Department of Labor 200 Constitution Avenue N.W. Washington, DC 20210 Re: RIN 1210-AB79; Proposed Rule; Extension of Applicability Date Dear Sir or Madam: The Investment Company Institute<sup>1</sup> supports the Department of Labor's (the "Department") proposed 60-day delay of the applicability date of the Department's fiduciary rulemaking.<sup>2</sup> The Department's proposal is in response to an order by the President directing it to engage in a comprehensive review of the final rule and related exemptions and to determine whether the rule may adversely affect the ability of Americans to gain access to retirement information and financial advice.<sup>3</sup> 1 The Investment Company Institute (ICI) is a leading global association of regulated funds, including mutual funds, exchange-traded funds (ETFs), closed-end funds, and unit investment trusts (UITs) in the United States, and similar funds offered to investors in jurisdictions worldwide. ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of funds, their shareholders, directors, and advisers. ICI's members manage total assets of US\$18.9 trillion in the United States, serving more than 95 million US shareholders, and US\$1.6 trillion in assets in other jurisdictions. ICI carries out its international work through ICI Global, with offices in London, Hong Kong, and Washington, DC. 2 The Department issued a final regulation defining who is a fiduciary of an employee benefit plan under the Employee Retirement Income Security Act of 1974 (ERISA) or an individual retirement account (IRA) under section 4975 of the Internal Revenue Code (Code), as a result of giving investment advice to a plan or its participants or beneficiaries, or an IRA or IRA owner. 81 Fed. Reg. 20946 (April 8, 2016). The applicability date of the final rule is April 10, 2017. The proposed delay was published at 82 Fed. Reg. 12319 (March 2, 2017). 3 See White House memorandum to the Secretary of Labor, dated February 3, 2017 and published at 82 Fed. Reg. 9675 (February 7, 2017), available at <https://www.whitehouse.gov/the-press-office/2017/02/03/presidential-memorandum-fiduciary-duty-rule>. Department of Labor March 17, 2017 Page 2 of 25 The proposed 60-day delay is supported by the record. Further, any potential "lost benefits" associated with the delay—including the Department's highly speculative foregone gains to affected retirement investors—are well justified by the avoidance of disruption to those investors that would be caused if the rule is not delayed. These disruptions include, for many retirement savers, lack of access to investment advice and severe limits in choice of investment products and service providers. We urge the Department to extend the delay beyond 60 days in order to

limit further market disruptions that will serve to harm these very investors. The Department should synchronize the applicability date with the timing of the Department's determination of whether to rescind or modify the final rule. If the Department determines not to rescind or modify the rule, for example, the applicability date should not be set until a date one year after any such determination by the Department. Set forth below are the Institute's responses to the questions raised by the Department relating to the proposed delay. Following an introduction and summary in Section I, the letter in Section II explains why the Regulatory Impact Analysis published on April 8, 2016 ("2016 RIA") is not a reliable indicator of potential losses from the proposed 60-day delay of the applicability date, and that the delay is necessary to avoid market disruptions that will harm retirement savers. In Sections III and IV, we discuss why delaying only certain portions of the final rule will not alleviate the disruptions described in Section II, and we explain why the length of the delay should correspond to the timing of the Department's ultimate determination regarding the final rule's status.

I. Introduction and Summary of Key Points. The Department has concluded that the comprehensive review of the fiduciary rule mandated by the President may not be completed before the rule's fast-approaching April 10, 2017 applicability date.<sup>4</sup> Because the Department's examination—which is required by the President's directive—could lead to the decision to rescind or revise the rule, the Department is proposing to delay the applicability date of the final rule and exemptions for 60 days to avoid unnecessarily disrupting the marketplace. Common sense advises that delaying the applicability date to allow the Department to carry out its mandated review is necessary to avoid substantial market disruptions in the event the Department reverses course a short time thereafter. Nonetheless, the Department considers the proposed 60-day delay to be subject to the requirements applicable to a "significant" regulatory action,<sup>5</sup> and has therefore 4 82 Fed. Reg. 12319 at 12320. 5 The Department states in the preamble to the notice proposing the delay that the Office of Management and Budget has determined that the proposed rule is economically significant within the meaning of section 3(f)(1) of Executive Order 12866, because it likely would have an effect on the economy of \$100 million in at least one year. See proposal to delay at 82 Fed. Reg. 12319 at 12320. Executive Order 12866 (see 58 Fed. Reg. 51735 (October 4, 1993)) is well understood to govern the rulemaking process and provides that Federal agencies should promulgate only such regulations as are required by law, are necessary to interpret the law, or are made necessary by compelling public need. In Executive Order 13777, issued on February 24, 2017, the current Administration instructed the Regulatory Reform Officer of each agency to ensure that the Department of Labor March 17, 2017 Page 3 of 25 asked for comment on the potential negative effect of the proposed delay on retirement investors. The Department has also asked for comment on the effect of the delay on compliance costs and whether a different delay period would best serve the interests of investors and the industry. As an organization with established research capabilities,<sup>6</sup> the Institute is well-positioned to evaluate the effects of a 60-day delay in the applicability date of the final rule. As discussed in detail below, there is ample justification for the Department's proposed delay. Simply put, the losses for retirement investors that the Department estimates could result from the 60-day delay are not only highly speculative, but illusory. The estimate of losses is based on the premise that the fiduciary rule will create benefits for retirement investors. In fact, the rule imposes substantial costs (as discussed further below) that would outweigh and absorb any supposed benefit. Delaying the rule thus creates benefits—not losses—for investors. The key points supporting this conclusion are as follows: • "Uncertain and incomplete" estimates of foregone gains do not weigh against delay. The Department uses data derived from the 2016 RIA to illustrate claims of potential investor losses if the rule does not go into effect, and thus potential harm to investors (in the form of "foregone gains") resulting from the 60-day delay. Based on this data, the Department states that the

60-day delay “could lead to a reduction in those estimated gains of \$147 million in the first year and \$890 million over 10 years using a three percent discount rate” (or an annualized “\$104 million using a three percent discount rate and \$87 million using a seven percent discount rate”).<sup>7</sup> By the Department’s own admission, the “illustration is uncertain and incomplete.”<sup>8</sup> But, even more damaging, the 2016 RIA on which the illustration is derived is inaccurate and woefully incomplete. Indeed, because the 2016 RIA’s benefit calculation is not supported by agency follows Executive Order 12866 in its regulatory reforms. It would be nonsensical to apply the requirements of Executive Order 12866 in the abstract and without reference to the Administration’s directive that the Department engage in a comprehensive review of the final rule and potentially propose rescinding or modifying it. <sup>6</sup> The Institute serves as a source for statistical data on the investment company industry and conducts public policy research on fund industry trends, shareholder characteristics, the industry’s role in U.S. and international financial markets, and the retirement market. For example, the Institute publishes reports focusing on the overall U.S. retirement market, fees and expenses, and the behavior of defined contribution plan participants and IRA investors. In its research on mutual fund investors, IRA owners, and 401(k) plan participants, the Institute conducts periodic household surveys that connect directly with investors. <sup>7</sup> 82 Fed. Reg. 12319 at 12320. It is not clear how the Department arrived at these numbers. Our calculations show the equivalent annualized estimates of the Department’s estimated gain at \$75 million using a 3 percent discount rate and \$64 million using a 7 percent discount rate. <sup>8</sup> *Id.* Department of Labor March 17, 2017 Page 4 of 25 the very studies on which it is based, estimates based on the 2016 RIA are also unreliable and of little relevance to assessing the potential impact of the delay on retirement investors. • Implementation costs significantly exceed the Department’s speculative and uncertain estimates of foregone gains. Even taking the Department’s “uncertain and incomplete” calculations at face value (which, as we discuss below, is not supportable), those figures are small in comparison to the Department’s own estimates of the fiduciary rule’s implementation costs. The Department estimates that implementing the rule will cost \$5 billion in the first year of the final rule’s application.<sup>9</sup> A significant amount of that cost will necessarily be incurred in the initial stages of the rule’s applicability. Thus, the Department’s estimated foregone gains in the first year after a 60-day delay —\$147 million—is heavily outweighed by first-year implementation costs of \$5 billion. Further, the Department acknowledges that the foregone gains calculation is highly uncertain, while by contrast the significant implementation costs that industry participants will incur if the rule is not delayed are indisputable. For this reason, the impact calculation weighs heavily in favor of delaying implementation so that the Department can further study the data and more fully consider how the final rule could limit retirement savers’ access to guidance, products, and services, or how such limits could affect savers—particularly lower- and middle-income savers with smaller account balances. These very effects, as discussed below, are already being manifest in the retirement marketplace. Moreover, the Department’s implementation cost estimate does not include sunk costs resulting from the failure to delay if the final rule is ultimately modified or rescinded. Such sunk costs will be significant and unrecoverable. As explained below, sunk costs relating to only one segment of product changes—the creation of T shares—could reach \$94 million. • The basis for estimated foregone gains is unfounded and not supported by data. Beyond the clear discrepancy between estimated implementation costs and speculative foregone gains that substantiate the need for the delay, the Institute has shown in a number of letters to the Department that its benefits calculations are fundamentally flawed.<sup>10</sup> The 2016 RIA does not <sup>9</sup> We believe that compliance costs will far exceed the Department’s estimate in the 2016 RIA. The Department did not include any estimate for the amount that asset providers, including mutual funds, will spend to come into compliance. See 2016 RIA at p.

244. Our members tell us that they have already spent a substantial amount. As described in the text accompanying footnote 58, we estimate that they will spend an additional \$94 million just to implement T shares. 10 See, for example, letter from Brian Reid and David W. Blass, to Office of Regulations and Interpretations, Employee Benefits Security Administration, U.S. Department of Labor (July 21, 2015) (“ICI Letter”), available at [https://www.ici.org/pdf/15\\_ici\\_dol\\_fiduciary\\_reg\\_impact\\_ltr.pdf](https://www.ici.org/pdf/15_ici_dol_fiduciary_reg_impact_ltr.pdf); supplemental letter from Brian Reid and David W. Blass, to Office of Regulations and Interpretations, Employee Benefits Security Administration, U.S. Department of Labor (September 24, 2015) (“ICI Supplemental Letter”), available at [https://www.ici.org/pdf/15\\_ici\\_dol\\_ria\\_comment.pdf](https://www.ici.org/pdf/15_ici_dol_ria_comment.pdf); and Department of Labor March 17, 2017 Page 5 of 25 provide an adequate basis for the supposition—on which the Department’s loss calculation is based—that broker-sold funds in fact do “underperform” by the 50 to 100 basis points the Department claims. The Institute has shown that, even if one accepts the 2016 RIA’s methodology, its misapplication of academic research means that the 2016 RIA overstated the estimated benefits of the final rule by 15 to 50 times.<sup>11</sup> Applying that factor to the Department’s estimate of foregone gains caused by a 60-day delay results in adjusted estimates of just \$2.94 million to \$9.8 million—heightening the vast gulf between these “losses” and the \$5 billion implementation costs of the final rule. • Calculation of potential benefits from final rule ignores societal costs. The 2016 RIA’s analysis is fundamentally flawed in another way. The Department’s calculation of benefits from the final rule is based essentially upon an assumption that investors could earn greater returns by moving from front-load shares.<sup>12</sup> But it did not add to its calculation the costs of mistakes made by investors who lose advice, or the additional costs investors who seek advice will bear from moving to fee-based advisers. The Institute has estimated that these costs would far outweigh potential benefits from moving to fee-based advisers. Although our concerns were dismissed by the Department in issuing the final rule, the pending application of the final rule is already having a consequential impact on the marketplace in the manner that we predicted. As widely reported, intermediaries have announced a variety of changes to service offerings, including no longer offering mutual funds in brokerage IRA accounts and raising account minimums or discontinuing advisory services and commission-based arrangements for lower balanced accounts.<sup>13</sup> In light of direct evidence of the rule’s impact, the Institute’s prior submissions regarding the negative effects on investors of the final rule should be incorporated in any analysis of the delay’s effect on retirement investors. Our estimates, as detailed in comment letters to the Department,<sup>14</sup> indicate that investors could lose supplemental letter from Brian Reid and Sean Collins, to Joseph Piacentini, Director, Office of Policy and Research & Chief Economist, Employee Benefits Security Administration, U.S. Department of Labor (December 1, 2105) (“ICI Letter to Joseph Piacentini”), available at [https://www.ici.org/pdf/15\\_ici\\_dol\\_ria\\_comment\\_supp.pdf](https://www.ici.org/pdf/15_ici_dol_ria_comment_supp.pdf). These letters respond to the RIA supporting the Department’s proposed rule. However, because the RIA supporting the final rule was largely unchanged, the analysis in our letters applies to the final rule’s RIA. 11 While the Department disputes the significance of this analysis in the 2016 RIA, that criteria is based on a clear misunderstanding and misapplication of the Institute’s arguments. See text accompanying footnotes 35 through 37, *infra*. 12 2016 RIA at p. 9. 13 See “A Complete List of Brokers and Their Approach to ‘The Fiduciary Rule’”, Wall Street Journal, February 6, 2017, available at <https://www.wsj.com/articles/a-complete-list-of-brokers-and-their-approach-to-the-fiduciary-rule-1486413491>. See also *infra*, footnotes 49, 50, and 51. 14 See footnote 10, *infra*. Department of Labor March 17, 2017 Page 6 of 25 \$109 billion over 10 years because of the rule’s implementation. This would amount to \$780 million per month in losses to investors.<sup>15</sup> A 60-day delay would thus save investors \$414 million in lost returns over the first year if the rule ultimately goes forward as now structured (at a 3 percent discount

rate).<sup>16</sup> These lost returns far exceed the Department's estimated \$147 million foregone gains—gains that as noted above, are vastly overstated. Our analysis demonstrates that the tangible benefits of delaying the applicability date, both for retirement savers and for providers of retirement services, far outweigh any estimated costs of delay. Far more important, a delay is urgently needed to allow for a thoughtful and appropriate review by the Department to re-examine the final rule and prepare an updated economic and legal analysis as directed by the President. The admitted uncertainties associated with the 2016 RIA strongly support the need for such a comprehensive reexamination. We believe that this review will demonstrate that the rule is inconsistent with the President's stated priorities of empowering Americans to make their own financial decisions and facilitating their ability to save for retirement and build the individual wealth necessary to afford typical lifetime expenses. The Department's reassertion of speculative foregone benefits with little basis in fact or theory should not serve as a barrier to the need for such thoughtful review.

II. The Department Must Delay the Applicability Date to Avoid Untenable Market Disruptions that Will Negatively Affect Retirement Savers. In evaluating the impact of the 60-day delay, we have considered the basis for the Department's conjecture that the delay could lead to losses in the form of foregone gains for retirement investors who follow affected recommendations, and these losses could continue to accrue until affected investors withdraw affected funds or reinvest them pursuant to new recommendations.<sup>17</sup> Here, the Department attempts to illustrate such potential losses by using data derived from the 2016 RIA that it says support claims of investor gains resulting from the final rule. Based on this data, the Department states that the 60-day delay "could lead to a reduction in those estimated gains of \$147 million in the first year and \$890 million over 10 years using a three percent discount rate." It goes on to state that "[t]he equivalent 15 This is calculated as the monthly payment required over a 10-year period at a discount rate of 3 percent to achieve a future value of \$109 billion at the end of 10 years. 16 This is calculated by first calculating the present value of \$109,000 million (i.e., \$109 billion) discounted at a 3 percent annual rate over 120 months (12 months x 10 years). This results in a figure of \$80,779 million, which is the present value of the \$109,000 million lost over 10 years if the rule is implemented on the applicability date April 10, 2017. The present value of \$80,779 million deferred two months (60 days) into the future at an annual discount rate of 3 percent is \$80,376 million. The difference between the two figures is \$403 million. At an annual rate, that amounts to \$414 million (at a 3 percent interest rate).

17 82 Fed. Reg. 12319 at 12320. Department of Labor March 17, 2017 Page 7 of 25 annualized estimates are \$104 million using a three percent discount rate and \$87 million using a seven percent discount rate.<sup>18</sup> The Department acknowledges that such estimates of potential investor foregone gains presented by the illustration are derived in the same way as the estimates of potential investor gains that were presented in the 2016 RIA, noting that the estimates "make use of empirical evidence that front- end-load mutual funds that share more of the load with distributing brokers attract more flows but perform worse."<sup>19</sup> The Department further states that "[r]elative to the actual impact of the proposed delay on retirement investors, which is unknown, this illustration is uncertain and incomplete," explaining that the illustration "assumes that the final rule and exemptions would entirely eliminate the negative effect of load-sharing on mutual fund selection, and that the proposed delay would leave that negative effect undiminished for an additional 60 days."<sup>20</sup> Accordingly, the Department explains that "the impact of the proposed delay would be smaller than illustrated here" if either or both (a) the claimed negative effect was not completely eliminated under the final rule, and (b) if market changes in anticipation of the final rule have already diminished that negative effect.<sup>21</sup> The Department also observes that "[t]he illustration is incomplete because it represents only one negative effect (poor mutual fund selection) of one source of conflict (load sharing), in one market

segment (IRA investments in front-load mutual funds).”<sup>22</sup> The Department invites comments on these points and on the degree to which they may cause the illustration to overstate or understate the potential negative effect of the proposed delay on retirement investors. And, the Department also asks whether entities are subject to the current regulation, but might not be subject to the same sort of regulation under a revised proposal, the industry might avoid additional costs now that would otherwise become sunk costs. There are two fundamental problems with the Department’s 60-day foregone gains estimate and its inquiry as to whether that estimate might possibly understate the potential negative effect of the proposed delay on retirement investors. First, the 60-day estimate is based on estimates and the methodology from the 2016 RIA, which was itself based on flawed assumptions, resulting in a gross 18 Id. The Department provides too little detail to determine how it arrived at these estimates. 19 Id. 20 Id. 21 Id. 22 Id. For example, the 2016 RIA makes clear that the studies that it relied on in concluding that broker-sold funds “underperform” found no correlation between revenue sharing and/or 12b-1 fees and poor performance. In fact, as already acknowledged by the Department, the primary study upon which it relies concludes the opposite. See 2016 RIA at pp. 176- 177 (Christoffersen, Evans, and Musto “find load sharing, but not revenue sharing, to predict poor performance”). Department of Labor March 17, 2017 Page 8 of 25 overstatement of the potential benefits of the final rule to consumers.<sup>23</sup> Second, as noted by the Department, the loss estimate derived from the 2016 RIA “represents only one negative effect (poor mutual fund selection) of one source of conflict (load sharing), in one market segment (IRA investments in front-load mutual funds).”<sup>24</sup> In fact, the 2016 RIA failed to include analysis showing the predictable negative impacts on retirement savers, particularly on small account holders, including more limited product choice, a move to more expensive asset-based fee arrangements, and an increase in account minimums for commission-based accounts. As detailed in our prior comment letters, correcting for the many errors and omissions in the RIA, we found that investors could lose \$109 billion over 10 years because of the rule’s implementation. This would amount to \$780 million per month in losses to investors, which in turn implies a first-year loss of \$414 million if the rule is not delayed by 60 days. Finally, as discussed below, sunk costs resulting from the failure to delay if the final rule is ultimately modified or rescinded will be significant and beyond recovery. As explained below, sunk costs relating to only one segment of product changes—the creation of T shares—could reach \$94 million.<sup>25</sup> A. The Department Should Not Rely on the Estimate of Investor Losses from the 2016 RIA as an Indicator of Potential Losses that Would Result from Delay. The Department requests comment on the degree to which the incomplete nature of the 2016 RIA may cause the Department’s 60-day loss estimate “to overstate or understate the potential negative effect of the proposed delay on retirement investors,<sup>26</sup> Significantly, however, Department’s query is based on a misguided premise—the notion that the 2016 RIA should serve as a starting point for its analysis. Indeed, because the 2016 RIA’s benefit calculation is inaccurate and woefully incomplete, estimates based on the 2016 RIA are also unreliable and of little relevance to assessing the potential impact of the delay on retirement investors. 23 ICI has submitted several comments describing in detail the significant problems in the Department’s RIA. See footnote 10 supra. 24 82 Fed. Reg. 12319 at 12320. 25 See text accompanying footnote 58, infra. 26 82 Fed. Reg. 12319 at 12321. Department of Labor March 17, 2017 Page 9 of 25 1. The 2016 RIA’s finding on the impact of load sharing is not supported either by the academic research it cites or by more recent market data. The Department acknowledges that the 2016 RIA conclusion that broker-sold funds “underperform” is based on a limited assessment “of one source of conflict (load sharing), in one market segment (IRA investments in front-load mutual funds).”<sup>27</sup> But beyond these limitations, the conclusion of underperformance in the range of 50 to 100 basis points suffers from the fact that the one negative effect it claims to show

(significant poor mutual fund selection by brokers) is not supported by the data. Our original comment letter to the Department identified several significant flaws in the RIA supporting the proposed rule.<sup>28</sup> As we explained, rather than conducting its own investigation of current, publicly available data to assess how its rule might affect fund investors, the Department turned to academic studies in an effort to find evidence supporting its rulemaking. In our comment letters, we identified several problems with the Department's application of the findings in such studies. First, none of these academic studies actually compares the outcomes of investing with a financial adviser that is a fiduciary to the outcomes of investing with a broker or other financial adviser that is not a fiduciary. Thus, the findings of underperformance cited in the 2016 RIA do not actually measure—and cannot measure, based on these studies—whether an investor using a fee-based ERISA fiduciary adviser would experience a different investment outcome than an investor using another financial adviser that is not an ERISA fiduciary. Instead, these studies seek to measure indirectly how investors fare when receiving assistance from financial professionals who are not fiduciaries, by comparing the performance of funds sold through brokers (“broker-sold” funds) with that of funds sold directly to investors (“direct-sold” funds). The 2016 RIA's inference is that any difference in performance by investors using brokers could be the result of the brokers' conflicts of interest. That, however, is not a direct test of the outcomes of using a financial professional that is not a fiduciary (as compared with using one that is a fiduciary). We further cautioned against using such a theory as a basis for the expansive regulatory action in the absence of testing it against actual investor experience. Second, the 2016 RIA ignores the fundamental transformation in the mutual fund markets. Most of the studies that the RIA cites measure the relative performance of broker-sold funds using data from the 1990s and early 2000s.<sup>29</sup> Reliance on these studies ignores significant changes in the mutual fund market.<sup>27</sup> 82 Fed. Reg. 12319 at 12320. 28 See ICI Letter and ICI Supplemental Letter, at footnote 10, *supra*. 29 See, for example, Daniel Bergstresser, John Chalmers, and Peter Tufano. “Assessing the Costs and Benefits of Brokers in the Mutual Fund Industry.” *Review of Financial Studies* 22, no. 10 (2009): 4129-4156; Diane Del Guercio, and Jonathan Department of Labor March 17, 2017 Page 10 of 25 fund markets that have led to significant head-to-head competition between broker-sold funds and no-load funds. For example, in 2000 only about half of the funds with a front-end load share class also had no-load share classes.<sup>30</sup> By 2010, however, 90 percent of funds with a front-end load share class also offered a no-load share class. These no-load share classes are available on investment-only 401(k) platforms, at discount brokerages, and through fee-based advisory firms. This head-to-head competition between broker-sold funds and no-load funds has transformed the market for mutual funds. A third challenge previously identified in our comment letters is that most of the studies the 2016 RIA cites do not assess the performance of investors using broker-sold funds on an asset-weighted basis. Most of the studies look only at individual fund performance. We explained that asset-weighted and sales-weighted returns provide a superior measure of overall market impact by showing how the average dollar invested with a broker-sold fund performs. Another reason for using asset- or sales-weighted returns is that the Department seeks to measure the final rule's impact on a market-wide basis. Asset- or sales-weighted measures of performance are necessary to make such calculations. Finally, the Institute questioned the Department's interpretation and use of a coefficient estimate in a study that is a linchpin of Department's impact analysis.<sup>31</sup> As discussed in detail in our comment letter,<sup>32</sup> the Department's conclusions of underperformance rest heavily on a paper by Christoffersen, Evans, and Musto (2013) (“CEM”), which the Department misapplies. The Department's misapplication presents a false impression of the relationship between fund performance and the payments of front-end loads to brokers (what CEM call “load sharing”). We explained that the CEM approach indicates that a subset of funds—those with

above-average front-end load sharing payments to brokers—underperformed the average return of their fund category during the next year. The Department, based on an incorrect assumption that all IRA assets that are invested in front-end load funds suffer the same underperformance, erroneously applies this result from a subset of load funds to all load funds. Once these errors are corrected, the Department’s sweeping statements about brokers’ incentives and investor harm collapse. Reuter. “Mutual Fund Performance and the Incentive to Generate Alpha.” *Journal of Finance* 69, no. 4 (2014): 1673-1704; and Christoffersen, Evans, and Musto (2013). 30 Throughout the ICI Letter, we exclude money market funds, variable annuities, and funds of funds. Money market funds constitute less than 0.1 percent of front-end load fund assets at year-end 2014. Including funds of funds would have created double counting in some of analysis, so we excluded them in all of the analysis. Funds of funds account for 6.6 percent of the front-end load fund assets. 31 Susan Christoffersen, Richard Evans, and David Musto. “What Do Consumers’ Fund Flows Maximize? Evidence from Their Broker’s Incentives.” *Journal of Finance* 68 (2013): 201-235 (“CEM”). 32 See ICI Letter at pp. 13-15. Department of Labor March 17, 2017 Page 11 of 25 In the 2016 RIA, the Department rejected the Institute’s critique of the RIA’s claims of a clear demonstration that funds sold with front-end loads underperform. In doing so, the Department stated that the Institute’s analysis “is not a direct measure of the impacts of conflicts of interest on investment performance,” that ICI’s “treatment of all broker-sold mutual funds in a single analysis likely obscures meaningful differences in underperformance across different types of broker-sold funds,” and that the “time-horizon for estimating the underperformance of broker-sold mutual funds likely renders their [ICI’s] estimates less reliable than if they had chosen a longer time horizon.”<sup>33</sup> The Department bases its critique in part on a supplemental comment letter from the CEM authors responding to the Institute’s interpretation of their results. In that letter, Christoffersen and Evans challenge some of the statements in our comment letter. They note, for example, that they included fund assets in their key regressions and “effectively the variances in the regression are asset- weighted.”<sup>34</sup> Our point, however, was not about the results in the CEM paper, which stand on their own merits. Rather, it was about how the Department misapplied results from that paper. We discussed at length the Department’s critique of our work in a supplemental letter to the Department.<sup>35</sup> That supplemental letter provides detail on how the Department misapplies a coefficient from the CEM study in its calculating the economic impact of the final rule. The coefficient measures the response of the excess return on a broker-sold fund to the fund’s “excess load,” which CEM measure as the difference between the front-load fee that a fund pays to a broker (what CEM call “load sharing”) and the front-load fee that one would expect the fund to pay the broker, as predicted by regression results in the CEM study (which for clarity we call “residual load shared”). Thus, the magnitude of any fund’s “residual load shared” is typically much smaller than the total front-load that a fund actually pays to (shares with) brokers. The Department erred by applying the coefficient to the total front-load paid to brokers rather than to the residual load paid to brokers, vastly inflating the Department’s estimate of the benefit of its proposed regulation. Figure 1 illustrates this problem. The figure show actual data on load funds’ assets and their residual loads for 2013.<sup>36</sup> The horizontal axis shows the residual loads shared attributable to various 33 2016 RIA at p. 164. 34 2016 RIA at p. 348, referencing letter from Christoffersen and Evans, Office of Exemption Determinations, Employee Benefits Security Administration, U.S. Department of Labor (Sept. 10, 2015), available at <https://www.dol.gov/sites/default/files/ebsa/laws-and-regulations/rules-and-regulations/public-comments/1210-AB32-2/02766.pdf>. 35 See ICI Letter to Joseph Piacentini, at footnote 10, *supra*. 36 Our supplemental letter applied the CEM framework to mutual fund data reported to the Securities and Exchange Commission (SEC) on Form N-SAR for the most recent four



years (2010 to 2013) that were available to us at the time the letter was written in late 2015. Department of Labor March 17, 2017 Page 12 of 25 funds. Funds with residual loads shared of greater than zero are those the CEM approach would characterize as having greater-than-average loads shared, after controlling for other factors. Funds with residual loads shared of less than zero are those the CEM approach would characterize as having below-average loads shared after controlling for other factors. The height of the bars shows the proportion of assets held in load share classes bucketed according to their residual loads shared as of 2013. Thus, for example, the figure shows that in 2013, about 20 percent of the assets in front-end load share classes had a residual load shared of about zero. Figure 1 How the 2016 RIA Misapplied Academic Research, Leading the RIA to Vastly Overstate Any Potential Benefits from its Fiduciary Rule Percent of total assets in front-load share classes, bucketed by "residual load shared," 2013 Sources: Investment Company Institute and Strategic Insight Simfund Figure 1 presents a concrete example of the error the Department commits in the 2016 RIA using 2013 data. It applied a residual load shared of +1.50 percent to 100 percent of the IRA assets it estimated to be in front-load share classes in 2013. This, as the figure demonstrates, is simply untenable. As can be seen in the figure, for the year 2013, virtually none of the assets in front-load share classes (whether IRA assets or otherwise) fall into the bucket with a residual load shared of 1.50 percent. Thus, what the Department did was to assume that a very high residual load shared (+1.50 percent) applied to 100 percent of IRA assets in front-load funds, when in fact it should have assumed that virtually none of the IRA assets in front-load funds had a residual load shared anywhere close to that level. This led the Department to overstate its benefits estimates by 15 to 50 times.

0 10 20 30 40 50 60 70 80 90 100  $\leq -1.50$  -0.50 -0.40 -0.30 -0.20 -0.10 0 0.10 0.20 0.30 0.40 0.50 1.50 Residual load shared with (i.e., paid to) brokers by funds with front-end load share classes (as a percentage of load sales) What the DOL assumed Department of Labor March 17, 2017 Page 13 of 25 In short, the Department has provided no evidence that leads us to alter our views that the both the 2015 RIA and 2016 RIA misapplied the results of the CEM study, leading the Department to overstate its benefits estimates by 15 to 50 times. We also stand by the view that any benefit study, done properly, needs to consider the costs to investors who will lose advice or will pay more under an asset-based fee approach. Until the DOL presents figures that factor in these considerations, the benefit calculations in the RIA must be taken as tenuous at best. 2. Investors' actual experience with broker-sold funds contradicts the 2016 RIA finding. Given the RIA's flawed analysis, the Institute analyzed the recent performance of fund investors in broker-sold funds. As discussed below, our findings contradict the 2016 RIA's "underperformance" claims. As we previously shared with the Department, the Institute found that front-end load funds have recently outperformed the average fund with the same investment objective. We also compared returns of front-end load funds to those of retail no-load funds.<sup>37</sup> For that comparison, we noted that to ensure commensurable return measures, it is necessary to adjust for 12b-1 fees, because investors who want advice services will have to pay for those services whether they use a broker or a financial adviser that is an ERISA fiduciary. It is also necessary to weight returns by either sales or assets to determine whether investors were skewing their purchases or holdings toward lower-cost funds. We found that on a commensurable basis over the period 2008-2014, the returns investors earned on front-end load funds were just 6 to 7 basis points lower than the returns investors earned on retail no-load funds, less than one-tenth the 100 basis point "underperformance" that the 2016 RIA asserts.<sup>38</sup> 37 ICI Letter at p. 16. 38 ICI Letter at p. 21. Department of Labor March 17, 2017 Page 14 of 25 Figure 2 Three-Year Returns on Front-End Load Share Classes and Retail No-Load Share Classes Relative to Their Morningstar Category Returns Average adjusted for 12b-1 fees, percent; selected periods ICI sales-weighted average Morningstar asset-weighted average Year of sales/assets Years

of returns Front-end load Retail no- load Front-end load Retail no-load 2007 2008–2010 0.15 0.00 0.44 0.47 2008 2009–2011 0.30 0.60 0.30 0.58 2009 2010–2012 0.37 0.37 0.46 0.57 2010 2011–2013 0.62 0.65 0.85 0.79 2011 2012–2014 0.64 0.73 0.90 0.90 2012 2013–2015 0.64 0.65 0.86 0.92 2013 2014–2016 0.59 0.83 0.81 1.05 Average: 2007–2013 2008–2016 0.46 0.56 0.67 0.78

Note: The relative return is calculated by taking the three-year return of a share class of a fund (net of expenses) less the three-year return on the share class's Morningstar category (net of expenses) for each year from 2010 through 2016. These relative returns are then matched to their three-year prior gross sales or assets. For example, the 2007 sales-weighted averages report the three-year relative return for the period 2008–2010 weighted by gross sales in 2007. The analysis includes equity, balanced, and bond mutual funds with at least one share class with a front-end load, excluding mutual funds available as investment choices in variable annuities and mutual funds that invest primarily in other mutual funds. Sources: Investment Company Institute and Morningstar

As we explained, the reason for focusing on the more recent time period (i.e., a period beyond the 2000 to 2009 time period covered by the studies relied upon by the Department) is that the mutual fund market has changed significantly in the past twenty years.<sup>39</sup> The 2016 RIA rejected our analysis, apparently on the view that we had used too short a period of fund returns: the “time-horizon for estimating the underperformance of broker-sold mutual funds likely renders their estimates less reliable than if they had chosen a longer time horizon.”<sup>40</sup> To alleviate this concern, we have updated our analysis using fund returns for two additional years, 2015 and 2016 (Figure 2). The last line in the figure (“Average”) shows that with nine years of return data (2008 to 2016), front-end load share classes underperformed retail no-load share classes by only 10 to 11 basis points (based on the calculation 0.46 39 Our analysis begins in 2007 because the shift to direct competition between broker-sold and direct-sold funds continued to occur in the mid-2000s. 40 2016 RIA at p. 164. Department of Labor March 17, 2017 Page 15 of 25 percent less 0.56 percent on a sales-weighted basis and 0.67 less 0.78 on an asset-weighted basis), only a bit higher than the 7 basis points we reported on the basis of 2008 to 2014 returns data. In short, these figures, updated and using nearly a full decade of the most recently available return data, continue to show that the RIA’s claim of 100 basis points of underperformance is untenable. Similarly, in a recent paper, Jonathan Reuter, revisits the performance of broker-sold and direct- sold mutual funds using distribution channel data that cover 2003–2012.<sup>41</sup> He reports results, consistent with the Institute early statements to this effect, indicating that “the average broker-sold fund has become more competitive with the average direct-sold fund.” Notably, he reports that broker- sold funds underperformed direct-sold funds (measured across all types of actively managed funds excluding municipal funds and adjusting for 12b-1 distribution fees) by only 18 basis points over the period 2003–2012 on an asset-weighted basis. This is a bit higher than the 11 basis we report in Figure 2, but still less than one-fifth of the 100 basis point underperformance assumed in the 2016 RIA. In conclusion, our analysis based on data over an even longer time horizon shows that the experience of investors in front-end load funds since 2007 is dramatically different from the 2016 RIA’s description of the experience of investors using front-end load funds. We find no evidence to support the 2016 RIA’s assertion that there is a “substantial failure of the market.”<sup>42</sup> As we describe in our prior comment letters—and despite the efforts of the Department to claim otherwise—these results invalidate the 2016 RIA’s assertion that the typical investment in a broker-sold fund underperforms by 100 basis points. In turn, that claim of 100 basis-point underperformance is the foundation for the Department’s prior claim that, in the absence of the final rules, investors in front-end load funds will lose \$500 billion to \$1 trillion in foregone returns during the next 20 years.<sup>43</sup> In fact, that claim is mere hyperbole, unsupportable by the data. As such, the Department should not rely on this estimate of potential foregone gains as an indicator of potential losses that would result

from the proposed 60-day delay. B. Market Disruptions Caused by a Failure to Delay Would Be Significant and Costly to Investors. The 2016 RIA fails as a reliable indicator of costs and benefits to retirement investors in another important way. It provides little data or other information on the benefits stemming directly or 41 See Jonathan Reuter, "Revisiting the Performance of Broker-sold Mutual Funds," working paper, Boston College and NBER, November 2, 2015, ("Reuter") available at [https://www2.bc.edu/jonathan-reuter/research/brokers\\_revisited\\_201511.pdf](https://www2.bc.edu/jonathan-reuter/research/brokers_revisited_201511.pdf). 42 See 2016 RIA at pp. 9, 96, 158, and 326. 43 Id. Department of Labor March 17, 2017 Page 16 of 25 indirectly from the source of conflict (e.g., load sharing) that it seeks to eliminate. For example, given the Department's identification of front-end loads as creating a potential conflict, it also should have identified and analyzed the benefits to investors of advice or information provided to them by the broker-dealers who receive those fees (for example, through the greater availability of guidance, diverse product offerings, educational tools, and information generally). The Department also should have provided data and other information showing the extent to which limiting access of IRA customers to services provided by persons or financial services firms who are paid indirectly (for example, through commissions)—a likely result of the final rule—would eliminate or otherwise impede IRA customer access to such accounts, products, services, and relationships (for example, through higher costs and account minimums). Such data findings should be segmented by account size, and income levels. Simply put, the 2016 RIA's one-sided perspective creates a significant gap in the Department's analysis and offers little analysis of the limits on future access to guidance, products, and services resulting from the Department's rulemaking. In our prior comment letters, we predicted specific negative effects that the final rule would have on retirement savers, particularly on small account holders. Those harms include more limited product choice, a move to more costly asset-based arrangements, and an increase in account minimums for commission-based accounts. The Department dismissed these concerns in the 2016 RIA, noting that the Institute's "estimates of costs to investors of having to pay more for and/or losing financial advice are based on unsupported assumptions that are contradicted by information provided by other commenters."44 Although these predictions were dismissed by the Department, the pending application of the final rule is already having a consequential impact on the marketplace in the manner that we predicted. As has been widely reported, several large intermediaries have announced a variety of changes to service offerings, including firms announcing that they will no longer offer mutual funds in brokerage IRA accounts; others no longer offering any IRA brokerage accounts at all; firms reducing web based financial education tools; and others announcing that account minimums will be raised or that advisory services for lower balanced accounts will be discontinued.45 In light of direct evidence that the final rule is having the impact that ICI predicted, the Institute's prior submissions regarding the negative effects on investors from the final rule should be incorporated in any analysis of the delay's effect on retirement investors. 44 2016 RIA at p. 166. 45 See "A Complete List of Brokers and Their Approach to 'The Fiduciary Rule'", Wall Street Journal, February 6, 2017, available at <https://www.wsj.com/articles/a-complete-list-of-brokers-and-their-approach-to-the-fiduciary-rule-1486413491>. See also *infra*, footnotes 49, 50, and 51. Department of Labor March 17, 2017 Page 17 of 25 1. Failure to delay the applicability date will result in increased costs for small account holders. The 2016 RIA dismissed with little analysis the economic impact of moving investors to fee- based accounts. While both models (fee-based and commission-based) have their advantages, the commission model can be a more cost-efficient means to receive advice, particularly for small account holders and buy-and-hold investors. The total annual cost for the services provided by brokers and their firms to investors in front-end load funds is about 50 basis points a year.46 By contrast, a recent study by Cerulli Associates finds that fee-based accounts—the most likely alternative to brokerage

accounts— cost investors 111 basis points per year on average, in addition to fund expenses. The Department’s final rule will reduce investors’ access to the commission-model.<sup>47</sup> The BIC Exemption<sup>48</sup> purports to provide for continued offering of commission-based models. Yet the BIC Exemption, while somewhat improved from the version proposed in 2015, requires an adviser to comply with a series of complex and burdensome conditions. In our prior letters, we warned the Department that advisers may not be inclined to subject themselves to the multitude of ambiguous and impractical conditions—subjecting them to significant litigation risk—required of those who wish to rely on the BIC Exemption. As we predicted, many advisers have already made determinations that the BIC Exemption is unworkable for certain products,<sup>49</sup> that the resultant risk and liability (including 46 ICI Letter at p. 25. 47 The Department correctly notes that “there is nothing in the Rule or exemptions that requires advisers to move clients from commission-based accounts to accounts that are charged an ongoing asset-based fee.” (Emphasis added). See Q&A 11 of “Consumer Protections for Retirement Investors – FAQs on Your Rights and Financial Advisers,” U.S. Department of Labor, Employee Benefits Security Administration, January 2017, initially posted at: <https://www.dol.gov/sites/default/files/ebsa/about-ebsa/our-activities/resource-center/faqs/consumer-protections-for-retirement-investors-your-rights-and-financial-advisers.pdf> (note that this page is no longer available on the Department’s website). However, because of the Department’s unfounded bias against commission-based models, it included numerous unnecessary conditions in the BIC Exemption that make commission-based accounts unduly burdensome. 48 The Best Interest Contract (“BIC”) Exemption, published at 81 Fed. Reg. 21002 (April 8, 2016), was issued at the same time as the final rule with the stated intent—subject to its many conditions—of permitting the payment of commissions and other compensation that would otherwise be prohibited under ERISA and the Code. 49 Edward Jones announced that it will no longer offer mutual funds and exchange-traded funds in commission-based IRAs. “Edward Jones Shakes Up Retirement Offerings Ahead of Fiduciary Rule,” Wall Street Journal, August 17, 2016, available at <https://www.wsj.com/articles/edward-jones-shakes-up-retirement-offerings-ahead-of-fiduciary-rule-1471469692>. Department of Labor March 17, 2017 Page 18 of 25 the substantial threat of unwarranted litigation) cannot be justified for certain accounts,<sup>50</sup> or that the BIC Exemption in its entirety is simply too burdensome.<sup>51</sup> Thus, it is clear that the final rule will drive a shift away from commission-based arrangements and toward fee-based accounts—and the result of this shift will be far reaching. Many savers who today rely on brokers and other commission-based advisers for investment services no longer will be able to do so. They will be forced either to engage fee-based advisers, significantly increasing their investment expenses, or to go without information and guidance—the most costly course of all. While some intermediaries already have made changes, many are still waiting to see what will become of the rule. The failure to delay the applicability date will hasten the transition away from commission-based to fee-based accounts, a move that will be difficult to unwind in the event the Department ultimately decides to rescind or modify the final rule. We estimate that moving investors to fee-based accounts will have a net cost, cumulatively over 10 years, of \$47 billion. The Department’s 2016 RIA ignored this cost to investors, a cost that must be included in any analysis of costs associated with the 60-day delay. 2. Failure to delay the applicability date for many investors will result in significant costs, in the form of a loss of access to advice, information, and education. As described above,<sup>52</sup> intermediaries are already in the process of changing their business models in response to the uncertainties caused by the final rule. Despite the 2016 RIA’s quick dismissal, the changes will cause an “advice gap” for new investors. Fee-based accounts in many cases will not be available to lower- and middle-income IRA investors who cannot meet minimum account balance requirements (frequently, \$100,000, although many

intermediaries are lowering the minimums required). It is quickly becoming apparent that—just as the Institute predicted—fewer advisers will provide commission-based accounts, and such accounts may be subject to more restrictions. These business model changes will affect many current investors. As we predicted, many intermediaries plan to “orphan” a number of accounts. Distribution partners have already notified many of our members that they plan to resign as broker-dealer of record and in some cases as custodians for certain blocks of business. Some intermediaries have begun the resignation process, while others 50 A number of firms, including Edward Jones, have raised the minimum on commission-based IRAs. “Fiduciary ready: Edward Jones Unveils Compliance Plans,” On Wall Street, August 19, 2016, available at <http://www.onwallstreet.com/news/fiduciary-ready-edward-jones-unveils-compliance-plans>. 51 Merrill Lynch and JP Morgan Chase announced that they will no longer offer IRAs that charge commissions, instead limiting new IRA accounts to those charging retirement savers a fee based on a percentage of their assets. “JPMorgan Chase to Drop Commissions-Paying Retirement Accounts,” Reuters, November 10, 2016, available at <http://www.reuters.com/article/us-jpmorgan-wealth-compliance-idUSKBN1343LK>. 52 See text accompanying footnotes 49, 50, and 51. Department of Labor March 17, 2017 Page 19 of 25 have not yet done so because they are waiting on the resolution of the rule. A sampling of our members<sup>53</sup> report that the typical average account balance of those accounts where an intermediaries has resigned is less than \$17,000.<sup>54</sup> If the rule is not delayed (and is not ultimately modified), many owners of these orphaned accounts will be left without access to advice, unless they are able to find other intermediaries who are willing to take their accounts. Due to the dominance of intermediary distribution, many funds have restructured their servicing models; they thus are no longer well- equipped to handle a large influx of orphaned accounts and are unable to provide the advice and information that the investors currently receive from their broker relationships. The final rule also threatens to severely reduce the commonplace exchanges of information- currently provided at no cost to millions of retirement savers through call centers, walk-in centers, and websites. Even the most basic information could trigger ERISA fiduciary status and prohibited transactions. While some of this information may be technically excluded from the definition of advice, the rule is likely to cast a chill on the provision of investment education to retirement savers, due to the risk of inadvertently triggering fiduciary status. Over time, investors who no longer have access to advice are likely to experience lower returns because of poor asset allocation and market timing, or because they incur tax penalties by taking early withdrawals. We calculate that the 10-year cost of lower returns caused by such errors would be \$62 billion. Indeed, the Institute estimates that retirement investors’ returns could be reduced, conservatively, by \$10.9 billion a year—or \$109 billion over 10 years—as a result of the additional fees and lost returns they will incur. These costs to investors must be included in the cost-benefit estimate of a 60-day delay. C. Sunk Costs Caused by Failure to Delay if the Rule is Ultimately Modified or Rescinded Would Be Significant and Unrecoverable. As the Department notes, some entities will incur certain costs that could prove unnecessary— called “sunk costs” by the Department—if they are forced to come into compliance with the final rule and the rule is later modified. The Department requests assistance with quantifying the potential 53 The Institute informally surveyed its members regarding such notifications regarding dealer resignations. Twenty-nine out of 45 mutual fund companies surveyed reported receiving notices regarding some volume of accounts that will become orphaned. Many smaller mutual fund complexes have not yet received requests from intermediaries asking to resign from accounts. Members have indicated that, depending on the outcome of the rule, they expect the volume of orphaned accounts to increase and that a significant increase could affect their ability to service shareholders. 54 This \$17,000 figure is the median of the average account balances

for orphaned accounts, as reported by 20 fund complexes. This sample of 20 fund complexes is representative of the industry in general: the median size of long-term fund assets under management of these complexes is \$141 billion, with the largest complex having assets of more than \$1 trillion and the smallest with assets of less than \$5 billion. Department of Labor March 17, 2017 Page 20 of 25 change in start-up costs that would result from a delay in the applicability date, including data that would contribute to estimation of such impacts. The industry has been working diligently over the past 11 months to prepare to comply with the rule before the April 10, 2017 applicability date. The implementation timeline demanded by the rule was never realistic, and the timetable will have significant negative consequences. This short timetable was exacerbated by the lack of clarity in several areas.<sup>55</sup> Because there was (and still is) a lack of clarity on many issues, many financial institutions have delayed making decisions. Those who did make decisions before the Department issued FAQs tended to make very conservative decisions (e.g., banning commissions in retirement accounts) out of necessity, based on the guidance then available. These decisions, although not optimal for all retirement investors (for example, those who believe that commission-based accounts are ultimately less costly), were necessary given the lack of clarity or concern about the risks imposed by relying on the BIC Exemption. By the Department's own estimates, implementation costs in the first year of the rule's application will be \$5 billion.<sup>56</sup> The fund industry already has incurred millions of dollars of costs analyzing the final rule; updating systems, internal processes, policies, and procedures; and developing various products to support intermediary business models. Given the lack of clarity discussed above and the possibility that the applicability date would be delayed, final decisions regarding the discontinuation of certain services and compliance activities have been delayed pending a final decision from the Department. The Department is therefore correct in its assessment that a "60-day delay could defer or reduce start-up compliance costs, particularly in circumstances where more gradual steps toward preparing for compliance are less expensive."<sup>57</sup> While such start-up costs are most commonly associated with intermediaries, product sponsors—including mutual fund advisers—also will incur significant start-up costs in preparation for the applicability date, costs that cannot be recovered even if the rule is rescinded or modified. One area where this is particularly true is with the creation of T shares—a temporary "fix" contemplated by many product sponsors in response to the demands of the intermediary community. T shares (or transaction shares) are being created specifically for the purpose of leveling compensation in order to bring greater certainty to BIC Exemption compliance. T shares generally have a uniform front-end load (similar to an A share), but with a lower commission, generally around 2.5%. <sup>55</sup> The Department issued two sets of FAQs—one set issued on October 27, 2016, and a second set issued on January 13, 2017. Not only were these FAQs released too close to the applicability date (165 days and 87 days prior to the applicability date), but they also failed to answer some of the questions asked by the industry. <sup>56</sup> 82 Fed. Reg. 12319 at 12320. <sup>57</sup> 82 Fed. Reg. 12319 at 12321. Department of Labor March 17, 2017 Page 21 of 25 We understand that intermediaries plan to use T shares for transitional purposes, until they can develop a better solution (such as "clean" shares, on which brokers charge an "external" commission). Because other solutions will require significant implementation time due to regulatory requirements, however, many fund companies have determined that they have little choice but to go through the expensive and time-consuming process of preparing the T shares. The launch of a new share class is complex and costly. Direct costs incurred by funds related to a share class launch generally include legal consultation, audit work, system modifications and establishment of product parameters (e.g., account minimums, shareholder eligibility, rights of accumulation calculations), various filing fees (e.g., NASDAQ, CUSIP), Blue Sky registration fees by state, print and typesetting costs for production of regulatory

documents, and seed money. These direct costs do not include compensation of full-time employees, overhead, and other “soft” costs. While the cost to launch a share class can vary widely depending on several factors, the data reported to the Institute show that on average the direct cost to launch a fund share class is \$31,000. We estimate that to comply with the rule, funds may need to launch more than 3,500 T share classes. The cost of creating approximately 3,500 new share classes will total at least \$111 million. Of this, we estimate that funds may have already spent upwards of \$17 million in costs that they will be unlikely to recover if the rule is revised or rescinded. If the rule implementation is not delayed, funds could therefore spend an additional \$94 million to create T share classes, all of which will be unrecoverable if the rule implementation is not delayed but is ultimately revised or rescinded.<sup>58</sup> The process for funds developing “level” fee arrangements is necessarily slow. Antitrust laws prevent the broker-dealer community from agreeing on, or even discussing, uniform compensation structures. Therefore, fund sponsors have had to wait for requests from individual broker-dealer firms.<sup>59</sup>

<sup>58</sup> These calculations are based in part on data provided by nine large to moderate-sized fund complexes. These fund complexes reported an average cost to create a new share class as \$31,000 per share class on a dollar-weighted average basis and \$32,000 on a simple-average basis. To arrive at the total cost to create T shares of \$111 million, we multiply the total number of front-load share classes in long-term mutual funds (including funds of funds) by \$31,000. This gives  $31,000 \times 3,580 = \$110.98$  million. Complexes reporting implementation costs estimate that they have already spent, or are planning to spend over \$17 million to create T share classes for their complexes. <sup>59</sup> The Institute informally surveyed its members regarding the status of product decisions. Twenty out of 45 mutual fund companies responded that they have not yet completed their product decisions, mainly due to a lack of clarity or final decisions from intermediaries. Intermediary decisions were fluid over the past 18 months based on the changing landscape (e.g., DOL FAQ guidance, SEC guidance under 22(d)) and uncertainty regarding the final outcome of the rule. Only one mutual fund sponsor of the 45 surveyed indicated that it had spoken with all of its intermediary partners. The majority of mutual fund sponsors have been in contact with 75 percent or fewer of their intermediary partners regarding product needs and the intermediary’s end state business model. The majority of mutual funds surveyed indicated that they had heard from the larger intermediaries but had not heard from many medium to smaller intermediaries. The majority of smaller mutual fund complexes surveyed told us that they had not heard from a majority of their intermediary partners regarding their end state business model. Therefore, it is difficult for them to determine what products to launch. Of those intermediaries that Department of Labor March 17, 2017 Page 22 of 25 Broker-dealer business models vary widely, and consequently the determination of the compensation structure needed is firm specific. In addition to the high volume of unique requests that funds receive, securities issues also complicate funds’ responses to broker-dealer requests. The SEC has recently released guidance<sup>60</sup> to assist funds and intermediaries with these issues, but these changes cannot be completed by April.<sup>61</sup> Compliance with the final rule also necessitates complex and time-consuming changes in information technology (IT). For example, some NSCC<sup>62</sup> enhancements have been implemented in response to the final rule, it is unclear whether additional modifications to NSCC will be needed to support T shares or clean shares. The result of rushing to an April 10, 2017 compliance date without an adequate implementation period is that financial firms of all types will have to spend significant amounts that would not otherwise be required if ample time was provided. The Department notes that “[b]eyond start-up costs, the delay would likely relieve industry of relevant day-to-day compliance burdens.”<sup>63</sup> The sunk costs that companies would save go beyond compliance costs. Over the duration of the delay, companies would also avoid costs associated with litigation, which is likely to increase with the applicability of the final rule.<sup>64</sup>

the smaller mutual funds have heard from, some have indicated that the intermediaries will be dropping smaller mutual funds from their product lineups. 60 See SEC Interpretive Letter (pub. avail. Jan. 11, 2017), available at <https://www.sec.gov/divisions/investment/noaction/2017/capital-group-011117-22d.htm>; SEC IM Guidance Update No. 2016-06 (December 2016), available at: <https://www.sec.gov/investment/im-guidance-2016-06.pdf>; and Frequently Asked Questions on IM Guidance Update 2016-06 (Mutual Fund Fee Structures), SEC Division of Investment Management (posted on February 15, 2017), available at: <https://www.sec.gov/divisions/investment/guidance/frequently-asked-questions-mutual-fund-fee-structures.htm>. 61 In light of the SEC guidance, some mutual fund companies have indicated that the changing market demand (e.g., demand for clean shares) is affecting their ability to complete product decisions. The guidance has also caused many intermediaries to rethink their business model decisions and many have indicated that any use of T shares most likely will be temporary until their systems have been modified to support clean shares. The delay by intermediaries in finalizing their product decisions is impacting funds' ability to complete system enhancements, develop policies and procedures, train staff, and communicate with shareholders. 62 As the securities industry utility, DTCC's subsidiary—the National Securities Clearing Corporation (NSCC)—provides critical services for trading and settlement (Fund/SERV®) and data exchange (Networking), which facilitates automated processing between mutual funds and intermediaries. 63 82 Fed. Reg. 12319 at 12321. 64 Morningstar states that “a long-term annual range for the industry from class-action settlements of \$70 million–\$150 million. That said, we wouldn't be surprised if near-term class-action lawsuit settlements exceed this by a multiple, as firms figure out how to determine, demonstrate, and document best interest. In a bearish scenario, the cost of class-action Department of Labor March 17, 2017 Page 23 of 25 III. A Partial Delay of Only Some Part of the Final Rule Would Not Serve the Interests of Investors. The Department invites comments on whether it should delay applicability of all, or only part, of the final rule's provisions and exemption conditions. For example, under an alternative approach, the Department could delay certain aspects (e.g., notice and disclosure provisions) while permitting others (e.g., the impartial conduct standards set forth in the exemptions) to become applicable on April 10, 2017. We strongly oppose a bifurcated approach to delaying applicability of the rule and exemptions. The rule defining who is a fiduciary by virtue of providing investment advice and the associated prohibited transaction exemptions for use by fiduciary advisers are inextricably linked. As an initial matter, it is imperative that the exemptions be available for use as soon as the fiduciary definition under the final rule becomes applicable. Likewise, it would not make sense to delay the fiduciary definition regulation, but allow the BIC Exemption (in whole or in part) to become applicable on April 10. More specifically, we caution against permitting any part of the BIC Exemption to become applicable while the Department is undertaking its reexamination of the rule and exemptions and accompanying economic analysis. The BIC Exemption currently is set to become applicable in two phases—with the impartial conduct standards, special interim disclosure requirements, and certain other aspects of the exemption applicable on April 10 and other aspects, such as the written contract requirement, conflicts policies and procedures, contractual warranties, and extensive disclosure requirements, becoming applicable on January 1, 2018. The current phased-in approach was intended to give advice providers much-needed time to implement the burdensome administrative aspects of the exemption while adhering to the core principles underlying the rule—providing advice that is in the best interest of retirement investors. In order to achieve the purposes of the delay—avoiding the market disruptions and sunk costs discussed above—the rulemaking must be delayed in its entirety. The best interest standard in particular (which is part of the BIC Exemption's impartial conduct standards) is



highly subjective and creates significant liability risk in the context of litigation. It represents a new standard that arguably differs from the existing ERISA duties of prudence and loyalty. The resulting uncertainty and increased liability risk is a significant concern for firms as they evaluate different possible compliance approaches, even without the written contractual warranties (not needed for ERISA-covered plans anyway).<sup>65</sup> If any part of the rule or exemptions is allowed to settlements alone could decrease the operating margin on the advised, commission-based IRA assets of affected firms by 24%–36%.” Michael Wong, “Costs of Fiduciary Rule Underestimated,” Morningstar, posted on February 9, 2017. <sup>65</sup> See footnote 48, *supra*. Department of Labor March 17, 2017 Page 24 of 25 become applicable while other aspects are delayed with the possibility of rescission or modification, firms will be forced to make speculative, uninformed business decisions that are less than optimal—if not harmful—for the businesses and for the clients they serve.

IV. The Length of Delay Should Correspond to Timing of the Department’s Ultimate Determination as to the Rule’s Status. The Department invites comments regarding whether a different delay period would best serve the interests of investors and the industry. We urge the Department to delay the rulemaking for a period longer than 60 days. As the proposal acknowledges, the purpose of the delay is to allow the Department to engage in the comprehensive review of the final rule and related exemptions ordered by the President, without causing significant market disruption, sunk costs, and harm to investors if the Department determines, as a result of its review, to rescind or modify the rule. It is highly unlikely that the Department will be able to complete its review and a new regulatory impact analysis within the 60-day extension.<sup>66</sup> Consequently, the need for another delay at the end of the proposed 60-day period seems almost certain. The regulated community is already operating in an environment of great uncertainty, creating inefficiency and suboptimal implementation decisions. A brief 60-day delay, along with more uncertainty over whether another delay will be granted, would only exacerbate these problems. The Institute has previously commented on the need for a much longer implementation period than that provided under the proposed and final rule.<sup>67</sup> We recommended an applicability date not earlier than two years after the rule was made effective, if the exemption had been modified consistent with our substantive recommendations, and not earlier than three years after the effective date in the absence of our recommended changes. This amount of time is needed to allow for the significant systems changes necessitated by the rule and exemptions (including, for example, the BIC Exemption disclosure requirements) and the business model changes (such as creating and implementing new mutual fund share classes as discussed above) that flow from the new framework. We understand that the current delay proposal is meant to address the Department’s task at hand—reexamining the rule—rather than the compliance challenges faced by the industry. <sup>66</sup> The proposal to delay the applicability date includes numerous requests for comment relating to the Department’s examination of the rule and exemptions, including many questions on market responses to the final rule to date, inadequacies in the 2016 RIA, and expected effects of the final rule. The Department must take sufficient time to digest these comments before completing a new legal and economic analysis. <sup>67</sup> See letter from David M. Abbey and David W. Blass, to Office of Exemption Determinations, Employee Benefits Security Administration, U.S. Department of Labor (July 21, 2015), available at [https://www.ici.org/pdf/15\\_ici\\_dol\\_fiduciary\\_best\\_interest\\_ltr.pdf](https://www.ici.org/pdf/15_ici_dol_fiduciary_best_interest_ltr.pdf). Department of Labor March 17, 2017 Page 25 of 25 Nevertheless, we recommend that the Department set the applicability date as one year after the Department’s determination as to whether to rescind or modify the rule. Tying the delay to this determination will minimize disruption and avoid the need for issuing further delays as the Department completes its review. If the Department determines to modify the rule, the delay should continue during the modification process. If the Department determines not to rescind or modify the rule, the

delay should be set to expire after a reasonable time (for example one year) following the Department's announcement of this determination, to allow the regulated community ample time to "re-start" the implementation process. Anything less will only result in more confusion, unnecessary costs, and inefficiencies in the marketplace. \* \* \* \* \* We appreciate the opportunity to comment on the proposal to delay the applicability date of the final rule. If you have any questions regarding our comments, or would like additional information, please contact Brian Reid, Chief Economist, at (202) 326-5917 or [brian.reid@ici.org](mailto:brian.reid@ici.org); Sean Collins, Senior Director of Industry and Financial Analysis, at (202) 326-5882 or [sean.collins@ici.org](mailto:sean.collins@ici.org); David Blass, General Counsel, at (202) 326-5815 or [david.blass@ici.org](mailto:david.blass@ici.org); or David Abbey, Deputy General Counsel—Retirement Policy, at (202) 326-5920 or [david.abbey@ici.org](mailto:david.abbey@ici.org). Sincerely, /s/ Brian Reid /s/ David W. Blass  
Brian Reid  
David W. Blass  
Chief Economist  
General Counsel  
Investment Company Institute  
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