Statement of the Investment Company Institute

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Hearing on "Restricting Access to Financial Advice: Evaluating the Costs and Consequences for Working Families and Retirees"

Subcommittee on Health, Employment, Labor, and Pensions

Committee on Education and the Workforce

United States House of Representatives

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The Investment Company Institute[1] is pleased to provide this statement regarding the U.S. Department of Labor's fiduciary proposal for the hearing in the Subcommittee on Health, Employment, Labor, and Pensions of the U.S. House of Representative's Education and the Workforce Committee. We thank Subcommittee Chairman Roe and Ranking Member Polis for the opportunity to testify, and Chairman Kline for the committee's continued bipartisan attention to an issue so critical to American retirement savers.

The mutual fund industry is especially attuned to the needs of retirement savers because mutual funds hold half of retirement assets in defined contribution (DC) plans and individual retirement accounts (IRAs).[2] The DOL's proposal would have a dramatic impact on the ability of those retirement savers to obtain the guidance, products, and services they need to meet their retirement goals.

ICI supports the principle at the heart of the DOL's proposal—that financial advisors should act in the best interests of their clients when they offer personalized investment advice. Unfortunately, the DOL did not stay true to the meaning of that principle. As a result, its proposed rule is hopelessly complex, confused, and, in its current form, unworkable. The DOL also chose to break away from a coordinated approach with the Securities and Exchange Commission (SEC), which itself is considering whether to impose harmonized fiduciary standards that would provide a single standard of care for all investors. If the DOL adopts its proposed rule, the result will be a

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[1] The Investment Company Institute (ICI) is a leading, global association of regulated funds, including mutual funds, exchange-traded funds (ETFs), closed-end funds, and unit investment trusts (UITs) in the United States, and similar funds offered to investors in jurisdictions worldwide. ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of funds, their shareholders, directors, and advisers. ICI's U.S. fund members manage total assets of $18.1 trillion and serve more than 90 million U.S. shareholders.

[2] At the end of 2014, U.S. retirement assets totaled $24.7 trillion, DC plan assets were $6.8 trillion, and IRA assets were $7.4 trillion. Investors held $3.5 trillion of IRA assets and $3.7 trillion of DC plan assets in mutual funds. *See* Investment Company Institute, *The U.S. Retirement Market, Fourth Quarter 2014* (March 2015), available at www.ici.org/info/ret_14_q4_data.xls.

regulatory hodgepodge that does not promote the best interests of retirement savers. In fact, it may well harm their interests.

ICI will submit a detailed comment letter to the DOL addressing our concerns about the proposed rule. In this statement, I will focus first on the DOL's failure to provide a sound economic rationale for its proposal. I will then describe some of the key ways in which the proposal is flawed.

The DOL's Regulatory Impact Analysis Is Fundamentally Flawed

The DOL relies on its Regulatory Impact Analysis to justify its proposed rule. But the Regulatory Impact Analysis fails to demonstrate the DOL's assertion that there is a "substantial failure of the market for retirement advice."[3] It also does not properly consider how the proposal actually 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.

The DOL argues in its Regulatory Impact Analysis that broker-sold funds "underperform," "possibly due to loads that are taken off the top and/or poor timing of broker sold investments."[4] The DOL's analysis does not provide a benchmark for returns against which it measures this claim of "underperformance." It contends that such underperformance could cost IRA mutual fund investors "$430 billion over 10 years and nearly $1 trillion across the next 20 years."[5] The DOL has arrived at these numbers by misinterpreting and incorrectly applying the findings of the academic research that it cites as the foundation of its conclusions. In fact, these assertions do not stand up when tested against actual experience and data.

The DOL also has on its website a white paper prepared by the White House Council of Economic Advisers (CEA). That white paper claims that "conflicted advice costs Americans about $17 billion in foregone retirement earnings each year."[6] This assertion is also not supported by sound analysis or data, as I explain below.

Adjusting for the errors in the DOL's analysis, we find that the claims touted by the DOL simply have no basis. Indeed, the DOL's proposal, if adopted, could actually have a significant net societal harm. The proposal's costs and burdens, including those on retirement savers, do not support adoption of the proposed rule. I have five points to explain why.

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[3] DOL, *Fiduciary Investment Advice Regulatory Impact Analysis* (Apr. 14, 2015), available at: www.dol.gov/ebsa/pdf/conflictsofinterestria.pdf, at p. 7.

[4] *Id*., at p. 98.

[5] *Id*.

[6] CEA, *The Effects of Conflicted Investment Advice on Retirement Savings*, (Feb. 2015), p. 21. The CEA white paper is available at: www.whitehouse.gov/sites/default/files/docs/cea_coi_report_final.pdf.

1. Contrary to the DOL's claims, investors who own funds that are sold with front-end loads actually have concentrated their assets in funds that outperform—not underperform—the average return for their fund category.

The DOL claims that if its proposal is not implemented, retirement investors will lose nearly $1 trillion over the next 20 years due to excess fees and underperformance losses. The analysis that the DOL uses to back this claim is deeply flawed.

Front-end loads are a form of commission used to compensate brokers who sell mutual funds. The DOL bases its claim of investor harm on the idea that front-end loads create incentives for broker-dealers to recommend particular funds, and that those funds tend to "underperform" by 100 to 200 basis points per year.[7] The DOL assumes that, after adoption of its proposed rule, the amount invested in underperforming funds that pay front-end loads will substantially decrease and that retirement savers will invest in higher-performing funds.

The DOL's calculation of $1 trillion in harm rests heavily on an academic paper that uses a set of computations to try to explain the range of loads that funds pay to brokers.[8] This paper finds evidence that a subset of funds—those whose front-end loads result in higher broker compensation than can be explained by the average of similar funds—underperformed the average return of their fund category during the next year. The DOL then assumes that *all* IRA assets that are invested in front-end load funds suffer the same underperformance—mistakenly applying a result from a subset of load funds to all load funds.

A simple test with hard data exposes the DOL's leap in logic and breaks down the central claim of its Regulatory Impact Analysis. In fact, investors who own funds that are sold with front-end loads have concentrated their assets in funds that outperform—not underperform—the average return for their fund category.

We examined front-load fund shares sold in each year from 2007 to 2013. Using Morningstar performance data, we measured fund returns net of expenses in the year after the sale (for example, we measured 2008 performance for fund shares sold in 2007, and 2014 performance for shares sold in 2013). For shares sold during the 2007 to 2013 period, the sales-weighted average returns for shares sold with front-end loads actually outperformed the Morningstar average return for all funds with similar investment objectives by 27 basis points per year. This demonstrates that investors who purchased front-end load funds concentrated their purchases in funds that outperformed their Morningstar average. This fact directly contradicts the DOL's assertions and raises serious questions about the DOL's contention that the market for retirement advice suffers from a substantial market failure.

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[7] As noted above, the DOL does not provide a benchmark for returns against which it measures underperformance.

[8] DOL, Regulatory Impact Analysis, at p. 98, citing Christoffersen, Evans, and Musto (2013). Attached to this written statement is a brief analysis of this and other key papers that the DOL relies on in its Regulatory Impact Analysis.

We have no explanation for why the DOL would choose not to test assertions and suppositions that are so critical to its conclusions against real and widely available data—a basic step in any economic analysis. By contrast, our test looks directly at the performance of actual fund shares sold with a load. The fact that investors concentrated their purchases of fund shares sold with a front-end load in those funds that outperformed the average return for their category undermines the DOL's analysis and eliminates almost all of the rationale the DOL uses to justify its proposal.

2. ***The DOL ignores market realities and assumes brokers will continue to offer advice and services despite substantial reductions in their compensation. It ignores the costs that investors will face if in fact they cannot use brokerage accounts for retirement savings.***

The DOL's analysis is flawed in another fundamental way: it ignores the cost of advice and services outside of broker-sold funds, resulting in an inappropriate overstatement of the benefits of the proposal. The DOL focuses solely on the costs of advice and assistance paid through a fund—through an up-front sales charge, for example. But the DOL fails to consider how these costs compare to the costs that investors incur when they pay a financial advisor directly for advice (for example, using an asset-based fee that an investor pays directly to a financial advisor) rather than paying through a fund. Ignoring the market realities of the cost of advice and assistance, the DOL exaggerates the benefits from lower loads resulting from their proposal and ignores possible costs that investors could incur if they move to fee-based advice.

How significant is this omission? The DOL argues that IRA investors currently pay between 26 and 28 basis points per year in front-end loads, in addition to fund expenses. 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.[9]

In the Regulatory Impact Analysis, the DOL asserts that retirement savers will continue to use brokers if its proposed rule is adopted, under its proposed "Best Interest Contract Exemption." It predicts that the Exemption will induce brokers to reduce loads. The DOL claims that annual front-end load costs will fall by 65 percent over the next 20 years.[10]

In fact, as I discuss below, the Best Interest Contract Exemption is prohibitively costly, in addition to being convoluted and unworkable. Brokers subject to the Exemption's many new limitations, burdens, and costs, as well as increased exposure to liability, are not likely to work for *less* compensation, as the DOL presumes.

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

[10] DOL, Regulatory Impact Analysis, at p. 113.

The DOL itself notes elsewhere in its Regulatory Impact Analysis that front-end loads already have fallen significantly. It states that these charges probably cannot fall much further without reducing the level of service and advice that brokers provide to fund investors.[11] It is difficult to reconcile that statement with the idea that adoption of the proposed rule—with its substantial new costs and liabilities—would induce brokers to accept commissions that are two-thirds below current levels.

In fact, many investors will still want to receive advice and will need to continue to pay for it. If brokers are largely foreclosed from providing that advice, investors will need to turn to fee-based accounts, if those accounts are available to them. In that event, many could end up paying even more, as evidenced by the current Cerulli data. For many investors—particularly those with small or even average balances—the total costs of fee-based accounts typically are higher than the cost of purchasing funds with front-end loads.

The DOL's failure to consider asset-based charges ignores the fact that a move to fee-based advice could raise costs for many IRA investors with small or even average balances.

3. ***The DOL fails to demonstrate that investment performance is different when an investor is advised by a fiduciary compared to when the investor is advised by a provider that is not a fiduciary.***

The DOL relies on a string of academic studies to buttress its claims that investors are harmed by their use of brokers.[12] These studies do not support the conclusions that DOL draws. The problem is that none of these academic studies actually compares the outcomes of investing with a financial advisor that is a fiduciary to the outcomes of investing with a broker-dealer or other financial advisor that is not a fiduciary. Thus, the DOL does not actually measure—and cannot measure, based on these studies—whether an investor using a fee-based ERISA fiduciary advisor will experience a different investment outcome than an investor using another financial advisor that is not an ERISA fiduciary.

Attached to this statement is a brief summary of the primary studies relied on by the DOL. The attachment also provides our analysis of why the papers offer little, if any, support for the DOL's hypothesis that investors purchasing funds through broker-dealers receive significantly lower returns than investors using fiduciary advisors. After careful review, it is our conclusion that the studies do not support the Regulatory Impact Analysis used to justify DOL's proposal.

4. ***The DOL fails to identify and analyze societal harms resulting from its proposal.***

In its estimates of the cost of its proposed rule, the DOL focuses only on administrative or compliance costs. It makes no attempt to acknowledge, much less measure, a significant harm that

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[11] DOL, Regulatory Impact Analysis, at p. 123.

[12] The CEA cites many of the same studies and draws the same conclusions as the DOL analysis. The CEA's misreading of the studies is also similar to the DOL's.

can occur if it adopts the proposed rule—the inevitable risk that at least some retirement savers would lose access to advice and information they currently rely on to meet their savings goals.

Research shows that investors with access to advice have more diversified portfolios and take on more appropriate levels of risk than those who do not receive advice or information. Indeed, in its justification of an earlier rule change, the DOL said that retirement investors who do not receive investment advice are twice as likely to make poor investment choices as those who do receive that advice.[13] The benefits of advice—and, conversely, the harm of losing access to advice—are significant.

The DOL's apparent belief that investors are ill-served by brokers ignores the fact that its rule could eliminate the guidance, products, and services that investors receive from broker-dealers that are compensated with front-end loads. Financial advisors, regardless of their standard of care, are unlikely to work in an environment of greater costs, limitations, and exposures to liability for less compensation. Indeed, many broker-dealers are likely to exit the market for retirement advice under the proposed rule. The DOL thus ignores the impact of its proposed rule on the quality and appropriateness of investment choices that retirement savers must make.

As a result, retirement investors may be left with no choice but to seek asset-based fee accounts to obtain the investment assistance that they need. But as we have already established, the total costs of investing through those accounts can be greater—not less—than the cost of investing with brokers.

Asset-based fee accounts pose an even more significant barrier. These accounts often require investors to have substantial balances that are significantly larger than the typical IRA balance.[14] As a result, fee-based accounts may not be available to lower- and middle-income IRA investors who cannot meet minimum balance requirements. Other market participants may seek to overcome the proposed rule's barriers and find ways to serve retirement savers who now rely on broker-dealers. It is entirely foreseeable, however, that many IRA investors would no longer be able to obtain advice under the proposed rule.

American workers will be worse off if they cannot get the assistance they need to determine how best to save for retirement. It is entirely inappropriate, and not credible economic analysis, for the DOL merely to ignore the harm that would come from retirement savers losing access to advice.

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[13] *See* Investment Advice—Final Rule. 76 Fed. Reg. 66136, 66152 (October 25, 2011).

[14] The median IRA balance in 2012 was $25,170. *See* Holden, Sarah, and Steven Bass. 2014. "The IRA Investor Profile: Traditional IRA Investors' Activity, 2007–2012." *ICI Research Report* (March). Available at www.ici.org/pdf/rpt_14_ira_traditional.pdf.

5. IRA investors are concentrated in funds that have lower costs on average—not in higher-cost funds, as the CEA white paper asserts.

The DOL has posted on its website a link to a CEA white paper that claims that variable compensation paid to broker-dealers and other financial advisors creates "conflicted investment advice," which in turn "can lead to underperformance: excessive fees, excessive trading, market mis-timing, and so forth."[15] The CEA white paper cites academic literature to support its claim that IRA investors using brokers suffer an underperformance of 100 basis points per year.

Unfortunately, the CEA, like the DOL, supports its claims by selectively choosing statistics and commentary from the academic studies it cites. The CEA also offers a hypothetical calculation of fees to illustrate the factors that it claims are harming IRA investors. The CEA first assumes that typical 401(k) plan investors pay fund expenses of only 20 basis points. It then assumes that investors pay 130 basis points in fund expenses after they roll their assets over to an IRA. The resulting assumed difference in fees—110 basis points—reduces returns for IRA investors by $17 billion annually, according to the CEA's illustration.

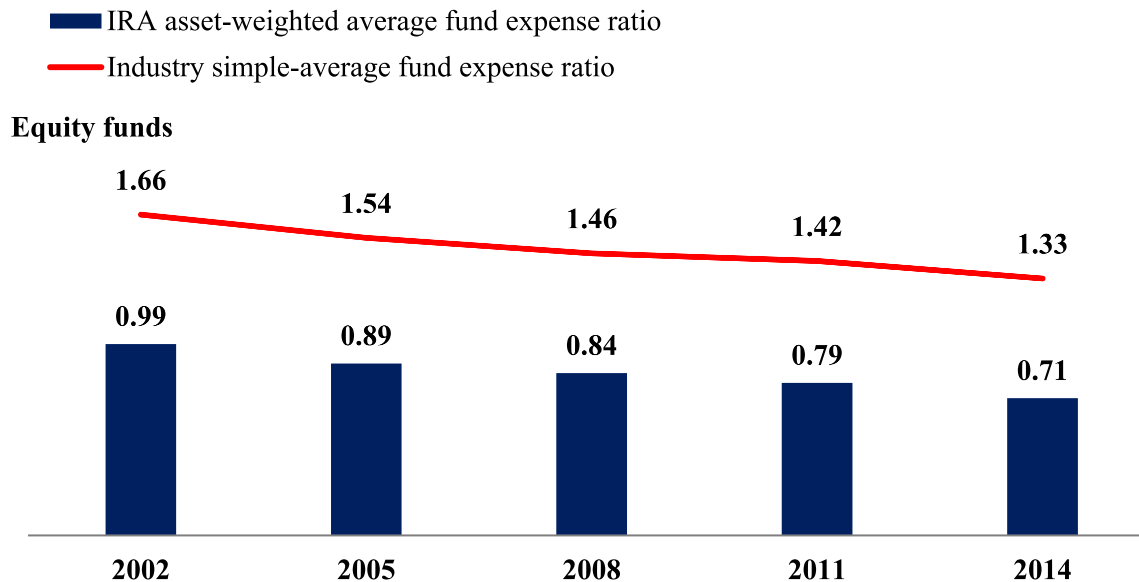
Actual data show that the CEA's illustration is far off the mark. The average fee paid by IRA investors in stock funds in 2014 was only 71 basis points. The average fee paid by 401(k) investors for investing in stock funds was actually 54 basis points. So the real difference in fees, based on what investors are actually paying, was 17 basis points—far less (almost 85 percent less) than the 110 basis point difference claimed by the CEA.

Further data show that actual IRA investors pay fees that are below the average fee for similar funds. As the chart below shows, IRA investors tend to concentrate assets in funds with expense ratios (the bars) that are far less than the simple-average expense ratio of all funds (the line). In 2014, for example, the average expense ratio paid by IRA investors on equity funds was 71 basis points—or 62 basis points less than the average expense ratio for all equity funds.[16] This pattern also holds true in hybrid and bond funds.

[15] CEA study, p. 16. Accessed on June 7, 2015.

[16] Calculation: 133 basis point average expense ratio on all equity funds minus 71 basis point average paid by IRA investors on equity funds equals a 62 basis point difference.

IRA Investors Pay Below-Average Fees



Note: Data exclude mutual funds available as investment choices in variable annuities.
Sources: Investment Company Institute and Lipper

Our data do show that 401(k) investors pay lower fees in mutual funds than IRA holders pay. This in part reflects economies of scale, as employer plans aggregate the savings of hundreds or thousands of workers. In addition, average fees are somewhat higher for mutual funds in IRA accounts because some IRA investors pay through fund fees for services, such as professional investment advice and assistance that are not available through their 401(k) plans.

The DOL's Proposed Rule, Like Its Regulatory Impact Analysis, Is Flawed

The DOL's rule proposal is confusing and convoluted.

Confusing. The DOL's rule proposal leaves quite unclear the circumstances under which a provider of investment information will be an ERISA fiduciary. Based on our initial analysis, providing even the most basic information—such as that offered in many common call-center and web-based interactions—will trigger ERISA fiduciary status. The result will be the restriction of even basic information provided to retirement savers, for fear that the information later will be viewed as advice triggering ERISA fiduciary status.

To provide a workable framework for its proposed rule, the DOL must provide clear and unambiguous thresholds for determining when a service provider is offering fiduciary advice. It must allow service providers to continue to offer meaningful investment education to retirement savers without inadvertently triggering fiduciary status.

The proposal breeds more confusion by asking a series of questions about a blanket exemption from ERISA prohibitions for so-called "high-quality low-fee" investment products.

The DOL does not actually propose such an exemption, nor does it specify how such an exemption would work and what investments might qualify. Indeed, the DOL's questions are hopelessly vague. DOL simply has not provided the public with enough information about this aspect of its proposal to comment in any meaningful way.

The DOL and other financial regulators must promote investor choice and remain product-neutral. Cost is not, and cannot be, the sole factor in making an investment decision. Nor does trust law, in articulating the nature of fiduciary duty, sanction low cost as a consideration exclusive of others. And regulators cannot and should not set themselves the task of determining what constitutes a "high-quality" investment product. We know of no useful criteria for this purpose that take into account the diverse portfolio needs of the millions of American retirement savers.

Convoluted. The proposal takes a straightforward concept—that investors should receive advice that is in their best interest—and turns that principle into an overcomplicated, unworkable rule.

The proposed "Best Interest Contract Exemption" is a primary example of this problem. The DOL purportedly designed that proposed exemption to permit broker-dealers and others to continue to receive variable compensation, such as commissions and front-end loads, notwithstanding their status as an ERISA fiduciary. Under the Best Interest Contract Exemption, however, a financial services provider must comply with a series of unworkable conditions that are not based on fiduciary principles. Among them are the following:

- Before giving any advice, the service provider must enter into a written contract containing a panoply of waivers and commitments that create significant litigation exposure and liability. Broker-dealers and others receiving variable compensation are likely to struggle, in operational and customer-service terms, to have a written contract in advance of every interaction that could be portrayed as advice-giving.

- The service provider's individual representative must be party to that contract.

  Taken together, these first two conditions imply a set of procedures that borders on the absurd. Before asking a question or receiving any information, an investor seeking information from a call center would be required to enter into a contract not merely with the corporate service provider, but with the employee operator at the call center. If that operator needs to refer the call to a more-knowledgeable colleague, the investor presumably would then be required to enter into yet another contract with that colleague. It is difficult to imagine the system that would accommodate three-way contracts for all of a financial services firm's thousands (perhaps tens of thousands) of representatives and many thousands of customers.

- The service provider must provide point-of-sale disclosure of impossible-to-calculate projected costs of investment, extensive website disclosure, and annual disclosure to investors. These disclosures must include, among other things, the total dollar amount of all compensation received by the service provider as a result of the investor's holdings and purchases. Some of these disclosures essentially would be impossible to provide because they assume perfect knowledge of future performance of an investment.

In seeking to impose these requirements, DOL has converted the fiduciary principle into a series of compliance traps and barriers for financial advice professionals and their firms, in particular smaller firms. This emphatically is not how fiduciary duty—a relationship of confidence and trust—should be defined and crafted. ICI supports efforts to promote the best interests of investors, but any regulatory initiative to do so must be workable and not restrict the information, advice, and services that investors require to meet their goals. We fear that the DOL's confusing and convoluted rule proposal will create real harm—a loss of access to information and advice—to America's retirement savers.

Conclusion

The economic analysis used to justify the DOL proposal is fatally flawed. It appears to be crafted solely to support the agenda of adopting the DOL's proposed rule—not to measure accurately the costs and benefits of the proposal. The Regulatory Impact Analysis does not properly analyze the impacts of the proposal. The DOL does not establish that the benefits of its rule justify its significant costs. In fact, the economic analysis raises the question of whether the DOL fully understands the market for investment advice.

We agree that retirement savers, and other investors, should be served by financial advisors who act in their clients' best interest. But the added layers of complexity and confusion that the DOL proposes to pile on top of that simple best-interest principle creates the risk that many savers will receive *no* advice or service, or none that they can afford. Sadly, we expect that the proposed rule, if adopted, will make retirement saving *more* challenging and costly for many retirement savers, particularly those with modest balances.

A better approach is one that balances the need for enhanced investor protections with the desire to minimize market disruptions and preserve investor choice. Such an approach would be more likely to result from a joint effort by the DOL and the SEC to work toward a harmonized fiduciary duty for all investors. Even more important, such an approach would stay true to fiduciary principles.

Attachment A—Review of Studies Relied upon by DOL and CEA

Set forth below is a brief summary of the studies relied on by the DOL and the CEA, and why they offer little, if any, support for the DOL's conclusion that investors purchasing funds sold through brokers receive significantly lower returns than do investors using fiduciary advisors.

1. Bergstresser, Chalmers, and Tufano (2009)

The 2009 paper by Bergstresser, Chalmers, and Tufano attempts to measure the returns to investors using funds sold through brokers before accounting for fees used to compensate the broker. Significantly, the paper compared broker-sold funds with direct-sold funds but does not measure whether a fiduciary relationship produces superior returns, net of fees, over a non-fiduciary intermediary (*e.g.*, brokerage) relationship.

The Bergstresser paper does not support the DOL's characterization of the paper's conclusion (*i.e.,* that investors purchasing funds from a broker fare worse than those purchasing funds from a fiduciary). In fact, the evidence in the Bergstresser paper, even if taken at face value, is highly inconclusive: the paper suggests that, compared to investors that purchased "directly sold" mutual funds, investors who used broker-sold funds earned lower returns on broad domestic equity funds and higher returns on foreign equity funds and perhaps money market funds between 1996 and 2004. (The evidence on bond funds is statistically inconclusive.)

Simply put, if underperformance is due to the conflicted compensation structure of the intermediary—as the DOL suggests—one would expect that the underperformance would occur in all types of funds, not just one.

2. Del Guercio and Reuter (2014)

The 2014 paper by Del Guercio and Reuter cited in the DOL's Regulatory Impact Analysis finds that actively managed funds sold directly to investors outperform index funds, and that broker-sold index funds outperform broker-sold actively managed funds. The paper speculates that this result is driven by broker incentives, but does not provide any test of this theory. Consistent with the limitations of the Bergstresser paper, the Del Guercio paper does not measure the net returns to investors using a fiduciary advisor versus a broker. They also do not examine where investors in broker-sold funds are concentrating their assets.

The CEA acknowledges that a limitation of both the Bergstresser and Del Guercio studies is that such comparisons cannot incorporate differences other than the involvement of an intermediary versus a "direct sale" of the mutual fund. It explains, for instance, that "investors purchasing funds through intermediaries may be more risk-averse and less experienced with investing than

those buying direct-sold shares from a mutual fund sponsor" and that "[f]ailing to account for such differences may potentially overstate or understate losses due to conflicts of interest."[17]

3. Chalmers and Reuter (2014)

The Regulatory Impact Analysis cites a 2014 paper by Chalmers and Reuter that attempts to measure the impact of broker recommendations on client portfolios. The authors find that plan participants who use brokers are likely to need help with asset allocation and fund selection. They also find that participants who were defaulted into a target-date fund received asset allocation at a lower cost than if they had used a broker. The paper does not test whether the result would have been different if they had invested with the assistance of a fiduciary advisor.

4. Christoffersen, Evans, and Musto (2013)

The DOL cites a paper by Christoffersen, Evans, and Musto that purports to measure the cost to investors of investing in funds sold through brokers. The paper finds that investors who were invested in funds that compensated brokers with higher-than-average loads, adjusting for a set of fund features, earned lower returns. Again, the paper does not measure or test if these returns were lower than those that investors would have received had they used a fiduciary advisor. Also, the paper finds that paying brokers through an annual 12b-1 fee or through revenue sharing did not produce lower returns, which is inconsistent with the argument that investors using a broker are more likely to be placed in underperforming funds. More important, however, is that the DOL does not properly adapt the findings of the paper to its economic analysis.

5. Foerster et al. (2014), Hackethal et al. (2012)

The DOL also references papers examining retail investment advice in Canada and Germany. While acknowledging that those countries' legal regimes differ from that in the United States, the DOL cites the studies as support for the conclusion that advised accounts underperformed by more than 150 basis points. This incorrectly represents what the authors claim to have found—and the papers appear to be irrelevant to the discussion here. First, while the papers do purport to study the value of advice offered by financial advisors, the papers are about investment advisors in Canada and Germany respectively, not the United States. The Foerster et al. findings are based on the authors' analysis of statistics from the Canadian Financial Monitor survey of Canadian households. The Hackethal paper relies on a review of investor accounts at "a large German bank." Whether the papers' results carry over to the U.S. regulatory regime, and thus to brokers or financial advisors in the United States, is unlikely or, at best, just not clear.

Significantly, the Foerster paper concludes that Canadian advisors induce their clients to take more risk—*i.e.*, invest a greater portion of their portfolios in equities—thereby raising expected returns. The paper also observes, however, that "the amount of risk an advisor takes in his or her own portfolio strongly predicts the risk taken by his or her clients." This suggests that the clients'

[17] CEA Report, at p. 11.

assumption of additional risk is consistent with their advisors' own beliefs—not an inherent conflict of interest resulting from the manner in which the advisor is compensated.

The Hackethal paper, based on a review of account data from a "single German bank," does find that accounts advised by an advisor had returns that were lower than the sample mean for self-managed accounts, reflecting lower holdings in equities by the accounts. Given that Germans tend to invest a lower percent of their portfolios in the stock market (23 percent of German portfolios are invested in stocks, compared to 50 percent for Americans), it is not clear that these findings reflect the outcome of broker conflicts. They might, for example, reflect investing norms in Germany, or the fact, as the study also observes, that "[o]lder clients (over 50) have significantly greater probability than investors between 18 and 30 of using an advisor," and might be at a stage of their retirement planning where they begin to reduce their holdings in equities in favor of fixed-income securities.