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February 24, 2012

(By email to piacentini.joseph@dol.gov)

Mr. Joseph S. Piacentini
Director
The Office of Policy and Research
Employee Benefits Security Administration
U.S. Department of Labor – Room N-5718
200 Constitution Avenue, N.W.
Washington, DC 20210

Attention: Definition of Fiduciary RIA Data Request - Supplemental Response

Dear Mr. Piacentini:

We are responding to your letter dated February 10, 2012, requesting assistance identifying data or data sources “that could help the Department [Employee Benefits Security Administration (“EBSA”)] evaluate the impact, if any, of conflicts of interest faced by brokers or others who advise IRA investors.” This letter supplements our January 13, 2012 response to your 30-day information request of December 15, 2011 and our meeting on January 24, 2012.¹

Your December 15, 2011 letter asked for comprehensive information about individual IRA accounts and their owners, including detailed data on all the investments held in a particular IRA and their performance over time; the characteristics and transaction history of the IRA account and whether transactions resulted from specific recommendations and whether the recommendations were solicited; and demographics of the IRA holder including his or her risk tolerance, financial literacy and investment strategy preferences. As we stated in our January 13, 2012 written response and at the January 24th meeting, the Institute conducts regular research on the 401(k) and IRA markets but does not collect the kind of detailed investment data on returns, investment strategies, advice, trades, and investor characteristics identified by specific individual investors that would allow EBSA to assess the impact of a particular recommendation made to an IRA customer.

¹ As you know, EBSA’s February 10th letter, which requested a response by February 17, 2012, was not received by the Institute until February 16, 2012. By email dated February 16th, EBSA extended the response date to February 24, 2012 “to account for any delay in your receipt of the letter.” We also note that EBSA’s February 10th letter refers to the meeting as taking place on January 27, 2012. Rather, the ICI attended a meeting with EBSA on January 24th.

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The Institute does, however, engage in research that may be helpful to EBSA's effort to determine what impact, if any, conflicts of interest faced by brokers or others who advise IRA investors have on IRAs and is pleased to share that research with you here.

The IRA Investor Database

As we have discussed with you, the Institute, in a joint research project with the Securities Industry and Financial Markets Association (SIFMA), maintains The IRA Investor Database™.² The IRA Investor Database™ contains certain account-level information from a wide range of participating mutual fund and insurance companies, which provided data for more than 10 million IRA investors in 2007 and 2008 (data for 2009 and 2010 are still being collected). The database is designed so that most of the data elements are comparable to those provided by the IRA trustee on IRS Forms 5498 and 1099-R. To ease the burdens on participating firms the data are collected on an annual basis: the account balances are year-end snapshots; and the contribution, withdrawal, and rollover activity are captured on a tax year basis.

In providing the data to be included in the database, participating data providers encrypt individual records to protect the identities of individuals, but provide, to the extent available, each investor's year of birth; gender; average income for their zip code; IRA assets (at year-end), contributions, withdrawals, and rollovers. The contract agreements with providers that participate in the database prohibit ICI from disclosing individual IRA balances, contributions, distributions and asset allocations, as well as demographic data pertaining to IRA account holders.³

The database receives the information for IRA accounts on a snapshot basis (*e.g.*, end of the year) and therefore does not allow for analysis that would focus on, for example, changes in flows and asset allocations to a particular account throughout the year. More specifically, the database does not track for each account: a personal rate of return (EBSA Request #1.a); time-weighted performance, investment strategy, measure of risk, and fee table of each fund/security (EBSA Request #1.b); gross

² ICI has a number of other on-going research projects related to IRAs. ICI estimates total IRA assets on a quarterly basis drawing on data from the IRS Statistics of Income Division, Federal Reserve Board, American Council of Life Insurers, and the Institute's own mutual fund surveys. Annually, the Institute also conducts a (phone) survey of IRA-owning households to understand their characteristics; as well as their contribution, rollover, and withdrawal activity. For the most recent report, see Holden and Schrass, "The Role of IRAs in U.S. Households' Saving for Retirement, 2011," *ICI Research Perspective* 17, No. 8 (November 2011), available at <http://www.ici.org/pdf/per17-08.pdf>.

³ To the extent EBSA is interested in the type of non-aggregated data on contributions, withdrawals, rollovers, and account balances in IRAs, such information is filed with the Internal Revenue Service on Forms 5498 and 1099-R.

flows by security/fund transacted date or price, commission/loads, mark-ups/downs in principal transactions or whether transaction was initiated by investor or adviser (EBSA Request #1.c); distribution channels (EBSA Request #2.b), identity or attributes of adviser (EBSA Request #2.c); compensation arrangements (EBSA Request #2.d); advice rendered (EBSA Request #2.e); and adviser service level and type (EBSA Request #2.f).

While the IRA Investor Database™ does not contain the type of data that would allow a review of a particular IRA investor's investment practices subsequent to the receipt of information or recommendation from a broker or adviser, the Institute has published a number of reports that analyze how individuals use IRAs in the process of planning for retirement, which we believe contain findings that are relevant to EBSA's query. To date, ICI has analyzed traditional IRA⁴ rollover activity in 2007 and 2008 (www.ici.org/pdf/rpt_10_ira_rollovers.pdf), traditional IRA contribution activity in 2007 and 2008 (www.ici.org/pdf/rpt_10_ira_contributions.pdf), and asset allocation of traditional IRAs at year-end 2007 and year-end 2008 (www.ici.org/pdf/rpt_11_ira_asset.pdf). Key results from the asset allocation analysis include:

- IRAs hold a range of investments, and the largest share of traditional IRA assets are invested in equities and equity funds, both in aggregate and across investor age or income groups.
- The pattern of holdings in traditional IRAs tended to vary with investor age, typically as expected across the life cycle.
 - The percentage of traditional IRA assets invested in bond holdings was higher the older the traditional IRA investor.
 - For the most part, younger traditional IRA investors tended to have a higher proportion of their accounts invested in equity holdings compared with older investors.
 - The oldest traditional IRA investors had higher allocations to money market holdings compared with middle-aged traditional IRA investors. The exception to the typically declining equity holdings pattern by age occurred in traditional IRAs held by investors younger than 35, which were more concentrated in money market holdings and less concentrated in equity holdings than expected (likely resulting, in part, from mandatory cash-out rules for smaller balances).⁵

⁴ The reference to "traditional IRAs" is meant to distinguish the IRAs that are the subject of this research from Roth IRAs.

⁵ See Internal Revenue Code § 401(a)(31)(B) (mandatory cash-out provision); 29 CFR 2550.404a-2 (Safe harbor for automatic rollovers for mandatory cash-outs).

- The pattern of investments among traditional IRA investors was broadly consistent with the patterns observed in 401(k) plans, in aggregate and by investor age.
 - Equities and equity funds were the largest share of both traditional IRAs and 401(k) plans, in aggregate and by investor age, at year-end 2007.
 - Bonds and bond funds represented higher shares of account assets among older investors compared to younger investors, whether looking at traditional IRAs or 401(k) plans. However, in aggregate, traditional IRAs had a higher allocation to bonds and bond funds than 401(k) plans, in part because traditional IRA investors tend to be older compared with 401(k) plan participants.
 - Money market funds had higher shares in traditional IRAs across all age groups compared to 401(k) plans and in aggregate, reflecting in part their use as a default investment for small rollovers and perhaps traditional IRA investors' higher demand for liquidity.
 - Younger investors had higher shares of their accounts (IRA or 401(k)) invested in target date funds. Target date funds were a higher share of 401(k) plan assets in aggregate, likely reflecting their use as default investments in many 401(k) plans.

We would be happy to meet with you to discuss in detail any of these reports.

Institute Research on Distribution Channels for IRA Investments

While we do not track distribution channels in The IRA Investor Database™, a recent ICI survey of IRA owners finds that 62 percent of traditional IRA-owning households with a retirement strategy consulted an investment professional when creating the strategy.⁶ However, this study did not explore fees paid or the type of specific recommendations made by investment professionals to their clients or whether and to what extent the IRA investor followed the investment professional's guidance (for example, we do not have information responsive to your questions 2.b-f.). In another and earlier study of mutual fund-owning households with ongoing advisory relationships with an investment professional, ICI explored who takes the lead in making the investment decision when an investment professional is consulted.⁷ The survey found that 38 percent of the households indicated that the

⁶ See Figure 28 in Holden and Schrass, "The Role of IRAs in U.S. Households' Saving for Retirement, 2011," ICI Research Perspective 17, No. 8 (November 2011), available at <http://www.ici.org/pdf/per17-08.pdf>.

⁷ The Investment Company Institute undertook a telephone survey in 2006 to examine mutual fund shareholders' use of ongoing financial advisory services. For information on the survey and other survey results, see Leonard-Chambers and

investment professional usually takes the lead in decisions; 34 percent indicated the investment professional and investor make decisions together; and 28 percent indicated that the investor usually takes the lead in decisionmaking. Similar to the other previously referenced study, this study did not explore fees paid or the type of specific recommendations made by investment professionals to their clients.

Expenses Investors Incur in Mutual Funds through 401(k) Plans and IRAs

Using a variety of data sources, the Institute estimates the expenses that investors incur when investing through mutual funds, including expenses on 401(k) assets or IRAs held in mutual funds. Such estimates are based solely on a review of total assets held in mutual funds, or 401(k) plans or IRAs held in mutual funds, as well as the expense ratios paid on those assets. Data on assets in mutual funds and their expense ratios are available from a number of sources, such as Lipper, Morningstar, and Strategic Insight. Through proprietary surveys, ICI also collects from its member firms data on 401(k) assets held in mutual funds and IRA balances held in mutual funds.

These data indicate that the expense ratios that all mutual fund investors incur differ little from those incurred for investing in mutual funds through 401(k) plans or in IRAs. For example, in 2010, the (asset-weighted) average expense ratio all mutual fund investors incurred in stock funds was 0.84% (84 basis points). In comparison, 401(k) assets invested in stock mutual funds incurred an (asset-weighted) average expense ratio of 0.71% (71 basis points). IRA investors incurred an (asset-weighted) average expense ratio of 0.83% (83 basis points). Expense ratios incurred on 401(k) assets in mutual funds are marginally lower than those incurred on IRA balances for a number of reasons. For example, 401(k) plan sponsors sometimes cover a portion of 401(k) plan costs, which allows them to select funds or share classes with less built-in servicing costs. Also, there is a more limited role for the services of investment professionals inside 401(k) plans; with IRAs, some of the costs of the services of investment professionals may be borne through expenses reflected in the mutual fund's expense ratio. Furthermore, many 401(k) plans have large average account balances, and such economies help to reduce the fees and expenses of the funds offered in these plans.

EBSA seeks to tie current account holdings in IRAs to the advice or recommendations received by the particular account holder from a broker (or investment professional) and draw conclusions as to whether potential conflicts that a broker may have had impacted the investment outcome of the IRA account. As we explained in our January 13th letter, the type of comprehensive individual account IRA data – showing the transition of an individual account from recommendation to investment – does not

reside with the Institute and its mutual fund members. As we also noted, households owning mutual funds outside of workplace retirement plans (including IRA investors) purchase their mutual funds through a variety of sources. Institute household survey research finds that 80 percent of households that owned mutual funds outside a workplace retirement plan held mutual funds purchased through an investment professional.⁸ Investment professionals include registered investment advisers, full-service brokerage firms, independent financial planners, bank and savings institution representatives, insurance agents, and accountants. In many cases, the mutual fund investments are held in omnibus accounts⁹ and the entire relationship and all contacts with the investor are maintained through the financial intermediary, not the mutual fund company. Even in cases where an investor purchases mutual funds for an IRA account directly from a fund company, rather than through an investment professional, the fund company would not know what the decision-making process of the investor was or have the type of investor demographic information the letter calls for.

Accordingly, while the Institute maintains comprehensive information about behavior patterns of IRA investors, including information about how they invest their account balances, identified by demographic data points, and whether they rely on investment professionals in making investment decisions, it does not maintain information regarding specific sources of information or recommendations that generated a particular IRA holder's investment decisions.

Other Sources of Data

While we do not have the particular information called for in your letter, as we are sure EBSA knows, the Securities and Exchange Commission's (the "Commission") books and records rules, Rule 17a-3 and Rule 17a-4 under the Securities Exchange Act of 1934 ("Exchange Act") (hereinafter the "Books and Records Rules"), subject broker-dealers to comprehensive requirements with respect to the collection and maintenance of records regarding customer transaction activity. Additional record collection and maintenance rules apply to the extent the broker-dealer has discretionary authority over the account or is required to make a suitability determination under the Federal securities laws or under

⁸ Among mutual fund-owning households in May 2011, 31 percent owned funds solely outside of employer-sponsored retirement plans, and 37 percent had funds both inside and outside these plans. Among these households owning mutual funds outside such plans, 80 percent owned funds purchased from an investment professional. See Figure 8 in Bogdan, Holden, and Schrass, "Characteristics of Mutual Fund Investors, 2011," *ICI Research Perspective* 17, No. 6 (October 2011), available at www.ici.org/pdf/per17-06.pdf.

⁹ An omnibus account is a master account representing the subaccounts of multiple investors that may include a mix of investor account types. An omnibus account is opened on the records of the mutual fund in the name of the intermediary and the fund complex typically does not have any information identifying or otherwise relating to the beneficial owners of the subaccounts.

the requirements of a self-regulatory organization of which the broker-dealer is a member.¹⁰ It is important to note, however, that such records are maintained in a format necessary to comply with regulatory requirements and not necessarily to respond to data survey requests. In this respect, while certain records (for example, "blotter" entries containing an itemized daily record of all purchases and sales of securities and for what account) may be entered by some broker-dealer firms into computerized data fields and maintained in digital format, other records, such as ledgers, copies of confirms, etc., may be maintained solely in hard copy or *pdf* format. Trying to piece together such records, which may be on different systems or stored in various formats at the broker-dealer, may require costly and time-consuming work and is unlikely to allow for consistent data sampling from broker to broker.

Utility of the Data to Meet EBSA's Goals

Moreover, as we have also pointed out in our January 13th letter, even if EBSA were able to collect information on recommendations provided to IRA holders and line up such information with current account information, we have concerns about the "practical utility" of using this kind of data to draw conclusions about broker-dealer behavior. As we have previously discussed with EBSA, it is not clear how a researcher would measure the extent to which a broker or investment professional did or did not act in the interests of clients with the type of data EBSA is trying to collect. For example, in doing any such analysis, it is not possible to judge the quality of advice or assistance to an IRA holder by looking only at the investments in the IRA account without also knowing what other investments the IRA owner, as an individual or a household, might hold. IRA investments might seem aggressive or undiversified when viewed alone but be reasonable and appropriate in the context of the entire portfolio of the individual or household. Furthermore, the interactions between investment professionals and their clients are complex, and clients do not always follow recommendations they receive. Disentangling these complex interactions and their effects on the investors' returns is beyond the scope of the statistical analysis EBSA apparently has in mind.

While we support the efforts of EBSA to properly assess the need for revisions to the fiduciary definition before re-proposing the investment advice fiduciary rule, we think that it is crucial that any such effort be based on findings about current practices that can only be achieved through an analysis of relevant data collected pursuant to valid data sampling techniques. In this respect, the scope and purposes underlying the Paperwork Reduction Act may be particularly instructive and helpful here. As you know, the Paperwork Reduction Act applies to the "collection of information" by an agency.¹¹

¹⁰ See Rule 17a-3(a)(17)(i). See also FINRA Rules 2090 and 2111, SEC Exchange Act Rel. No. 63325 (Nov. 17, 2010).

¹¹ "Persons" is defined broadly to include corporations, associations, partnerships, and the like. 44 U.S.C. § 3502(10). The requirements of the Paperwork Reduction Act apply regardless of whether the request for information is mandatory or

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"Collection of information" is defined to mean, as relevant here, "the obtaining, causing to be obtained, soliciting, or requiring the disclosure to third parties or the public, of facts or opinions by or for an agency, regardless of form or format, calling for . . . answers to identical questions posed to, or identical reporting or recordkeeping requirements imposed on, *ten or more persons*,¹² other than agencies, instrumentalities, or employees of the United States[.]" 44 U.S.C. § 3502(3)(A)(i) (emphasis added).

When an agency attempts the "collection of information" as defined by the statute, the agency must engage in a notice and comment period.¹³ After which, OMB then approves or disapproves the request, based on its determination of whether the information is "necessary for the proper performance of the functions of the agency, including whether the information shall have practical utility."

44 U.S.C. § 3508. *See generally* Memorandum for the Heads of Executive Departments and Agencies, and Independent Regulatory Agencies, from Cass R. Sunstein, Administrator of the Office of Information and Regulatory Affairs (April 7, 2010).

While we assume that EBSA made a determination that its December 15th and February 10th requests were not subject to the notice and public vetting process required by the Paperwork Reduction Act, we do think that many of the Institute's concerns, which are focused on ensuring that any revision of the fiduciary rule "gets it right" and is based on valid findings drawn from relevant data, could be alleviated by first assessing whether the information being requested will have "practical utility" within the scope of the Act. In this respect, we encourage EBSA to—

voluntary. 5 C.F.R. 1320.3(c) (providing that definition of "collection of information" applies "whether such collection of information is mandatory, voluntary, or required to obtain or retain a benefit").

¹² The regulations provide that the determination of whether ten or more persons received the request should include any requests made by the agency within any 12-month period, 5 C.F.R. 1320.3(c)(4), and that "ten or more persons" includes "any independent entities to which the initial addressee may reasonably be expected to transmit the collection of information during that [12-month] period[.]" *Id.*; *see also* *Ctr. for Auto Safety v. Nat'l Highway Traffic Safety Admin.*, 244 F.3d 144 (D.C. Cir. 2001) (holding that agency's collection of information from airbag manufacturers was unenforceable because manufacturers needed to collect information from their numerous suppliers in order to respond). Finally, the regulations provide that "[a]ny collection of information addressed to all or a substantial majority of an industry is presumed to involve ten or more persons." 5 C.F.R. 1320.3(c)(4)(ii).

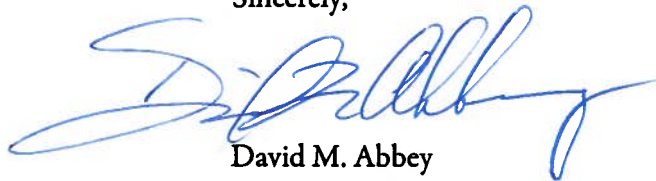
¹³ The agency must first publish a 60-day notice in the Federal Register soliciting public comment on the proposed collection of information. The agency must consider any comments received and then submit the proposed collection of information to OMB. An additional notice in the Federal Register is required to alert the public to the start of OMB review and inform interested parties that they may submit comments to OMB during a 30-day period. 44 U.S.C. § 3508.

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- Determine whether the data exist in a format readily obtainable and/or whether differences in how brokers and others maintain their records will impact EBSA's ability to obtain a valid sampling of data derived from a proper cross-section of firms.
- Evaluate whether the costs associated with the collection of trading and client data, much of which is likely found only in hard copy or *pdf* format, can be justified in light of the likely utility of such data and the availability of existing research providing relevant findings.¹⁴
- Consider whether there will be gaps in the data sampling (*e.g.*, the data show a single investment in one account, but not the investor's total portfolio) and how such gaps might impact how a researcher could measure the extent to which a broker or investment professional did or did not act in the interests of clients.

We appreciate being able to share the Institute's research findings with EBSA and our thoughts on how EBSA might better ensure that any findings it makes are drawn from relevant data. We would be happy to discuss any of the matters set out in this response at your convenience. Please do not hesitate to call me.

Sincerely,



David M. Abbey
Senior Counsel – Pension Regulation

cc: The Honorable Phyllis C. Borzi
Michael L. Davis
Alan D. Lebowitz

¹⁴ As discussed above, the Institute's research shows that IRA investors invest their IRA account assets in much the same way as they invest their 401(k) account assets and that differences in investment patterns among IRA holders are more likely to be based on demographic differences, such as age, than some other factor.