sifma
Invested in America

Testimony

Testimony of Kenneth E. Bentsen, Jr. on behalf of the Securities Industry and Financial Markets Association before a U.S. Department of Labor Hearing on the Proposed Definition of Fiduciary Regulation

Good morning. I am Ken Bentsen, Executive Vice President for Public Policy and Advocacy at the Securities Industry and Financial Markets Association[1]. We appreciate the Department's decision to hold a hearing on this proposal and hope that our comments are helpful to the Department as it assesses the impact of the proposal on plans and their participants.

We believe this regulation is far broader than the aims it seeks to address. It imposes fiduciary status without a relationship to a plan and creates prohibited transactions and co-fiduciary liability on entities who have *no* understanding with a plan or IRA that any services at all will be provided. The Department also states that participants and beneficiaries would directly benefit from the Department's more efficient allocation of enforcement resources by providing greater protections than are available under the current regulation. However, no example or explanation of this benefit is provided that would justify these sweeping changes. We believe there is no evidence that the proposed regulation will be more protective but a great deal of evidence that these "protected" accounts will suffer greater costs and fewer choices – new asset-based advisory fees to replace a commission/spread based structure, additional transaction costs, elimination of investment options and alternative vehicles, constriction of the dealer market, limits on permissible assets in IRAs, and the elimination of pricing of anything other than publicly traded assets.

The Department suggests that the proposed regulation will benefit its enforcement program by helping to resolve difficult factual questions and enforcement challenges by removing the requirements that advice be provided on a regular basis, based on the parties' mutual understanding and that it serve as a primary basis for plan investment decisions. This proposed rule would reverse 35 years of case law, enforcement policy and the understanding of plans and plan service providers, without any legislative direction to depart from the Department's contemporaneous understanding of the statute, in order to make it easier for the Department to sue service providers. That seems to us to be an inadequate basis for proposing such a dramatic change. And of course, this enforcement rationale cannot apply to IRAs, over which the Department has no enforcement authority.

Intersection with Dodd Frank

This rule would appear to be in conflict with recent action by Congress. Just six months ago, in section 913 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, Congress asked the Securities and Exchange Commission to conduct a study on investment advisers and broker dealers and the distinctions between them when providing personalized investment advice and further authorized the SEC to promulgate a rule establishing a uniform standard of care for the provision of such advice. SIMFA strongly supported this provision of the Dodd-Frank Act.

---

[1] SIFMA brings together the shared interests of hundreds of securities firms, banks and asset managers. SIFMA's mission is to support a strong financial industry, investor opportunity, capital formation, job creation and economic growth, while building trust and confidence in the financial markets. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association. For more information, visit www.sifma.org.

The SEC has now presented it's study to Congress and recommended that the Commission adopt such a standard, that, based on the SEC study and direction from Congress, would appear to quite different than the standard being proposed in the DOL's proposed rule. In addition, FINRA has proposed changes to its "Know Your Customer" and "Suitability" rules. The preamble to the DOL's proposed regulation notes that the Department does not have cost data regarding how that conclusion alone would implicate the prohibited transaction rules of ERISA and the Code. One would hope that the agencies will coordinate rule-making so that the change in the standard of conduct would be effective at the same time that this regulation and the changes in the necessary prohibited transaction trading exemptions were effective.

Importantly, the SEC 913 study does NOT suggest or recommend ERISA-like fiduciary duties with its attendant prohibited transactions, but rather a uniform standard of care that is business model/fee neutral and permits (i) principal trading, (ii) commission based arrangements and (iii) sale of proprietary products, all ctivities that ERISA's prohibited transaction rules would prohibit for fiduciaries. The SEC 913 Study changes the standard of care without requiring all trading practices and products to be reconsidered; the SEC approach is carefully tailored to help retail accounts without increasing their costs, eliminating their choices, and making their trading less efficient.

If all brokers who provide market color or investment information are deemed to be fiduciaries, regardless of the intentions of the parties, the vast majority of ommission based accounts may move toward fee based arrangements. Securities and currency transactions that were formerly executed with a dealer as principal will be executed on an agency basis against a third party dealer, subjecting the account to an asset-based fee, plus commissions and markups. The effect of these changes on the capital markets should be studied by the agencies with jurisdiction over the securities markets.

The Department's proposal would deem a broker a fiduciary merely because it is complying with industry rules intended to set standards for brokers who are not investment advisers. Without some clarification, brokers may simply refuse to effect solicited trades for plans if, by calling a client with investment ideas and market color, they back themselves into fiduciary status. Accordingly, any suggestions, array of alternatives or recommendations from a futures merchant, such as market, or liquidity, or time of day for the trade, regardless of whether the plan is represented by its own third party investment manager, may make the futures merchant a fiduciary and its receipt of a commission a prohibited transaction.

In addition, we are concerned about the impact on swap transactions. During the debate over the Dodd-Frank Act, Congress considered the question of a counter-party providing a fiduciary duty to plans and it rejected such an approach because it wanted to be sure that plans could continue to engage in swaps. However, this proposal would make it nearly impossible for the plans to engage in swaps, denying plans an important risk management tool used by most major plans and corporations. And, further, the intersection with the CFTC's proposed business conduct standards will create further difficulties for plans who want to engage in swaps.

Costs of the Change to Plans and Participants

The Department's cost estimates focus on the cost to service providers, and not the cost to plans and IRA holders. While we believe the Department greatly underestimated such costs, more importantly we think this emphasis is misplaced. The real question is the cost to plans and their participants and the impact on their retirement savings. And even the list of uncertainties does not once mention IRAs. IRAs hold more than $4.3 trillion as of March 2010. The vast majority of these assets are in self-directed accounts.

The costs to such account holders would be significant. Data collected for a study SIFMA commissioned from Oliver Wyman comprised of 33% of households and 25% of retail investments suggests that over 95% of households with investments hold commission based accounts; with the strongest preference among the small investor segment (less than $250,000 in assets). These accounts hold $58 billion of fixed income securities purchased through commission based accounts. If these self-directed, nonfiduciary accounts were to be deemed fiduciary accounts as proposed all fixed income securities would be required to be purchased from broker-dealers unaffiliated with the

account's primary broker at an additional cost of 23-27 basis points each year. While PTE 86-128 permits fiduciaries to select themselves or an affiliate to effect agency trades for a commission, there is no exemption that permits a fiduciary to sell a fixed income security (or any other asset) on a principal basis to a fiduciary account.

The result of that prohibition is that the broker would trade away from his own firm, charging a commission for the trade on top of the mark-up charged by the selling dealer. That commission would result in an added cost for these self-directed accounts, and would disproportionately fall on smaller investors, such as small plans and IRAs. In addition, the mark-up on these small trades would likely be higher than the broker's own firm would have charged an existing client because the trades are so small.

One potential effect on plans is that the accounts will enter into asset based fee arrangements with their brokers so the brokers can comply with the prohibited transaction rules that govern fiduciaries under ERISA and the Code. More importantly, the estimates do not reflect the likely advisory fees that will be imposed on small plans and IRAs. If one looks only at IRAs and assumes an advisory fee of 100 basis points or 1%, the likely added costs are $43 billion a year, many times the Department's estimates of the costs. These additional costs, when added to the advisory fees that a fiduciary will likely charge its clients, will significantly erode the investment return of these smaller accounts.

Based on the facts in advisory opinions issued by the Department, this estimate may be significantly low.

Proper Cost Estimate Needed

The Department suggests that the cost of complying with the new regulation will be $10 million in 2011 (for existing service providers to analyze their plan relationships), and almost $1 million each year thereafter, for new service providers to do a compliance review. The analysis does not include banks, trust companies, fund administrators, private funds, FX dealers, all of whom sell products to plans and may be fiduciaries under the proposed regulation. The analysis also does not include advisers, which we think is mistaken, since the rule imposes additional fiduciary requirements on advisers simply because of the "status" tests for fiduciaries and advisers. The Department's estimates are based on the Form 5500 data and thus ignore the entire IRA universe.

The estimates ignore the costs of retooling all of the systems which create a compliance structure for the 4500 broker dealers in this country alone, ignoring the insurance agents, banks and trust companies, consultants, appraisers, recordkeepers, each of whom will have similar costs. The estimates also ignore the costs of retraining hundreds of thousands of professionals, of revising every plan service provider contract, of changing how transactions are effected in the principal markets, such as fixed income and currency, and the cost of the scores of exemptions that will be required.

The estimates also ignore the additional fees and commissions that plans and IRAs will incur to do all transactions away from the broker dealer, resulting in both markups and commissions. The estimates ignore the constraints that the regulation will put on dealers who disseminate research or opinions, publicly or privately, to the plan sponsor or its fiduciaries. The trading costs to plans of dealing only with smaller dealers who are "institutional only" are critical components of any cost study. Finally, the estimates ignore the cost of the litigation that will ensue because of the lack of certainty or the lack of mutual understanding between the parties.

Conclusion

On behalf of its members, SIFMA respectfully urges the Department to reconsider its proposed changes to the definition of fiduciary regulation, to reassess its economic analysis, and to confer with FINRA, the SEC and the CFTC on the interaction of these changes with the requirements of Dodd-Frank.

I thank you for permitting SIFMA to testify today, and would be happy to answer any questions.