VOICE OF INDEPENDENT FINANCIAL SERVICES FIRMS
AND INDEPENDENT FINANCIAL ADVISORS

Testimony of
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Before the
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Subcommittee on Capital Markets, Securities, and Investment

On

"Impact of the DOL Fiduciary Rule on the Capital Markets"

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Introduction

Good morning, Chairman, Ranking Member and members of the Subcommittee. I am David Knoch, President of 1st Global based in Dallas, Texas. I am a Certified Investment Management Analyst® with nearly 20 years of experience in the financial services industry. 1st Global is the largest independently owned wealth management partner to nearly 400 Certified Public Accountant (CPA) and legal firms across the United States. The company was founded in 1992 by CPAs who believe that accounting, tax and estate planning firms are uniquely qualified to provide comprehensive wealth management services to their clients. 1st Global is a research and consulting partner that provides our affiliated financial advisors with the education, technology, business-building framework, and client solutions that make these firms leaders in their professions.

I am here representing the Financial Services Institute (FSI).[1] I first became involved with FSI in 2005, one year after it was initially founded in 2004, by Dale Brown, the CEO of FSI and Tony Batman, the founder, Chairman and CEO of our firm, 1st Global.

As President of 1st Global and a member of FSI's Executive Committee, I have seen the power of having a voice in Washington, as well as the need for being a pragmatic participant in important conversations impacting our industry. FSI is the only organization advocating solely on behalf of independent financial advisors[2] and independent financial services firms[3], representing the industry's interests before Congress, the SEC, FINRA, NASAA, other federal and state regulators, and, of recent note, the Department of Labor (DOL). FSI engages in the state and federal legislative and regulatory process, working to create a healthy and thoughtful regulatory environment for their members so they can provide affordable, objective advice to hardworking Americans. Since 2004, FSI has successfully promoted a more responsible regulatory environment through advocacy, education, and public awareness, including on key programs to improve financial literacy and prevent elder abuse in communities across the nation.

At 1st Global, our purpose is clear: 1st Global exists to enable intentional living.

We believe in the virtue of personal responsibility and that all Americans must be accountable for their actions and must intentionally take total responsibility for all of their

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[1] The Financial Services Institute is the only organization advocating solely on behalf of independent financial advisors and independent financial services firms. Since 2004, through advocacy, education and public awareness, FSI has successfully promoted a more responsible regulatory environment for more than 100 independent financial services firm members and their 160,000+ affiliated financial advisors – which comprise over 60% of all producing registered representatives. We effect change through involvement in FINRA governance as well as constructive engagement in the regulatory and legislative processes, working to create a healthier regulatory environment for our members so they can provide affordable, objective advice to hard-working Main Street Americans. For more information, please visit financialservices.org.

[2] The term "financial advisor" is used to denote registered representatives of broker-dealers, investment advisor representatives of investment advisors, and persons who are dually registered in both capacities.

[3] FSI firm members operate as broker-dealers subject to SEC, FINRA, and state oversight; and registered investment advisers under SEC or state authority.

decisions, the choices they make, the beliefs they carry, and what motivates them to live lives with dignity and humility.

We believe in free enterprise as one significant essence of liberty, and economic freedom is grounded in large part in the opportunities we pursue through our vocations. Creating and building businesses provides opportunities for us and others to pursue happiness and live dignified lives.

We believe in the virtue of moral courage and that we must always morally and courageously do only the right thing for ourselves and our clients, even if this means refusing what could be a lucrative financial opportunity. In addition, we must always boldly advocate for both the nobility of business enterprise and we must advocate for the protections of those who suffer injustice.

We believe that honoring promises is at the core of our successful business. Whether to our partner CPAs and advisors, their clients, or each other, we are dedicated to enabling all individuals to make and keep their important promises.

Lastly, we believe that independence and objectivity are the key to providing the right financial solutions that meet every client's unique financial needs and independent financial advisors are particularly well-situated to provide advice and services to hard-working Americans with a wide range of incomes and needs.

1st Global-affiliated advisors are knowledgeable and professional and, as CPAs, among the most trusted professions in America. In fact, according to a recent Gallup study, accountants are the eighth most trusted profession in America,[4] with 39 percent of respondents indicating that the honesty and ethical standards of individuals in this profession are "high" or "very high." Wealth management is a natural complement to the complex services and high practice standards of CPAs. As evidence of these high standards and "client first" principles of professional care, 93 percent of 1st Global-affiliated advisors are CPAs, Certified Financial Planner® (CFP) professionals, or Accredited Investment Fiduciaries, and as such are already today held to varying levels of fiduciary duty to their clients.

Our Regulatory Environment

Independent financial services firms such as 1st Global play a critical role in American lives. However, the future of the independent firm is in question due to persistently expansive new regulations, such as the DOL Rule, creating an overly complex and increasingly burdensome regulatory environment.

Furthermore, 1st Global-affiliated financial advisors are also unique in terms of the many layers of regulations to which they must comply in order to provide both tax and financial

[4] http://www.gallup.com/poll/187874/americans-faith-honesty-ethics-police-rebounds.aspx

planning services to their clients. As CPAs, our affiliated financial advisors are already subject to a separate and distinct duty to work in their clients' best interest as it relates to their accounting services, which include their wealth management and retirement planning practices.[5] In addition, our CPA financial advisors are also subject to the SEC standards and FINRA's standards of commercial honor and just and equitable principles of trade.

I believe strongly that the DOL Rule adds unnecessary complexity to an already complicated regulatory environment for broker-dealers, investment advisers, financial advisors, and, in the case of 1st Global, CPAs. The DOL Rule's intricate regulatory framework raises new barriers to the availability of professional investment services for millions of Americans. More importantly, the DOL Rule requires already confused investors[6] to understand several standards of care. In fact, the SEC's own study, performed in 2008 by the RAND Corporation, indicates that, "investors typically fail to distinguish broker-dealers and investment advisers along the lines that federal regulations define. Despite their confusion about titles and duties, investors express high levels of satisfaction with the services they receive from their own financial service providers."[7]

Furthermore, I believe that, whether through the DOL Rule's intent, or the prevailing public view of the standard of care to which financial advisors should be held, there is no way for anyone who provides a service to another, financial advisor or otherwise, to be "conflict free." It is an impossibility in all businesses. The purpose of business and commerce is to make people's lives better. Any business or person who is selfishly motivated only by profit will perish in a society of fierce market competition to make people's lives better at a fair value which implies a fair price for the services and goods rendered.

Conflicts of interest are inherent in democratic capitalism. Coupled with the temperance of a moral foundation, these conflicts of interest are what make America's commercial society function, make people's lives better, and has created widespread prosperity for employees, consumers, and producers for over 250 years. No alternate system has come close to improving the happiness of mankind as that of democratic capitalism. Every business and every consumer have something to sell or purchase, respectively, thus creating a conflict in each side attempting to maximize their own utility. The elimination of conflicts of interest effectively eliminates the frictional engine of all commerce and thus the engine that improves people's lives. A conflict is inherent in free market capitalistic societies in all services provided and all transactions rendered for profit. The paradox of conflicts of interest is essential to happiness for all. A society's moral foundation, its transparency of the market pricing mechanism, transparency of the inherent conflicts of both producers and consumers, and a fair system of justice can temper the occasional temptations of a few that may contemplate violating the happiness of others.

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[5] See the American Institute of CPAs (AICPA) code of professional conduct *available at* http://www.aicpa.org/Research/Standards/CodeofConduct/DownloadableDocuments/2014December15ContentAsof2016August31CodeofConduct.pdf.
[6] https://www.sec.gov/news/press/2008/2008-1_randiabdreport.pdf
[7] Ibid

In a recent *Wall Street Journal* article titled "Why Your Financial Adviser Can't Be Conflict Free," columnist Jason Zweig eloquently wrote, "All financial advisers—like all people who perform a service for anyone else, including journalists—have conflicts of interest. That's true regardless of whether they work for someone else or for themselves, whether they earn fees or commissions, or whether they call themselves 'fiduciaries' who put clients' interests ahead of their own." Neither the DOL's rulemaking, nor any bill proposed by Congress, should expect to eliminate conflicts which are inherent and unavoidable, nor should they propose excessive disclosure of conflicts, which will continue to add to the already problematic epidemic of clients ignoring the enormous volume of regulatory disclosures they are required to read. Instead, a more realistic approach is to require firms and financial advisors to effectively manage conflicts of interest to ensure that investors are aware they may exist and can choose whether to work with the financial advisor or not. Managing conflicts of interest can also assure that the financial advisor is not incentivized to work in their own interest. The more practical approach of managing conflicts of interest can be done in a way that does not diminish customer protection and still effectively protects investors from harm.

FSI supports the Draft Bill because it creates a uniform standard of care enforced by the SEC as the appropriate jurisdictional agency with the necessary expertise, and provides for reasonable and streamlined disclosures as a way to require industry participants to communicate their conflicts. In addition, 1st Global and firms like ours, are already subject to their direct oversight and examination. My testimony will first answer the several questions you asked and then focus on how the Draft Bill will achieve what I believe is the true intention of the DOL Rule, and allow for independent financial advisors to continue to provide advice and investment options that are tailored to their clients' needs, by establishing a simplified, uniform fiduciary standard in the correct agency.

Questions specifically asked by the subcommittee

In light of the partial implementation of the rule on June 9, 2017, please discuss the ability of financial advisers, including broker-dealers, to provide affordable and reliable investment advice to their customers.

The DOL Rule reached its initial implementation date on June 9, 2017, and is now part of the compliance responsibilities of financial services firms like 1st Global. Segments of the financial services industry have expressed concern that the DOL Rule, even with the recent partial implementation, will reduce the willingness and ability of financial advisors to provide affordable retirement advice to their clients, particularly those working with a broker-dealer affiliated advisor. In our view and experience, this concern has merit.

In many cases, the least expensive method for clients to hold mutual funds is to custody them directly with the originating mutual fund company (often referred to as "direct business," "direct-way business," or "retail direct.") Since the beginning of 2016, the number of accounts held by 1st Global clients directly with mutual funds companies has declined nearly 10 percent

and the number of new accounts established dropped 19 percent during the first six months of 2017. We expect this trend to increase and by the end of this year anticipate that the total number of accounts held in these programs will drop 35 percent from 2016 levels. In contrast, we have seen a 123 percent increase in new accounts established using our "level-fee" [8] advisory programs since the beginning of the year. These are accounts offered through our Registered Investment Adviser (RIA), held to a fiduciary standard, supervised by the SEC, and expected to qualify for the level-fee exemption offered by the DOL Rule.

There are two key drivers behind this trend and both are derived from compliance with the DOL Rule. The first driver is our affiliated financial advisors moving the accounts to our fee-based advisory platform where the onerous requirements and legal risks of relying on the Best Interest Contract Exemption (BICE) are eliminated, and supervision of advice and aggregation of clients' assets is more manageable. The second is related to policy actions that 1st Global has enacted in response to both the DOL Rule and a need to modernize our firm.

The DOL Rule has also required us to adopt the "level-fee" fiduciary exemption for our discretionary retirement accounts. These are accounts where the financial advisor has contractual authority to purchase or sell securities in the account without prior notification to clients. While previously we charged reasonable transaction fees, we will be removing these fees and charging a reasonable base platform fee instead. While this will largely be a re-characterization of existing costs to clients, it will nevertheless raise the costs for the median client. Moving from a "pay for what you use" method to a "level-fee" method, in order to qualify for the level fee exemption offered as part of the BICE, as well as by the Impartial Conduct Standards applicable on June 9, will mean that those clients who place trades less frequently will subsidize frequent traders as all clients on the platform will be assessed the same "level fee."

Next, we have been particularly challenged to offer a viable solution for small employer retirement plans, particularly SIMPLE IRAs[9] where account balances can be quite small, as low as $50 for a newly established plan. Even with new "level fee" advisory programs created by 1st Global, we have been challenged to find a viable, cost-effective solution. As a result, many of our affiliated firms are exiting this marketplace and will no longer offer these plans to small business clients, and in some cases, will end their client relationship with existing plans. Since the beginning of 2016, we have seen the number of accounts in these programs decline by just over 20 percent and project that these accounts will shrink from the 2016 levels by 28 percent before the end of this year, and by 41 percent by the end of 2018. These changes will negatively impact small

[8] A "level fee" is a fee or compensation provided to a financial advisor based on a fixed percentage of the value of the assets or a set fee that does not vary with the particular investment recommended. A level fee also does not include a commission or other transaction-based costs.

[9] Per the IRS, "A SIMPLE IRA plan (Savings Incentive Match PLan for Employees) allows employees and employers to contribute to traditional IRAs set up for employees. It is ideally suited as a start-up retirement savings plan for small employers not currently sponsoring a retirement plan." More information *available at* https://www.irs.gov/retirement-plans/plan-sponsor/simple-ira-plan.

businesses and their employees, who rely on these solutions to offer retirement benefits to their employees before they are large enough to consider the adoption of a 401(k) plan.

Additionally, we have seen our affiliated financial advisors increasing the minimum account size to serve clients and even ending relationships with clients whose accounts are not cost effective to continue to service. This is due in large measure to the increased paperwork and operating burden imposed by increasing regulation, as well as by the potential risks to their business posed through the utilization of the BIC, points I discuss in greater detail throughout this writing. Since the DOL Rule's announcement, our call center leaders estimate that inquiries on how to end relationships with clients have increased four-fold, a sentiment I hear expressed by my industry peers.

Finally, we have worked over the past few years to lower the costs of more expensive commissionable solutions by lobbying product manufacturers[10] to lower their costs, as well as decreasing ours. However, this change was not initially prompted by the DOL's rule-making, rather it was the result of a well-functioning, competitive marketplace, largely characterized by firms and financial advisors who do this work because they want to help people (first) and earn a reasonable living (second).

As you can see through these examples, there is merit to the argument that the cost of DOL Rule compliance is being borne in part, or in whole, by the consumer. These examples also highlight that client access to investment products, solutions, platforms, and methods of compensation are also being restricted and that this is particularly pronounced for clients with smaller accounts.

Finally, as a firm that has worked hard to be among the best in terms of preserving client choice, we believe strongly that as one expands their view of the market to include all financial services firms, particularly those like ours, the number, type, and impact of decisions such as those described above will grow substantially, as will the impact on smaller clients, typically not served by the RIA/fee-only marketplace.

Discuss the impact of the DOL's fiduciary rule once it becomes effective on Jan. 1, 2018, as it relates to the ability of broker-dealers to continue to provide retirement investment advice to low and middle-income investors.

While the DOL Rule has already gone into effect on June 9, 2017, the rule's full implementation has still yet to occur. On January 1, 2018, when the DOL Rule is fully applicable, the withdrawal from certain markets, products, and methods of compensation described above will be even greater than it is today.

In our view, the most problematic aspect of the full DOL Rule is the myriad documentary requirements it imposes. In fact, streamlining the documentary requirements is at the forefront of

[10] *See* https://financialadvisoriq.com/c/1457773/165863.

our recommendations, as detailed throughout this testimony, and one of the areas where we are in full support of the Draft Bill. These documentary requirements, in particular the utilization of the contract per the BICE, are at the forefront of an accelerated withdrawal by financial advisors across America from serving low- and middle-income investors, and they are at the forefront of the changes our firm has already seen. These documentary requirements lie at the heart of the debate about "can" vs "will." Yes, financial advisors can use the Prohibited Transaction Exemptions (PTEs) to continue to offer commissionable solutions to smaller account holders. But will they accept the financial and reputational risks of doing so? We believe, and have seen through our experience, that the answer is no.

Those who disagree would say that if financial advisors are doing nothing wrong, they have nothing to be afraid of, but that argument is overly simplistic and disconnected from reality. Before the DOL Rule became effective, clients did not need to suffer actual harm, receive poor or conflicted advice, or have a fraud committed against them to pursue legal recourse. And in fact, cases where no wrongdoing or negligence on the part of financial advisors are brought all the time and are often settled to avoid the exorbitant costs of defense. With class action lawsuits a possibility after January 1, a financial advisor no longer needs to have personally committed a fiduciary violation, they merely need to be part of a class where a fiduciary violation *may* have occurred or part of a class where attorneys, armed with the benefit of hindsight, opportunistically attack a marketplace. This will cause the legal and compliance costs of firms like ours and our associated financial advisors to increase, as well as our costs of insurance. In fact, while our Errors & Omissions (E&O) insurance carrier has not yet raised rates as they are waiting for claims to occur, we have felt compelled to raise our policy limits in anticipation of the DOL Rule, which increased our premiums by 7 percent, and was passed along to our affiliated firms despite no change in our pattern of claims, and despite making every effort to be compliant with the rule.

Next, we have also heard our associated financial advisors discuss retirement from the financial services industry and the sale of their practices should the rule's impact be too great. These are, more often than not, sole practitioner CPAs who offer both tax preparation and wealth management services to small business owners and individuals in small rural communities. Given the geographic dispersion of these firms, it may be hard for them to merge with other larger practices and maintain service to their clients. We expect to see an acceleration in these retirements or sales after the rule's final implementation date on January 1, should the rule be enacted as written. The result will be fewer choices of affordable financial advice in smaller communities across the country.

I can use our experience at 1st Global to put the impact of the DOL Rule in real terms. To date we have spent 35 percent of our profits on DOL Rule compliance, through both direct costs and increased payroll costs. In addition, we expect to incur future costs that will continue to erode these profits by over half the amount spent to date. So far, these costs have been borne by us and have not been passed along to clients or our affiliated financial advisors. However, this is likely to change as we are contemplating increased affiliation fees in the fourth quarter of this

year to offset any ongoing costs of increased compliance. Additionally, should revenues decline as a result of the DOL Rule requirements, we would expect to increase these costs to offset some or all of these declines. An example of this is the restructuring of our pricing related to fee-based advisory accounts described earlier. The DOL Rule, as written, will no longer allow reasonable transaction-based costs in discretionary accounts, therefore we will apply a level, reasonable asset-based fee to investors in order to offset the elimination of these costs.

In addition to these metrics about our own costs of implementation, FSI engaged Oxford Economics in 2017 to conduct another study, "How the Fiduciary Rule Increases Costs and Decreases Choice" (2017 Oxford Economics Study) to update their economic analysis on the impact of the final Fiduciary Rule.[11] The findings of the 2017 Oxford Economics Study are based on the actual experience of FSI member firms implementing measures to comply with the DOL Rule, not assumptions or projections, which makes these figures far more reliable than the DOL's Regulatory Impact Analysis figures. This new report found that even Oxford's own 2015 predictions of the cost of the DOL Rule were significantly underestimated, as FSI members had already spent nearly half of the $400 million implementation cost the study predicted.[12] More specifically, the 2017 Oxford Economics Study found that FSI members have already spent $190 million preparing for DOL Rule implementation and will continue to spend an additional $205 million in preparation costs if the DOL Rule was to go into effect.[13] This means that start-up costs of the regulation are roughly 20 times higher than even the updated DOL Regulatory Impact Analysis estimated.[14] Whether because DOL's 2016 revisions to their 2015 proposed rules were not as effective at cost reduction as it thought, or because Oxford's original cost estimates were too low, the new estimates of total start-up costs are roughly 1.8 to 3.0 times higher than the DOL's most recent estimates.[15] If the FSI members' experiences were extrapolated to the universe of all broker-dealers, the total implementation costs to the industry will likely approach $1.8 billion.[16] Once implemented, these firms expect to pay an additional $230 million per year in recurring costs complying with the DOL requirements.[17] The DOL's revised Regulatory Impact Analysis did not provide a new detailed estimate of recurring costs, relying on the 2015 Regulatory Impact Analysis, while Oxford estimates the actual recurring costs to be 16.4 to 41.5 times higher than what the DOL has estimated.[18] Based on these results for startup and recurring

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[11] Oxford Economics 2017 Report, "How the Fiduciary Rule Increases Costs and Decreases Choice" (April 2017), *available at* http://www.financialservices.org/uploadedFiles/FSI/Advocacy_Action_Center/The_Fiduciary_Rule_Increases_Costs_And_Decreases_Choice.pdf.
[12] *Id.*
[13] *Id.*
[14] *Id.*
[15] *Id.*
[16] *Id.*
[17] *Id.*
[18] *Id.*

costs, Oxford calculated the total 10-year costs to the industry of the DOL Rule to be approximately $14.2 billion.[19]

Comparison of Cost Estimates

	Per-firm costs			Total BD industry costs
	Small BD	Medium BD	Large BD	
Industry size (DOL)	2,320	147	42	2,509
Start-up costs				
DOL original estimates (Apr 2015)	$53,000	$145,000	$1,091,000	$190,097,000
DOL "high" estimates (Apr 2015)	$242,000	$663,000	$5,000,000	$868,901,000
OE/FSI 2015 report (Aug 2015)	$1,118,000	$3,350,000	$16,266,000	$3,769,382,000
DOL adjusted estimates (Apr 2016)	$556,301	$1,777,688	$7,366,036	$1,861,311,968
Current estimates (Apr 2017)	$911,000	$3,787,000	$13,105,000	$3,220,619,000
Ratio of current estimate to 2015 DOL estimate	17.2	26.1	12.0	16.9
Ratio of current estimate to 2016 DOL estimate	1.6	2.1	1.8	1.7
Recurring costs				
DOL original estimates (Apr 2015)	$21,000	$58,000	$436,000	$75,558,000
DOL "high" estimates (Apr 2015)	$97,000	$265,000	$2,000,000	$347,995,000
DOL adjusted estimates (Apr 2016)				$413,000,000
Current estimates (Apr 2017)	$344,000	$2,407,000	$7,375,000	$1,461,659,000
Ratio of current estimate to 2015 DOL estimate	16.4	41.5	16.9	19.3
Ratio of current estimate to 2016 DOL estimate				3.5

Source: Oxford Economics and DOL Regulatory Impact Analyses

Additionally, FSI's research indicates that there will also be other consequences of rising compliance and other costs. FSI members widely report that one consequence of the DOL Rule is that the economics of managing small accounts will cause these investors to lose access to retirement planning services and investment education, a concern I expressed as it relates to our firm above. The reality is that for many small accounts, the fixed cost of servicing the account will exceed revenue that will be earned. As a result, most FSI member firms indicate that smaller investors will be offered robo-investing type account services or be asked to move their accounts. These small (often entry level, novice investors) would lose access to the personalized retirement planning services to which they have become accustomed. This area of the market is already underserved when it comes to receiving professional financial advice. Only 32 percent of adults in the U.S. receive professional financial advice[20] and only 8 percent of financial advisors focus on targeting and serving American households with less than $100,000 in investable assets.[21] Roughly 71 percent of American households (89.6 million) have less than $100,000 in investable assets.[22] Financial advisors play a critical role in the retirement investing process by counteracting one of the challenges to investors achieving this goal – their own behavior. A 20-year analysis

[19] *Id.*

[20] Northwestern Mutual 2016 Planning & Progress Study *available at* https://www.northwesternmutual.com/about-us/studies/planning-and-progress-study-2016.

[21] Id.

[22] Id.

from DALBAR showed that voluntary investor behavior – actions such as panic selling, excessively exuberant buying, and attempts at market timing – was the single-largest contributor to long-term underperformance.[23]

While the definition of a small investor varies among our member firms, they generally estimate that the breakeven point for servicing a client's investment account ranges from $35,000 to $75,000 in assets.[24] Since the median IRA balance ranged from $23,785 to $33,185 between 2010 and 2014, it is clear that without significant changes the DOL Rule will have a devastating impact on investor access to retirement planning services.[25]

Figure 3
Average and Median IRA Balances, by IRA Type, Age, and Gender, 2010–2014

	Average					Median				
	2010	2011	2012	2013	2014	2010	2011	2012	2013	2014
All	$91,864	$87,668	$105,001	$119,804	$127,583	$25,296	$23,785	$27,987	$32,179	$33,185
Type										
Traditional-Conts.^	88,403	78,051	97,286	112,943	120,163	29,756	24,721	32,161	37,611	39,389
Roth	24,798	25,741	31,288	37,010	39,544	11,471	11,344	12,796	15,190	15,847
Traditional-Rlvrs^	123,426	110,918	134,354	150,261	157,277	38,138	31,944	39,172	43,535	43,598
SEP/SIMPLE	55,733	56,479	67,457	79,424	84,599	15,471	15,711	17,794	20,257	20,604
All Traditional	103,346	98,797	118,645	134,791	142,780	32,647	28,457	35,803	40,996	42,157
Unknown	96,441	83,062	60,212	66,950	70,508	18,815	21,982	6,443	6,318	6,241
Age										
Under 25	21,986	11,434	11,165	13,103	13,264	5,782	3,238	3,360	3,708	3,433
25–29	10,290	12,278	11,009	12,537	12,552	4,769	4,488	4,721	5,000	4,826
30–34	16,236	18,106	17,704	20,456	21,120	7,229	6,612	7,036	7,661	7,531
35–39	25,683	27,664	29,202	33,784	34,903	10,819	10,072	11,003	12,325	12,138
40–44	36,968	38,354	42,826	49,948	52,582	14,745	13,751	15,770	17,745	17,864
45–49	50,998	51,006	59,471	68,683	72,177	19,329	18,312	21,463	24,264	24,564
50–54	74,046	66,771	80,525	91,976	96,726	24,505	23,216	28,056	31,692	32,639
55–59	92,196	86,572	108,074	122,957	130,459	31,762	29,080	36,363	41,149	42,950
60–64	129,976	116,415	147,739	165,139	175,418	42,998	38,838	49,899	55,807	59,138
65–69	170,672	145,575	191,208	212,812	224,144	58,965	50,122	66,852	75,277	79,928
70 or older	162,857	144,252	192,961	219,790	232,389	56,198	49,994	65,419	75,627	80,500
Unknown	108,765	280,290	160,233	126,759	177,699	35,255	116,475	43,666	45,801	44,692
Gender										
Female	71,112	66,529	81,700	96,339	94,774	23,246	21,642	27,826	30,660	29,651
Male	120,719	114,745	139,467	160,589	153,649	32,752	30,704	40,103	43,449	41,057
Unknown	85,037	76,604	85,230	91,853	128,631	22,820	19,916	26,589	23,576	30,923

Source: EBRI IRA Database.
^ Traditional-Conts.=Traditional-Originating from Contributions, Traditional-Rlvr=Traditional-Originating from Rollovers. Both of these accounts could have received contributions or rollovers after their origination, so these are NOT proxies for employment-based dollars versus IRA only dollars. The Traditional-Originating from Rollovers do provide an estimate of the dollars that have been moved into a new IRA.

Source EBRI.org "Individual Retirement Account Balances, Contributions, Withdrawals, and Asset Allocation Longitudinal Results 2010-2014: The EBRI IRA Database" (January 17, 2017).

What additional interim actions should the DOL adopt as it continues to review the rule's implementation as part of its Request for Information?

The most meaningful interim action the DOL should take is to immediately delay the DOL Rule's final applicability date until April 10, 2019. This will allow one of three major actions to be undertaken. First, it would allow the DOL an appropriate amount of time to fully review and

[23] 20th Annual Quantitative Analysis of Investor Behavior, DALBAR (April 2016) *available at* http://kyestates.com/wp-content/uploads/2015/02/DALBAR-QAIB-2014.pdf.
[24] Id.
[25] "Individual Retirement Account Balances, Contributions, Withdrawals, and Asset Allocation Longitudinal Results 2010-2014: The EBRI IRA Database" (January 17, 2017) *available at* https://www.ebri.org/pdf/briefspdf/EBRI_IB_429_IRA-Long.17Jan17.pdf.

consider the industry's input and make meaningful and necessary modifications. Second, it would allow Congress to fully analyze and adopt meaningful, comprehensive measures such as The Draft Bill. Third, should it be necessary, it would allow the industry additional time to implement sales and operating practices that incorporate industrywide changes being contemplated in response to the DOL Rule.

Furthermore, while a clear and substantial delay is an appropriate interim action, it also does not address our overarching concerns with the DOL Rule. To that end, we make three recommendations. First, and most importantly, is the implementation of a uniform fiduciary standard of care by the SEC, as recommended by the Draft Bill. Second, if this outcome should fail to be achieved, it is our recommendation that the DOL discontinue all further implementation of the rule, leaving in place the existing implementation requirements that became effective June 9. Third, failing both these outcomes we offer the following recommendations, taken from our response to the DOL's Request for Information:

1. Streamline BICE documentation and disclosure.
2. Create a single best interest standard applicable to all investors.
3. Revise and broaden the reasonable compensation rules.
4. Revise the rules for IRA rollovers.
5. Expand the rule's grandfathering provisions.

Please provide an overview of how the SEC is better equipped to update the standard of care for broker-dealers.

FSI has long supported a uniform fiduciary standard of care applicable to all professionals providing professional investment advice to retail clients.[26] This uniform standard of care would require financial advisors to act in the best interest of their clients, consistent with the intent of the Draft Bill.

While broker-dealers are already subject to a robust regulatory and enforcement regime designed to protect investors, FSI recognizes that multiple and differing standards of care between retirement versus non-retirement investments and transaction-based versus advisory-fee based advice leads to several negative unintended consequences for the client. These include but are not limited to overly complex disclosures, increased costs, limitations of investment choices, and reduced access to professional financial planning services.

As such, FSI supports the creation of a uniform fiduciary standard of care that would be applicable to all financial advisors regarding all investment products, not just tax-deferred retirement savings. FSI is uniquely situated to provide input on such a standard because its

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[26] *See, e.g.*, Letter from David T. Bellaire, Executive Vice President & General Counsel, Financial Services Institute, to Elizabeth M. Murphy, Secretary, U.S. Securities and Exchange Commission (Jul. 5, 2013) (commenting on Duties of Brokers, Dealers, and Investment Advisors, Release No. 34-69013; IA-3558; File No. 4-606), *available at* https://www.sec.gov/comments/4-606/4606-3138.pdf.

members, including 1st Global, are either dually-registered firms, or own separately registered BDs and RIAs (as we do), that provide both brokerage (commission-based) and advisory (fee-based) services to all types of American investors.

The SEC has clear statutory authority to regulate all financial advisors and securities products and has done so since it was established by Congress in 1934 for the sole purpose of regulating the commerce in investment products. The SEC Office of Compliance Inspections and Examinations (OCIE) has designed existing examination and enforcement protocols and trained staff to perform these functions. The SEC divisions such as enforcement, corporate finance, investment management, trading and markets as well economic and risk analysis all work to regulate and enforce U.S securities regulations for the purpose of investor protection.

The DOL lacks the expertise to effectively develop, implement, and regulate the standard of care afforded to the investing public. The DOL expertise lies in the development and implementation of regulations pertaining to wage earners, employment discrimination, employer-sponsored retirement accounts, workers compensation, and other legal and regulatory aspects pertaining to employment. Therefore, it is FSI's firm belief, and I fervently agree, that the SEC is the most appropriate governmental agency to regulate the standard of care afforded to the investing public.

This Draft Bill achieves this necessary uniform standard of care by establishing the standard of conduct for broker-dealers and their registered persons when providing recommendations to a retail customer. The recommendation must be in the customer's best interest and reflect reasonable diligence, care, skill, and prudence. The Draft Bill also empowers the SEC to issue additional regulations with regard to the standard of care. The SEC has unique expertise in regulation of broker-dealers and investment advisers as evidenced by numerous studies the SEC has conducted as required by Congress since its inception and, unlike the DOL, has the ability and authority to examine for compliance with the standard and bring corrective actions when necessary. By establishing this standard for broker-dealers, investors will no longer have to wonder what the difference is between various financial professionals and what duty of care their financial advisors owes to them.

What steps could the SEC take as part of its June 1, 2017 request for public comment on standards of conduct for investment advisers and broker-dealers?

FSI is still in the process of developing comments to the SEC in response to their request. Once the comments are complete, FSI will provide a copy to the Committee.

Comment on the discussion draft to create a best-interest standard for broker-dealers

In addition to the commentary already provided in support of the Draft Bill, I offer the following additional comments.

Meaningful Disclosures

The DOL rule creates a significant volume of disclosure that are cumbersome and expensive to create, will confuse investors with their sheer volume and complexity, and because of the private right of action created by the DOL Rule, could create immeasurable legal liability. Today, in our entry-level investment advisory programs for a fiduciary account with a minimum asset size of $5,000, the paperwork bundle that the client is required to sign is 191 pages in length. Of these 191 pages, 149 are disclosure, including the delivery of Form ADV and its required inclusions. This means that 78 percent of the paperwork a client signs in our “entry level” investment advisory program is disclosure. If you add the prospectus delivery requirement to the count, a client receives 503 pages of paperwork, totaling 461 pages of disclosure, or 92 percent of the paperwork. Additionally, after the January 1 applicability date, for a small commission-based account, which can be opened with as little as $50 initial investment utilizing the Best Interest Contract Exemption, we expect the number of pages of paperwork to be 98 pages, with 70 of those pages being disclosure. When prospectus delivery is added, the number swells to 117 of the 145 total pages, or 81 percent of the total paperwork burden imposed on clients.

The DOL itself acknowledged in their Regulatory Impact Analysis that disclosures are ineffective by stating, “Disclosure alone has proven ineffective to mitigate conflicts in advice. Extensive research has demonstrated that most investors have little understanding of their advisers’ conflicts of interest, and little awareness of what they are paying via indirect channels for the conflicted advice. Even if they understand the scope of the advisers’ conflicts, many consumers are not financial experts and therefore, cannot distinguish good advice or investments from bad. The same gap in expertise that makes investment advice necessary and important frequently also prevents investors from recognizing bad advice or understanding advisers’ disclosures. Indeed, some research suggests that even if disclosure about conflicts could be made simple and clear, it could be ineffective – or even harmful.”[27]

Furthermore, the DOL Rule’s website and transaction level disclosure obligations are particularly burdensome and do not provide investors the type of information that they actually want, such as the fees they are paying and what they are receiving for those fees. Investors want and need relevant disclosures in a simplified way they can understand. The complicated and comprehensive nature of the DOL Rule disclosures makes it highly unlikely that they will be effective in achieving the DOL’s goal of transparency and usability for investors. Investors do not need or want these voluminous and duplicative disclosures, and will not read, refer to, or rely on them. Especially when they drive up their investment costs and limit their access to solutions.The cost of complying with the heavy disclosure requirements vastly outweighs any marginal usefulness of them for the investor.

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[27] See page 9 of the Regulatory Impact Analysis *available at* https://www.dol.gov/sites/default/files/ebsa/laws-and-regulations/rules-and-regulations/completed-rulemaking/1210-AB32-2/conflict-of-interest-ria.pdf.

Additionally, as FSI firms, including 1st Global, have worked in the months since the DOL Rule was released to try to scope and begin building technological systems to comply with the transaction-level disclosures, it has become apparent that industry-wide changes must be considered, reviewed, structured, and implemented. This would necessitate considerable time and expense that are unrealistic with a January 1, 2018 implementation date. Further, these complex requirements make it possible, or even likely, that firms operating in good faith will make unintentional errors in their disclosures, which could further confuse clients and potentially have significant financial consequences for firms. For business leaders who partner with the owners and leaders of other businesses, the act of investing large sums of money and employee time into a likely source of increased liability and risk does not make business sense. Add in the likelihood for client frustration and you've got an excellent example of regulatory overreach.

In contrast, this Draft Bill includes a disclosure requirement at the outset of the account relationship, when the information is the most relevant, and provides a workable format: a clear and concise disclosure with a description of the type and scope of services to be provided, the standard of conduct applicable to the relationship, the types of compensation that may be charged, and any material conflicts of interest. It also allows the SEC to require disclosure of fees received by the broker-dealer prior to the transaction. The Draft Bill allows the SEC to establish the timing and content of the disclosures, which is appropriate given that the SEC has expertise and knowledge about how financial advisors work with investors.

Furthermore, the Draft Bill does not proscribe the medium for disclosure as the DOL Rule does. The provisions of the Draft Bill would allow firms the flexibility to deliver the disclosure in ways the investor wants to receive it, such as in writing, electronically, or both.

Additionally, the North American Securities Administrators Association (NASAA) has recently established a voluntary model fee disclosure template which also offers a concise and cogent summary of account expenses. This template serves as a model for disclosing relevant information to investors via the Internet. In fact, 1st Global was one of the first firms to voluntarily adopt the template on our website as we felt the information it contained was useful to investors and the format of the template is easy to read and understand.[28] Finally, the Form ADV disclosure already used by investment advisers provides useful information for client disclosure in this context.

Again, the SEC has jurisdiction over both investment advisors and broker-dealers and will have actual ability and expertise to examine for compliance with disclosure requirements and take corrective action where necessary. The common-sense disclosure requirements of the Draft Bill along with other already-available options will provide investors with the information they need to make intelligent decisions without confusion or information overload.

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[28] NASAA model template information *available at*: http://www.nasaa.org/industry-resources/broker-dealers/model-fee-disclosure-resource-center/. 1st Global fee template *available at*: http://www.1stglobal.com/downloads/acctfees2.pdf.

Material Conflicts of Interest

The DOL Rule requires firms and financial advisors to avoid conflicts of interest or avail themselves to one of the PTEs and in any case, provide advice “without regard to the financial interest of the adviser.”

As FSI member firms, including 1st Global, have worked in the months since the DOL Rule was promulgated to try to comply with the vague standard of “reasonable compensation” and “eliminating” conflicts of interest, it has become apparent that industry-wide changes must be considered, reviewed, structured and implemented. Although the industry has worked diligently to consider how to implement these changes, more time is required for all parties in the product manufacturing and distribution chain to implement all the necessary adjustments.

Some FSI member firms may choose to address the compensation and conflicts of interest challenges by becoming level fee fiduciaries. As stated earlier, "level fee" is a fee or compensation provided to a financial advisor based on a fixed percentage of the value of the assets or a set fee that does not vary with the particular investment recommended. A level fee also does not include a commission or other transaction-based costs. The DOL has indicated that such an approach may be a powerful means of reducing conflicts of interest with respect to mutual fund recommendations and correspondingly reduce the need for heightened surveillance around conflicts of interest. Broadening the availability of this option may be beneficial to FSI member firms that would like to offer institutional share classes (also known as “clean shares”) and reduce their regulatory burden given this payment structure is likely to meet the current definition of “level fee.” However, the success of this approach depends upon the availability of appropriate investment products. There has been considerable public comment from DOL about the development and availability of “clean shares” as a primary means of creating a levelized compensation structure for sales of mutual funds, but it does not appear these shares can be made fully operational for at least 18 months, if not more.

As mutual fund, insurance, and other companies develop new share classes or other pricing options, clearing, as well as introducing firms such as 1st Global must wait to develop the necessary trading, surveillance, commission, and other systems to support their use. Once these products and resulting systems are finalized and implemented, firms will need to not only train their staff on the particulars of the products and how to supervise them but will also need to train financial advisors as well. The result is a sequential process of systems development that simply cannot be completed by the January 1, 2018 deadline.

This Draft Bill takes a more practical and reasonable approach, requiring firms and their registered persons to “avoid, disclose, or otherwise reasonably manage” material conflicts of interest that may influence a financial advisor to make recommendations in their own interest instead of the best interests of their clients. The Draft Bill specifically states that transaction-based compensation, proprietary products, and principal transactions are not per se violations of the best interest standard nor does the standard does require advisors to recommend the least

expensive product. The least expensive product is not automatically the best product for every customer. Advisors take into account a wide range of factors when making a recommendation and the least expensive product may not have important features a more costly product can provide.

Instead, the Draft Bill recognizes that it is essential to continue to allow investors to have several options for ways in which they can work with a financial professional and the means by which they choose to protect themselves and their families and plan for their future. In fact, it was Congress' expressed intent in section 913 of the Dodd-Frank Act that any uniform standard developed by the SEC should be reflective of various business models.[29] By providing for commissions and acknowledging that the lowest cost option is not always the best option, this Draft Bill avoids preferential treatment of one business model over another and recognizes that commissions and sales charges are acceptable ways to compensate investment professionals and even preferable to many investors.

Most importantly, the Draft Bill clearly recognizes the value of advice. The language of the Draft Bill acknowledges the reality that investors need and flexibility in the means by which they have access to financial advice.

Conclusion

While the DOL no doubt had good intentions when it developed their fiduciary standard and requirements, the unintended consequences that many in the financial services industry have continued to raise are without a doubt already coming to fruition. I wish to emphasize that my concern and the concerns of FSI are not that the DOL Rule expands the ways in which we are held to a fiduciary standard of care. Both FSI and I agree that a carefully-crafted, uniform fiduciary standard of care would be beneficial for investors and reduce regulatory confusion. We believe, however, that this standard of care should be created and overseen by the SEC, which is what this Draft Bill accomplishes. We also believe that investors need and deserve clear and concise disclosures that provide them with useful information in an easy-to-read format of their choice. Again, the DOL Rule fails on this point while the Draft Bill accomplishes helpful disclosures for investors.

Furthermore, we strongly believe that all investors must retain access to valuable advice in order to provide them the means and resources to plan for a dignified retirement. The DOL Rule's focus on eliminating conflict and reducing fees is miscalculated, misdirected, and misapplied. The result is that it threatens investor access to advice by creating favored means of working with an advisor.

This Draft Bill makes the important distinction between low cost advice and valuable advice. The value of working with a financial advisor goes well beyond fees. A 2016 study conducted by Vanguard determined that the value of a financial advisor to a client is worth up to

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[29] Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 913, 124 Stat. 1376 (2010).

2.95 percent, net of fees, if the advisor focuses on relationship-oriented services — such as providing cogent wealth management via financial planning, discipline and guidance — rather than by trying to outperform the market.[30] Investors who have access to and receive financial advice enjoy both tangible and intangible benefits that cannot be expressed in dollar terms.

This Draft Bill will allow the financial advisors 1st Global serves, who are already heavily regulated and, because of their high ethical standards, already working in their clients' interests, regardless of the regulatory framework they operate under, to focus on the investor rather than unnecessary and cumbersome regulatory requirements.

Finally, my testimony would not be incomplete without dedicating at least one paragraph to defend the honor of the CPA wealth management firms I have the privilege to work with daily. This DOL Rule has been hard on them, not just for the compliance burden which has been discussed here at length, but because their good work and honor has been needlessly attacked. I work with nearly 1,000 professionals, as well as 200 employees in our home office, who show up every day to serve their clients and their communities, and make their world just a little bit better each day. Every CPA financial advisor I have ever spoken with is called to service for two reasons: they enjoy solving complex problems and they enjoy doing good for others, and offering wealth management services to their clients lies at the intersection of this calling. Without eschewing the need for reasonable regulation, what I see are people who do what is right for their clients, not because of a regulatory requirement or a published standard of care, but because it is merely the right thing to do. It is a dishonor to the vast majority of our marketplace who are called first to serve their communities, and happen merely to earn a living for doing so, to accuse them of putting selfish interests first. It is simply not what I see. What I see is the business owner who has worked her entire life to grow a business and is now graced with the sale of it, and has no idea what do with the proceeds so that she can honor the promises she has made. What I see is the family member suffering from cancer who can focus on his recovery because his financial affairs are completely and fully in order. What I see is the widow who relies on her financial advisor to transition to life without her spouse. What I see is the person entering retirement who can enjoy the fruits of their hard work, because they have an advisor who helped them plan and save, and who now guides them on living a dignified life, sustained by the power of choice. Where the authors of the DOL Rule see the financial services industry as populated with shadowy characters out for themselves, I see nothing but genuine concern and valuable expertise when I work with our financial advisors. My wish for you is to see what I see and help independent financial advisors like ours across America serve more clients, serve them better, and serve them more completely by reducing their regulatory burden without reducing the standard of care.

I thank the Chairman, Ranking Member, and the rest of the Subcommittee for allowing me to share my thoughts on the major challenges and unintended consequences of the DOL rule and the ways in which this Draft Bill provides the same investor protections while applying practical,

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[30] Putting value on your value: Quantifying Vanguard Advisor's Alpha®, September 2016 *available at* https://www.vanguard.com/pdf/ISGQVAA.pdf.

common-sense requirements that will ensure that Americans can continue to receive professional financial advice while they work toward a dignified retirement.