



## **The DOL Fiduciary Rule: A study on how financial institutions have responded and the resulting impacts on retirement investors**

August 9, 2017

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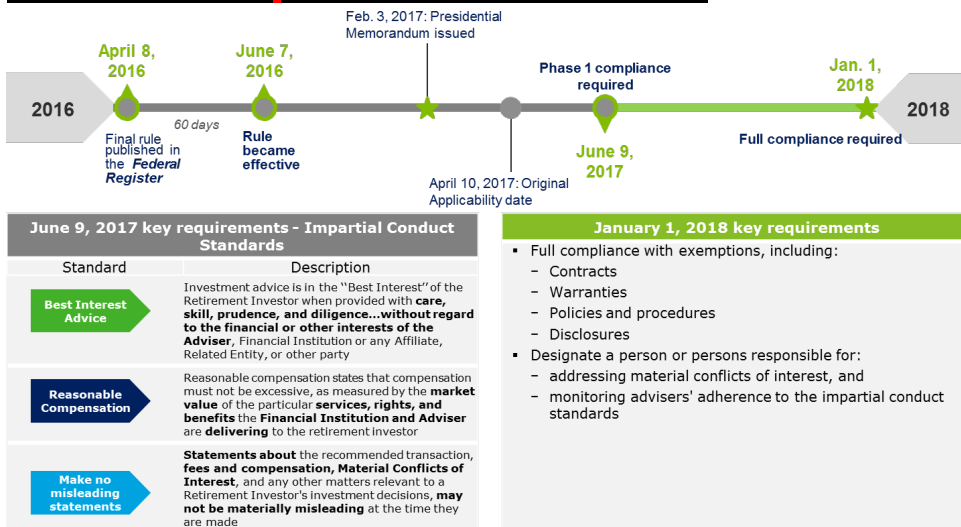
# 1. Executive Summary

## 1.1 Background

On April 20, 2015, the Department of Labor (“DOL”) proposed a new definition of who is a “Fiduciary” under the Employee Retirement Income Security Act of 1974 (“ERISA”) and the Internal Revenue Code of 1986. On the same day, the DOL published new administrative class exemptions from the prohibited transaction provisions of ERISA (29 U.S.C. 1106) and the Code (26 U.S.C. 4975(c)(1)): The Best Interest Contract Exemption (“BIC” Exemption) and the Class Exemption for Principal Transactions in Certain Assets Between Investment Advice Fiduciaries and Employee Benefit Plans and IRAs (“Principal Transactions Exemption”), as well as amendments to previously granted exemptions (referred to collectively as “the Rule” throughout this document).

The Rule became effective on June 7, 2016 and was originally scheduled to be phased in across two compliance dates with the first phase of compliance beginning on April 10, 2017. Following a Presidential Memorandum<sup>1</sup> directing an updated economic analysis of the Rule, the DOL removed certain transition period requirements, delayed the initial applicability date to June 9, 2017, and postponed the onset of certain Rule and exemption requirements until January 1, 2018.

**Figure 1.1: Updated Rule timeline and requirements**



## 1.2 Approach

The Securities Industry and Financial Markets Association (“SIFMA”) engaged Deloitte to facilitate a study with 21 SIFMA member firms (referred to as the “study participants” or “financial institutions” throughout this document) whose businesses include providing individual investors with financial advice and related services. The study was conducted to understand and analyze the

<sup>1</sup> Source: <https://www.whitehouse.gov/the-press-office/2017/02/03/presidential-memorandum-fiduciary-duty-rule>

realized and potential impacts of the Rule on retirement investors and financial institutions.

Through the analysis of information gathered via facilitated interviews of study participants, as well as data received from them, Deloitte sought to identify the impacts from study participants' business and compliance decisions to retirement investors in the following areas:

- Access to investment advice
- Access to investment products
- Costs of investment advice and products

Furthermore, this study assessed the impacts of the Rule and corresponding business and compliance decisions on the study participants in the following areas:

- Operational impacts and associated costs
- Litigation and regulatory risks

While the focus of this report is on retirement accounts under the purview of the DOL, there were instances noted where non-retirement accounts were also impacted.

### 1.2.1 Overview of Financial Institutions Participating in the Study

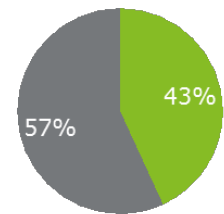
The 21 member firms invited by SIFMA and choosing to participate in the study account for more than 132,000 financial advisors<sup>2</sup>, representing 43% of US financial advisors<sup>3</sup>. The study participants serve approximately 35 million retail retirement accounts holding approximately \$4.6 trillion in assets, which represents 27% of the \$16.9 trillion US retirement savings marketplace<sup>4</sup>.

In addition to covering a large portion of the marketplace, the range of size and business mix of study participants reflects the diversity of the financial institutions offering retirement advice to retail investors in the US.

The assortment of participating financial institutions included, but was not limited to, coverage of the following characteristics:

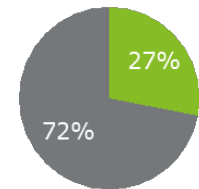
- Firm size: Small, medium and large firms by assets under management ("AUM"), number of clients, number of advisors and amount of net capital
- Business models: wirehouses, regional broker-dealers, independent broker-dealers, bank-owned broker-dealers, dual registrants and boutique firms

**Figure 1.2: Study participants covered a large cross section of the industry**  
**All Financial Advisors**



Our data represents **132,767** out of the 310,504 financial advisors in the United States

**All Qualified Assets**



Those advisors manage an aggregate **\$4.6T qualified assets** out of the \$16.9T retirement savings marketplace

■ Participating Firms  
■ Remaining Marketplace

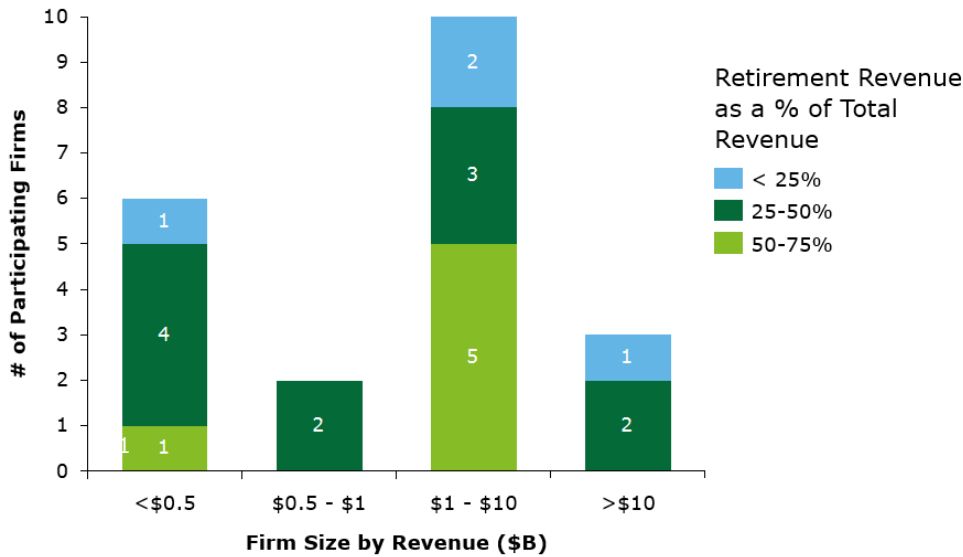
<sup>2</sup> This study uses the term "advisor" to mean individuals registered with broker-dealers or dually registered broker-dealers/registered investment advisors, maintaining the securities licenses to conduct activities they engage in (e.g., Series 6, 7, 63, 65)

<sup>3</sup> Based on comparison of study participants' financial advisor population to Cerulli 2016 data

<sup>4</sup> Board of Governors of the Federal Reserve System, "Financial Accounts of the United States: Flow of Funds, Balance Sheets, and Integrated Macroeconomic Accounts: Fourth Quarter 2016" Federal Reserve Statistical Release Z.1; available at: <http://www.federalreserve.gov/releases/Z1/current/z1.pdf>. DB assets do not include claims of pension fund on sponsor. Also see Investment Company Institute (ICI), "U.S. Retirement Market, Fourth Quarter 2016"

- Client segments served: mass market, mass affluent, high net worth, ultra-high net worth
- Product Offerings: equities, fixed income, mutual funds, annuities, directly held funds, alternative investments and managed accounts

**Figure 1.3: Study Participant breakdown by advisor count and retirement revenue percentage**



## 1.3 Summary of Findings<sup>5</sup>

### 1.3.1 Primary findings

- **Access to brokerage advice services has been eliminated or limited by 53% of study participants as part of their approach for complying with the Rule**
- **The shift of retirement assets to fee-based or advisory programs has accelerated as the result of the elimination or limitation of brokerage advice services**
- **95% of study participants have made changes to the products available to retirement investors, including limiting or eliminating asset classes offered and certain share classes or product structures**

### 1.3.2 Additional findings

- **Financial institutions' responses and approaches to complying with the Rule have varied, reflecting the wide ranging legal and compliance interpretations of the Rule**

<sup>5</sup> The findings were made based on the analysis of information and data provided by the study participants to Deloitte. Deloitte has analyzed, aggregated and summarized the information provided, but was not asked to and did not independently verify, validate or audit the information presented by the study participants.

- **Rule implementation and ongoing compliance efforts have caused significant operational disruption and increased costs for financial institutions**
- **Uncertainty surrounding the future of the Rule is causing financial institutions to incur additional real costs as well as ongoing opportunity costs**

## 2. Overview of Financial Institutions' Responses and Approaches to the Rule

Financial institutions' responses and approaches to the Rule varied widely, though enhancements to fee-based services and reductions in advised brokerage products and services were common themes.

### **2.1 There was wide variability in financial institutions' approaches for complying with and operating under the Rule**

Based on the information provided to Deloitte, steps that study participants' have taken to comply with the June 9, 2017 applicability date, as well as in their preparations for the January 1, 2018 applicability date, vary widely.

The variations in approaches generally resulted from the combination of how financial institutions differed on decisions and outcomes within the following areas:

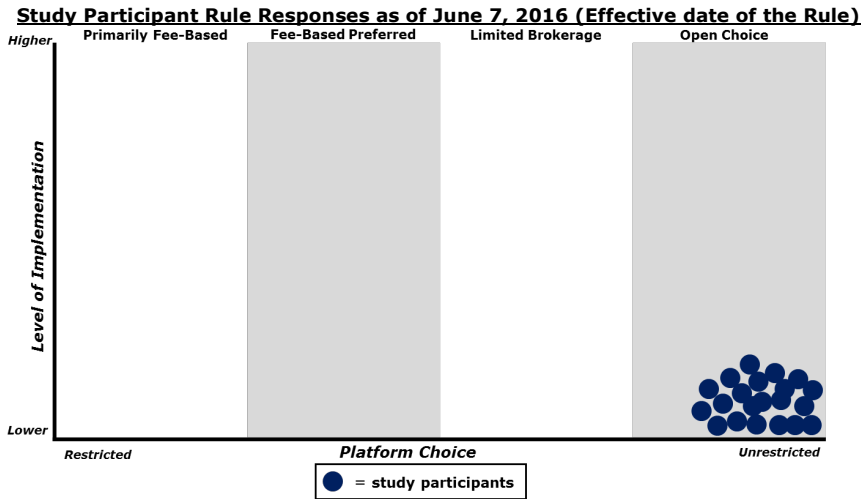
- Service offerings
- Product offerings
- Level of implementation

Many financial institutions that had similar profiles before the Rule, in terms of service and product offerings, diverged considerably in their post-Rule operating models, some extensively and some in minor ways. The variety of responses also reflects the wide ranging legal and compliance interpretations of the Rule and its requirements.

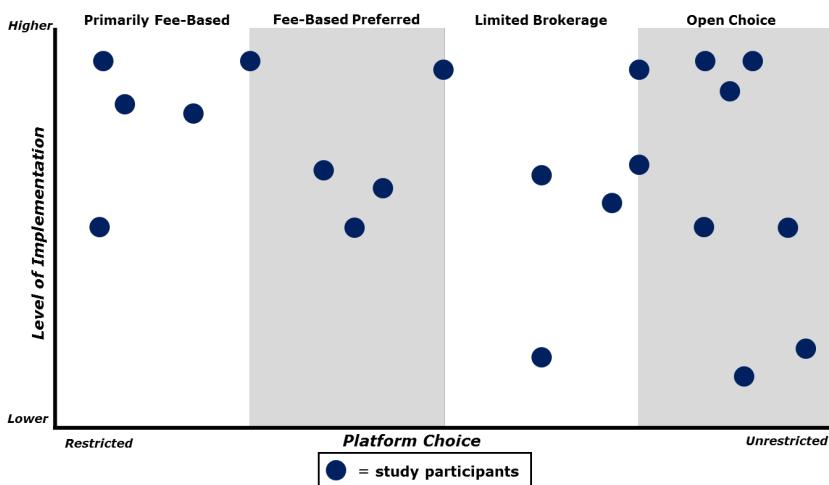
Because implementation efforts for many financial institutions are ongoing as they optimize their June 9<sup>th</sup> requirements and prepare for January 1<sup>st</sup>, it is possible that there will be more changes to financial institutions' operating models that will result in even more divergence in approaches to complying with and operating under the Rule.



**Figure 2.1: Study Participants' responses to the Rule as of June 7, 2016 and June 9, 2017**



**Study Participant Rule Responses as of June 9, 2017 (Applicability date of the Rule)**



**2.2 Although there was variability in the specific changes to service and product offerings, generally the changes resulted in a shift towards fee-based accounts and a reduction in available products in retirement brokerage accounts**

Although responses to the Rule resulted in a wide array of changes to individual financial institutions' advice services and product offerings for retirement accounts, these responses can be broadly categorized into four different approaches:

- **Primarily Fee-Based:** Elimination of, or vast reduction in advised brokerage; retirement advice offered via a fee-based platform
- **Fee-Based Preferred:** Introduction of enhanced fee-based offerings and program changes intended to promote the fee-based platform over advised brokerage alternatives (e.g., ETF and mutual fund model portfolios with low account minimums)

- **Limited Brokerage:** Limiting access to advised brokerage platforms based on account minimums or product availability (e.g., mutual funds only, fixed income / equities only)
- **Open Choice:** Retaining broad access to advised brokerage and fee-based platforms

It should be noted that while the Rule was the primary driver of the strategies noted above, in certain cases, advice service and product changes were extended to non-retirement accounts as well, broadening the impact of the Rule. For example, in some cases fee schedule changes were made in response to the Rule but were applied to both retirement and non-retirement accounts.

It should also be noted that within each of the categories above, study participants' decisions and strategies varied widely. For example, financial institutions that chose the "open choice" model differed from each other in how they implemented that strategy.

### 2.3 Many of the expected impacts of financial institutions' responses to the Rule have not yet been realized because financial institutions are at different stages of implementing those responses

Though all financial institutions indicate they are currently in compliance with the Rule, some are further along in their implementation of changes meant to optimize operations supporting the June 9<sup>th</sup> requirements or to meet the January 1<sup>st</sup> requirements. Many of the changes and decisions that have not yet been implemented include changes or additional refinements to advice service offerings, products, compensation, operational processes, internal controls, and technology.

As a result of the variation that existed in financial institutions' level of implementation, Deloitte categorized each financial institution as "Lower," "Medium," or "Higher" according to the level of implementation based upon the information provided by each as compared to the definition of the categories set out below.

- **Lower Level of Implementation:** Financial institutions that are awaiting clarity on timing and potential changes to the Rule before finalizing decisions and beginning implementations
- **Medium Level of Implementation:** Financial institutions that have made key decisions and planned for implementation, but are awaiting Rule clarity before executing most implementation plans, or are trying to build flexibility to account for possible changes
- **Higher Level of Implementation:** Financial institutions that have made and implemented many key Rule decisions and are largely planning on going forward with these decisions even if the Rule changes

However, many of the study participants that were categorized as "Lower," or "Medium" indicated that their pace of planning and implementation was primarily driven by concerns that making significant investments in changing their business models and supporting people, processes and technology could become "throw-away" costs if the Rule were to be substantially changed or delayed (please see Section 5, *Impact of Rule Uncertainty to Investors and Financial Institutions*, for a more detailed discussion).

If the Rule remains substantially intact with the January 1<sup>st</sup> applicability date, based on responses from study participants it is likely that many of the "Lower" and "Medium" financial institutions will increase their implementation levels and shift their approaches away from "open choice" and towards "fee-based."

#### **2.4 Litigation risk has been a key driver in business and compliance decisions**

Almost all study participants indicated that litigation risk has been a primary concern throughout their process to prepare for the Rule. These concerns became one of the most prevalent driving factors in the majority of business and compliance strategy decisions taken to date and the study participants stated that such concerns will continue to weigh heavily in compliance strategies for the January 1<sup>st</sup> applicability date.

Financial institutions indicated that the unease over litigation risk was amplified because they felt that it is virtually impossible to quantify this risk since there are (i) no precedent of lawsuits or enforcement actions, (ii) relatively minor compliance or reporting errors could lead to fiduciary liability, and (iii) the litigation risk is perpetual.

These amplified concerns often led to financial institutions taking conservative approaches to compliance that resulted in risk-based decisions to eliminate or limit services or products to retirement investors. Many financial institutions felt that products and services they chose to eliminate could have been offered in a way that complied with the spirit and letter of the Rule, but that the risk of litigation was too great.

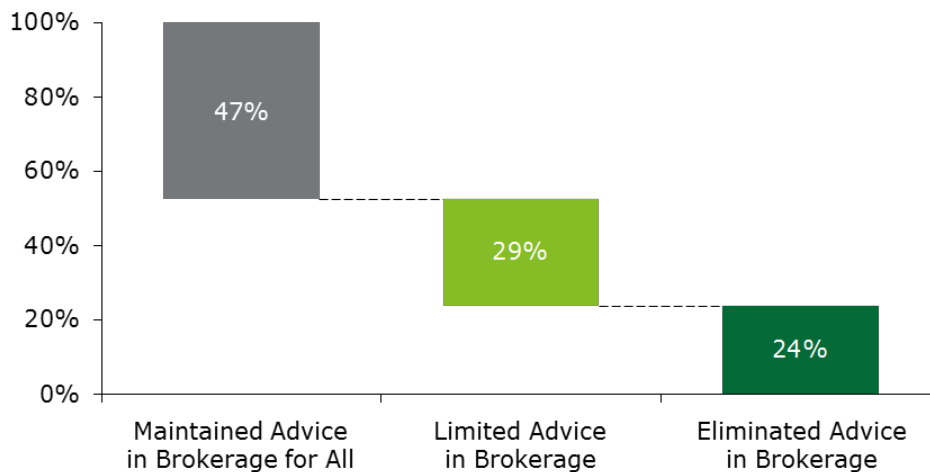
# 3. Impact to Investors

In many instances, financial institutions’ responses to the Rule resulted in a reduction of choice in services and products available to investors.

**3.1 There were substantial changes in service model options available to retirement investors, with the most common change being the reduction of brokerage services as an option**

As of June 9<sup>th</sup>, 53% of study participants reported limiting or eliminating access to advised brokerage for retirement investors, impacting 10.2 million accounts and \$900b AUM.

**Figure 3.1: Elimination or limitation of access to advised brokerage**



It was observed that 53% of study participants eliminated or limited retirement investors’ access to advice in a brokerage account. The study participants that are classified as “Eliminated Advice in Brokerage” did so by exiting advised brokerage services for retirement investors, and the study participants that are classified as “Limited Advice in Brokerage” increased account or household minimums required to continue to receive advice. As business and service models changed, retirement investors with advised brokerage accounts at one of these financial institutions generally chose to:

- **Transition from an advised brokerage account to a fee-based account**

- **Transition from an advised brokerage account to a self-directed account**
- **Transition their advised brokerage account to a different financial institution continuing to offer the service**

It should be noted that all of the study participants, including those classified as “Maintained Advice in Brokerage for All,” have made at least some changes to the products within their advised brokerage platforms, including eliminating certain asset classes, product types, and share classes.

In addition, several financial institutions noted that they plan to make additional limitations to their advised brokerage offering should the current version of the Rule go into effect on January 1, 2018.

### 3.1.1 Transitions from advised brokerage to fee-based

*The trend towards fee-based accounts was likely accelerated by the Rule*

In order for investors to retain access to advice on retirement accounts from the study participants who eliminated or limited advised brokerage access, 10.2 million accounts, with \$900 billion in assets, would have to move to a fee-based option. To accommodate clients leaving advised brokerage, 62% of study participants broadened access to advice through fee-based programs by lowering account minimums, launching new offerings, or both.

*The fee-based model is significantly different from advised brokerage and carries with it a different fee structure*

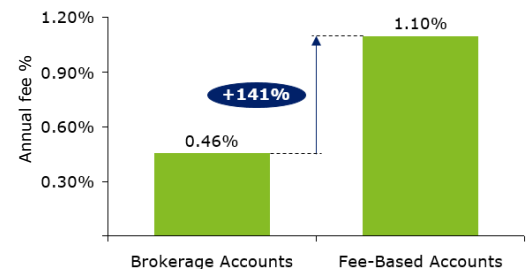
Fee-based accounts are Fiduciary accounts regulated by the US Securities and Exchange Commission under the Investment Advisers Act of 1940. Typically, fee-based accounts offer a higher level of service than brokerage accounts and often include automatic rebalancing of accounts, comprehensive annual reviews, enhanced reporting to account holders, and access to third party money managers. The fees are generally an “all-in” asset-based fee that is generally higher than the fees paid in an advised brokerage account (to compensate for the additional services).

Out of the subset of study participants that provided their average advised brokerage and fee-based account fees, it was observed that annual fee-based account fees were 64 bps higher than advised brokerage fees, on average (110 bps versus 46 bps).<sup>6</sup>

*There are likely additional reductions in service model options to come*

It was noted that the majority of the study participants that were classified as having a “Higher” level of implementation, as well as a “Medium” level of implementation, had eliminated or limited their advised brokerage offering, as well as noticed a large number of retirement investors choosing to transition their brokerage accounts to a fee-based relationship.

**Figure 3.2: Fee-based options often carry an increase in services and fees<sup>6</sup>**



“Study participants, particularly those with a ‘Medium’ or ‘Lower’ level of implementation, have planned to execute account transitions...but have not yet implemented those changes.”

<sup>6</sup> Average annual account fees for advised brokerage and fee-based programs were provided by a subset of study participants. An aggregate average was taken for each program, as noted above

Study participants reported that additional retirement investors would lose access to an advised brokerage account if the Rule were to go into effect as is on January 1, 2018. Study participants, particularly those with a “Medium” or “Lower” level of implementation, have planned to execute account transitions to a client’s chosen option (generally fee-based accounts if in the retirement investor’s best interest, or self-directed brokerage accounts) but have not yet implemented those changes.

### **3.1.2 Transitions from advised brokerage to self-directed**

63% of study participants that limited or eliminated access to advised brokerage had retirement investors elect to move to a self-directed account. These investors lost access to personalized advice for any assets transitioned to the self-directed model.

Financial institutions that eliminated or limited their advised brokerage platforms gave retirement investors an option to either transition to a fee-based program, self-directed brokerage account, or in some cases, a new platform they were launching. Study participants indicated that many retirement investors moved into a self-directed brokerage account for one or several of the following reasons:

- the retirement investor did not want to move to a fee-based account
- it was not in retirement investor’s best interest to move to a fee-based account
- the retirement investor did not meet the account minimums required for a fee-based account
- the retirement investor wished to maintain positions in certain asset classes which were not eligible for a fee-based account

### **3.1.3 Decrease in access to Rollover Advice for Retirement Investors**

19% of study participants limited or eliminated rollover advice for retirement investors, restricting advisors to an education-only capacity when discussing rollovers with retirement investors.

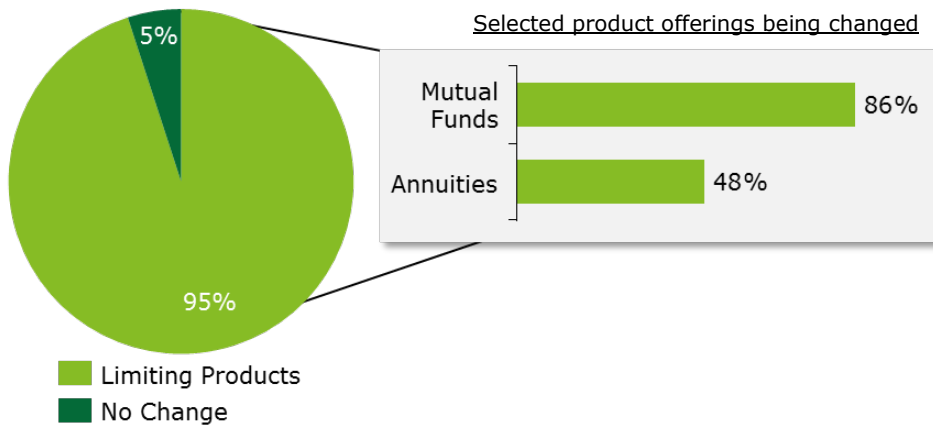
Of the 81% that retained access to rollover advice, study participants added requirements for investors to produce additional documentation around plan fees and services. This documentation is not easily accessible and does not exist in a single database or source. Study participants report that it is too early to understand the impact of these changes but some expect to see a decrease in rollovers as a result (please see Section 4, *Impact to Financial Institutions’ Operations*, for a more detailed discussion).

## **3.2 Reductions and changes in access to products for retirement investors**

95% of study participants reduced access to or choice within the products offered to retirement investors regardless of the level of sophistication of the retirement investor. Products affected included, but were not limited to, mutual funds, annuities, structured products, fixed income, and private offerings. It was also noted that study participants had to limit asset classes for which a prohibited transaction exemption was not available (e.g., risk-based principal sales of non-investment grade debt, certain underwriting and new-issue activities). The limitation of products available to retirement investors

potentially impacted 28.1 million accounts and \$2.9 trillion in AUM of study participants.

**Figure 3.3: Percentage of study participants changing available products<sup>7</sup>**

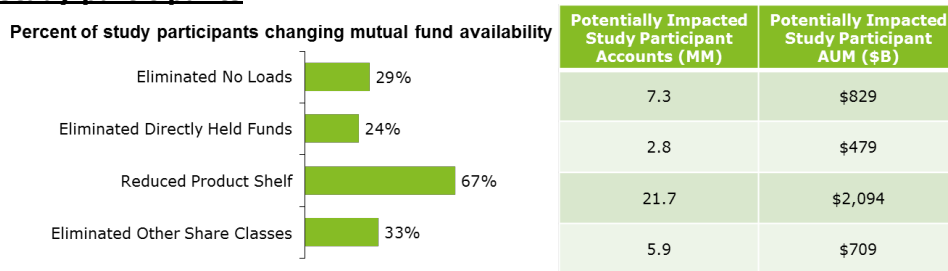


### 3.2.1 Reduction in Mutual Funds Available to Investors

The most commonly seen change to product offerings was a reduction in the number and types of mutual funds available to retirement investors, with 86% of study participants reporting having done so. The reduction in available mutual funds primarily took shape in three common ways:

- Elimination of certain share classes
- Elimination of certain mutual fund families or specific funds
- Elimination of all mutual funds in advised brokerage platforms

**Figure 3.4: Potential impact of reduction in mutual fund availability by study participants<sup>8</sup>**



#### *Elimination of No Load Funds*

It was observed that 29% of study participants eliminated No Load funds from their brokerage platform. The elimination of No Load funds from advised

<sup>7</sup> Changes were not mutually exclusive

<sup>8</sup> Ibid

brokerage platforms results in retirement investors losing access to what is sometimes the lowest cost share class of certain funds.

#### *Elimination of Directly Held Funds*

24% of study participants eliminated mutual funds held directly at mutual fund companies, and additional participants stated that if the Rule goes into effect as is for January 1<sup>st</sup>, they plan to do the same.

Eliminating directly held mutual funds potentially changes the service model for the retirement investor. Retirement investors who do not move directly held funds to their financial institutions will lose access to advice on those assets. Additionally, they will need to interact directly with the fund company for any future servicing needs. For investors moving directly held funds to their financial institution, increased costs may be incurred. Directly held funds are typically less expensive for investors due to the elimination of certain costs, such as account and maintenance fees, associated with holding a fund in a brokerage accounts at a financial institution.

#### *Reduction in Mutual Fund Product Shelf*

67% of the study participants reduced the number of mutual funds offered to retirement investors. Reductions included removing funds offered from certain families and funds within families. Often, the reduction in the mutual fund product shelf occurred during the enhanced product due diligence efforts financial institutions undertook during their Rule compliance implementation, as well as while renegotiating compensation agreements with fund families.

The reduction of the mutual fund product shelf for the majority of the financial institutions impacts investors by reducing their choice of available funds.

#### *Eliminations of Other Share Classes (not including A shares)*

Close to 33% of study participants that continue to offer an advised brokerage platform to all or a subset of retirement investors eliminated other share classes, including B shares and C shares.

### **3.2.2 Reduction in Annuities Available to Investors**

Throughout the course of the study, it was observed that 48% of study participants made reductions to their annuity offerings to retirement investors.



**Figure 3.5: Potential impact of study participants’ change in annuity availability**



In addition, a few study participants communicated that they had, or were exploring, eliminating variable annuities and/or fixed indexed annuities from their offerings to retirement investors.

*Reduction in Annuity Share Class*

Study participants limited the available share classes specifically for variable annuities to their retirement investors. Limitations were commonly placed on C shares, which have no up-front or back-end sales charges, as well as a few other share classes. It was observed that 24% of study participants reduced the share classes available for annuities to retirement investors. Common reasons for doing this included due diligence and compensation changes.

*Consolidation of Carriers Available*

In addition to study participants reducing the share classes available for variable annuities, study participants also consolidated the carriers that they offer variable annuities from to their retirement investors. 43% of study participants reduced the annuity carriers available to their retirement investors.

Reduction in carriers occurred as a result of study participants performing a product due diligence exercise and renegotiating compensation terms with the carriers. Several study participants reduced and simplified the way they compensated their advisors and collected third party payments from annuity carriers to remove conflicts of interests, and carriers that were unable or unwilling to accommodate changes to compensation structures were often removed.

# 4. Impact to Financial Institutions' Operations

Complying with the Rule has required significant investment and resulted in operational impacts across people, process and technology.

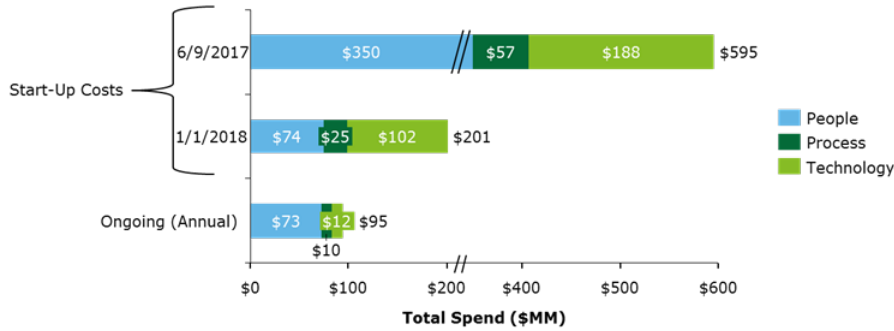
## 4.1 Study participants have spent over \$595 million on Rule readiness activities to date

Across people, process and technology, study participants spent approximately \$595 million preparing for June 9<sup>th</sup> and expect to spend over \$200 million more before the end of 2017 ("start-up costs"). Total ongoing annual spend by study participants to support Rule decisions is estimated to be nearly \$100 million with their annual estimates ranging from \$125,000 to \$15 million. The breakdown of average spend by financial institution based on size is shown below:

<b>Financial Institution Size<sup>9</sup></b>	<b>Net Capital</b>	<b>Average Start-Up Spend Per Financial Institution (\$MM)</b>	<b>Average Ongoing Spend Per Financial Institution (\$MM)</b>
<b>Large</b>	Greater than \$1 billion	\$54.64	\$5.89
<b>Medium</b>	\$50 million to \$1 billion	\$16.37	\$3.15
<b>Small</b>	Less than \$50 million	\$2.3	\$1.1

<sup>9</sup> The financial institution size categories used are the same categories used by the DOL in their Regulatory Impact Analysis (source: <https://www.dol.gov/sites/default/files/ebsa/laws-and-regulations/rules-and-regulations/completed-rulemaking/1210-AB32-2/conflict-of-interest-ria.pdf>, Page 216, Section 5.2.6)

**Figure 4.1: Study participants' total spend on people, process and technology<sup>10</sup> to support Rule decisions**



Even with the significant spend to date, study participants noted that many of the operational changes put in place for June 9<sup>th</sup> are highly manual, stop-gap measures, which are unsustainable long-term due. Additionally, study participants highlighted that ongoing spend estimates cannot account for potential risk events such as litigation, regulatory changes, or marketplace shifts which could substantially change costs.

**4.1.1 Estimated total broker-dealer costs**

In order to understand the potential costs to the broader broker-dealer industry, Deloitte multiplied the average cost estimate of each financial institution size category by the number of institutions<sup>11</sup> in their respective size category.

Financial Institution Size	Net Capital	Number of broker-dealers in industry, per DOL <sup>12</sup>
Large	Greater than \$1 billion	42
Medium	\$50 million to \$1 billion	147
Small	Less than \$50 million	2,320

Applying this methodology, but excluding small financial institutions<sup>13</sup>, broker-dealers are estimated to have spent in excess of \$4.7 billion on start-up costs relating to the Rule. This estimate is considerably greater than the range of start-up cost estimates provided by the DOL in their 2016 Regulatory Impact

<sup>10</sup> "People, process and technology" describes human capital, process change and technology costs. See sections 4.2.1, 4.3 and 4.4 for further details of each category

<sup>11</sup> Source: DOL Regulatory Impact Analysis <https://www.dol.gov/sites/default/files/ebsa/laws-and-regulations/rules-and-regulations/completed-rulemaking/1210-AB32-2/conflict-of-interest-ria.pdf>

<sup>12</sup> DOL Regulatory Impact Analysis (source: <https://www.dol.gov/sites/default/files/ebsa/laws-and-regulations/rules-and-regulations/completed-rulemaking/1210-AB32-2/conflict-of-interest-ria.pdf> , Page 233, Figure 5-9 Total Costs for BDs (In Millions of Dollars))

<sup>13</sup> In the 2016 Regulatory Impact Analysis, the DOL appears to have excluded small firms from their total costs estimates. Deloitte has followed this same methodology when calculating estimated total start-up and ongoing costs for the marketplace

Analysis, which estimated that the total start-up costs for the broker-dealer marketplace would be between \$2 billion and \$3 billion<sup>14</sup>.

Notably, the total broker-dealer marketplace start-up cost of \$4.7 billion is nearly identical to the start-up cost estimate that was included in the "Report on the Anticipated Operational Impacts to Broker-Dealers of the Department of Labor's Proposed Conflicts of Interest Rule Package" published by Deloitte in 2015<sup>15</sup>, though that report underestimated the total start-up costs for large financial institutions and overestimated the total start-up costs for medium financial institutions.

Estimated total broker-dealer start-up costs to comply with Rule requirements				
Financial Institution Size Category	Number of Financial Institutions	Cost Per Financial Institution (\$MM)	Total Cost (\$MM)	DOL 2016 Projection <sup>16</sup> (\$MM)
Large	42	\$ 54.64	\$ 2,295	
Medium	147	\$ 16.37	\$ 2,407	
<b>Estimated Total Start-up Cost</b>			<b>\$ 4,702</b>	<b>\$2,052- \$3,001</b>

Following the same methodology, when applied to ongoing costs, it is estimated that broker-dealers will spend over \$700 million annually to comply with the Rule. The 2016 Regulatory Impact Analysis conducted by the DOL estimated total ongoing costs for the broker-dealer marketplace between \$463 million and \$679 million.

Estimated total ongoing annual costs to comply with Rule requirements				
Financial Institution Size Category	Number of Financial Institutions	Cost Per Financial Institution (\$MM)	Total Cost (\$MM)	DOL 2016 Projection <sup>17</sup> (\$MM)
Large	42	\$ 5.89	\$ 248	
Medium	147	\$ 3.15	\$ 463	
<b>Estimated Ongoing Annual Cost</b>			<b>\$ 711</b>	<b>\$463 - \$679</b>

<sup>14</sup> DOL Regulatory Impact Analysis (source: <https://www.dol.gov/sites/default/files/ebsa/laws-and-regulations/rules-and-regulations/completed-rulemaking/1210-AB32-2/conflict-of-interest-ria.pdf> , Page 233, Figure 5-9 Total Costs for BDs (In Millions of Dollars))

<sup>15</sup> Source: Report on the Anticipated Operational Impacts to Broker-Dealers of the Department of Labor's Proposed Conflicts of Interest Rule Package <https://www2.deloitte.com/content/dam/Deloitte/us/Documents/regulatory/us-advisory-broker-dealers.pdf>

<sup>16</sup> DOL Regulatory Impact Analysis (source: <https://www.dol.gov/sites/default/files/ebsa/laws-and-regulations/rules-and-regulations/completed-rulemaking/1210-AB32-2/conflict-of-interest-ria.pdf> , Page 233, Figure 5-9 Total Costs for BDs (In Millions of Dollars))

<sup>17</sup> See footnote 9, above

#### 4.1.2 Opportunity cost of the Rule

While difficult to quantify in terms of dollars, 100% of study participants indicated substantial opportunity costs incurred across people, process and technology due to the Rule. The focus on Rule priorities led to the delay or abandonment of projects and initiatives spanning people, process and technology, including but not limited to:

- Customer experience enhancements
- Business development initiatives
- Investor education activities

#### 4.2 Study participants' human capital spend will exceed \$420 million before 2018, with an additional \$70 million in estimated ongoing annual costs

Generally, human capital needs to support financial institutions' responses to the Rule and ongoing compliance have or will be addressed through:

1. Additional full-time employees ("FTE") or reallocating existing employees
2. Engaging third parties (e.g., contractors, vendors)

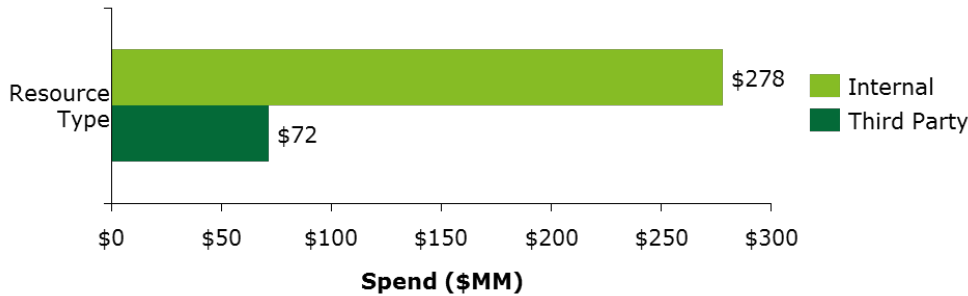
According to study participants, these resources are primarily supporting efforts in the following ways:

Staffing source	Primary Roles
<b>1) New or Reallocated FTEs</b>	<ul style="list-style-type: none"><li>• Surveillance</li><li>• Supervision</li><li>• Compliance</li></ul>
<b>2) Third-parties</b>	<ul style="list-style-type: none"><li>• Rule understanding</li><li>• Legal Strategy</li><li>• Business strategy</li><li>• Project/program management</li><li>• Technology initiatives</li></ul>

#### 4.2.1 Study participants spent approximately \$350 million on human capital needs to ready for June 9<sup>th</sup>

To support the human capital needs of Rule decisions, study participants have spent a total of nearly \$350 million to date. This number is primarily driven by the onboarding of FTEs and reallocation of existing employee resourcing toward surveillance, supervision and compliance roles, including those needed to support an adherence to the Impartial Conduct Standards and enhanced rollover processes.

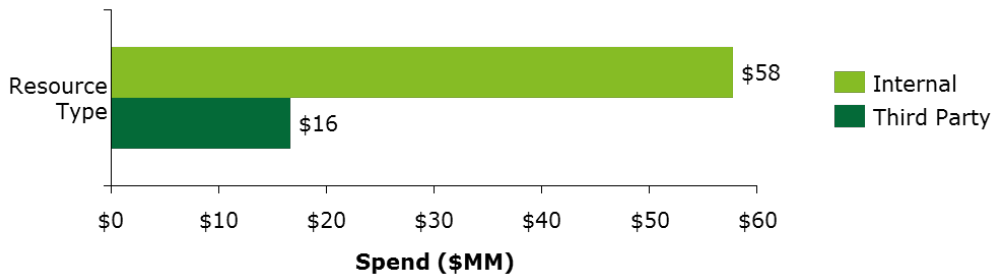
**Figure 4.2: Breakdown of human capital spend to-date as of June 9, 2017**



**4.2.2 Human capital spending related to the Rule is expected to continue through 2017 and ongoing annual costs are expected to be significant**

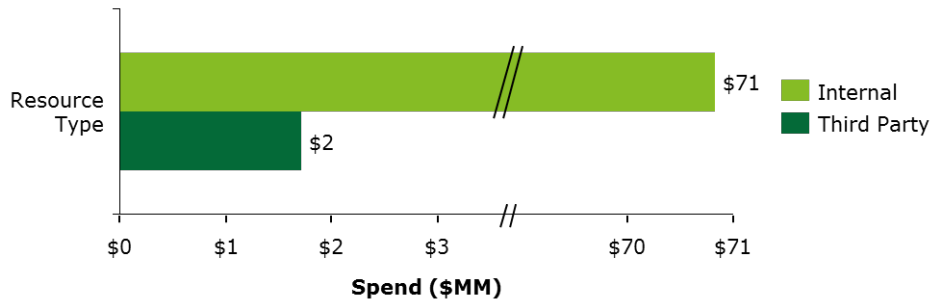
Internal resources are expected to continue to drive human capital spending through the remainder of 2017, making up over three quarters of the estimated \$74 million total additional spend by study participants. This number is primarily driven by the onboarding of FTEs and reallocation of existing employee resourcing toward surveillance, supervision and compliance roles, including those needed to support an adherence to the Impartial Conduct Standards and enhanced rollover processes.

**Figure 4.3: Breakdown of estimated additional human capital spend through January 1, 2018**



Estimated ongoing annual costs associated with human capital needs totaled almost \$73 million, with study participants' annual estimates ranging from \$75 thousand to \$14 million.

**Figure 4.4: Breakdown of estimated ongoing, annual human capital spend**



### 4.3 Significant disruption has resulted from process changes

Processes to support financial institutions' responses to the Rule also led to noticeable operational impacts by study participants. Specifically, financial institutions noted large operational impacts from new or enhanced processes related to:

- Rollover recommendations
- Product due diligence
- Financial institution and advisor compensation evaluation

#### 4.3.1 Rollover Recommendation Processes

Due to the Rule's revised definition of investment advice, certain rollover recommendations are now subject to the Impartial Conduct Standards. As a result of this change, 100% of study participants indicated that significant efforts were expended to evaluate their rollover processes and if rollover advice would be allowed going forward.

Financial institutions continuing to allow rollover recommendations have spent significant time and effort developing how a recommendation would be documented and evaluated against the Impartial Conduct Standards. The most common process change identified was substantially enhancing documentation requirements relating to rollover recommendations, particularly around existing plan costs and services. While some study participants invested in technologies to aid in the rollover recommendation process, most indicated that new processes are highly manual and accomplished via forms populated through conversations with and documentation received from retirement investors. All financial institutions indicated the lack of easily accessible and reliable plan data, such as 404a-5 fee disclosures, has significantly disrupted the rollover process. The necessity of manual processes and lack of easily accessible data has the potential to increase financial institutions' operational risk.

In addition to enhanced documentation processes, certain study participants changed their review and approval process for rollover recommendations. Some financial institutions set up teams, staffed with FTEs dedicated solely to the review and approval of rollover recommendations. In addition to costs associated with the development of new processes and, in certain circumstances, the hiring of FTEs, all respondents indicated that the most substantial impact of the change in rollover processes has been the increase in time and effort required to deliver rollover advice to retirement investors.

### *Education-only Processes*

Those financial institutions, which elected to prohibit or significantly limit rollover recommendations and serve in an education-only capacity, also implemented policy and process changes including updates to retirement investor onboarding and documentation. The primary impact noted by financial institutions electing to operate in an education-only capacity for rollovers was the substantial training efforts undertaken to ensure advisors understand what is and is not allowed under the model. In addition to the training requirements, study participants that previously allowed rollover recommendations but now operate in an education-only capacity indicated that the process change has been a significant disruption for their advisors and retirement investors, who had become accustomed to delivering and receiving rollover advice.

#### **4.3.2 Product Due Diligence Process Changes**

In order to support the changes to product offerings discussed earlier, almost all study participants indicated that their due diligence processes were changed or enhanced. Due diligence process changes include:

- New or enhanced internal research for certain products
- New or enhanced vendor research for certain products

In a number of instances, financial institutions made changes to both internal and vendor research support for their due diligence processes. Impacts resulting from changes to due diligence processes include increased costs for additional FTEs and vendor contracts, as well as changes in product offerings due to the results of new due diligence processes. As discussed in Section 3, "Impact to Investors," mutual fund product shelves were most affected by new due diligence processes. During interviews, some financial institutions indicated the removal of over a thousand funds from their platforms as a result of their new processes.

#### **4.3.3 Changes to Compensation Processes**

Beyond rollover advice and due diligence process changes, 76% of study participants implemented updates or revisions to their firm and advisor compensation evaluation processes. All study participants indicated that they plan to implement new or additional process changes if the Rule remains as is for January 1, 2018.

### *Advisor Compensation*

The most common change indicated or anticipated is leveling compensation arrangements to both the financial institution and to advisors. The primary operational impacts resulting from these new processes were:

- Resource time and efforts to carry out the evaluation
- Resource time and efforts to implement changes

### *Third Party Compensation & Revenue Share*

Specific operational impacts arose from renegotiating selling partner agreements (i.e., revenue sharing) and compensation features (e.g., commission percentages, payout options) with product manufacturers. As with

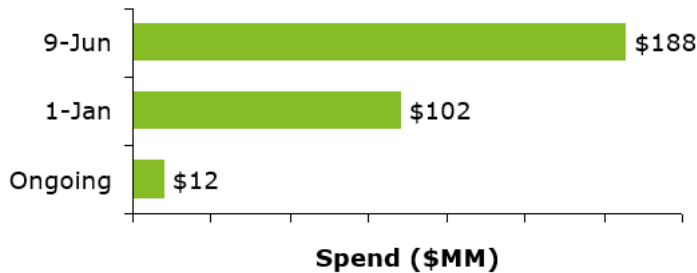


changes in due diligence processes, the change in compensation evaluation processes has led certain financial institutions to reduce their product offerings due to product manufacturers being unable or unwilling to conform to the new compensation criteria.

#### 4.4 Technology efforts to support people and process change has led to significant costs

Study participants' technology operations were significantly impacted by Rule decisions. To support their people and process changes, financial institutions have spent heavily on technology initiatives. Total technology spend through June 9, 2017 by study participants was in excess of \$185 million, with spending expected to continue through January 1, 2018 and on an ongoing annual basis.

**Figure 4.5: Financial Institutions' technology expenditures to support Rule decisions**



The average technology spend through June 9, 2017 among study participants was \$12 million, with estimated average additional spend through January 1, 2018 of \$6.5 million and average ongoing annual technology costs of roughly \$1 million.

Respondents indicated that technology to support the following Rule responses have been the primary drivers of technology impact:

- Rollover processes
- Principal trading controls
- Disclosure requirements, including website

# 5. Impact of Rule Uncertainty to Investors and Financial Institutions

Uncertainty with the future of the Rule has caused study participants to postpone their Rule response activities leading to additional potential firm and investor impacts.

Uncertainty in the January 1, 2018 Rule requirements has resulted in study participants delaying:

- Finalizing product and service changes
- Implementing technology solutions
- Adjusting compensation received from third parties and paid to their advisors

Study participants have indicated that they plan to make additional product and service changes as they get more clarity around the Rule, specifically around:

- Additional mutual fund share class changes
- Reduction in variable annuity availability
- Resignation of directly held mutual funds
- Limitation on additional asset classes
- Further client segmentation (e.g., loss of advice, movements into other platforms)
- Launch of new platforms (e.g., robo-advice, call-center, self-directed)

One consistent theme noted was that due to the uncertainty of the Rule, though study participants were actively exploring T shares, Clean shares, or modified A shares, almost none had moved forward with implementation on their advised brokerage platform. A few financial institutions adopted lower cost fund options on self-direct brokerage and/or advisory platforms, but not on their advised brokerage platform. Future adoption of T shares, Clean shares, and modified A shares is unclear but has the potential to substantially impact the makeup of mutual funds offered by financial institutions to retirement investors.

Delays in finalizing these decisions may lead to retirement investors purchasing products that may no longer be offered following future clarity on the Rule.

Further rollout and implementation of new share classes, limitation of additional asset classes, compensation changes, and further client segmentation all are disruptive to the client experience, and many of the study participants are awaiting final clarity on the Rule before moving forward with some of these activities.

Study participants have postponed certain additional investments in technology to avoid investment in capabilities that may not be needed in the future if the Rule changes. Study participants would prefer to allocate the funds to other projects and would also reduce impacts to retirement investors in the event that the Rule requirement changes. Therefore, while many financial institutions have taken a “wait and see” approach before moving forward with technology activities, the “wait and see” period is quickly ending. Technology development activities are generally locked down due to technology freezes surrounding calendar year-end, meaning that many respondents are nearing a “drop dead” date to begin development, in order to ensure they are fully prepared for a January 1<sup>st</sup> compliance date.

Financial institutions indicated that if Rule clarity is not received soon, study participants might have to start making Rule response decisions in advance of such clarity, which may lead to increased firm investment and additional disruptions to retirement investors’ access to products and services.

## 6. Key Takeaways

The DOL Fiduciary Rule has had significant impact across the retirement advice industry and was widely reported as an extremely disruptive regulation by study participants. Many financial institutions reported making business decisions, such as restricting their brokerage offerings and accelerating their momentum to a primarily fee-based business model, which has resulted in limiting choice for retirement investors. These business decisions have been made in a very uncertain operating and regulatory environment given the Rule delay from April 10<sup>th</sup> to June 9, 2017, changes in requirements for the first applicability date, and the potential for further Rule changes or delays. The business model changes has also resulted in a bifurcated experience for retirement investors who hold both retirement and non-retirement assets within the same financial institution. Financial institutions are quickly approaching what they call “drop dead” dates to begin making substantial investments into people, process, and technology, which in the end, may be unnecessary if the Rule is delayed or rescinded.

The impacts across the industry on retirement investors and financial institutions vary widely and the key takeaways from the study are summarized below:

- **Each study participant approached the Rule differently depending on their business objectives, rule interpretation, and risk appetite, resulting in wide range of responses around service and product offerings across the industry.**
- **Although there has been substantial change to services and products in advance of June 9<sup>th</sup>, many financial institutions have indicated there is more change coming should the current version of the Rule go into full effect.**
- **Retirement investors who wish to retain access to advice may have to choose to move to a fee-based model, which changes the service relationship and may result in an increase in average fees paid per year or choose to move to a new financial institution.**
- **Significant investment has been made to date and is planned for the future. This investment has been higher due to increased costs associated with stopping and restarting certain projects due to the changing nature of the Rule.**



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