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before the United States Department of Labor

Public Hearings on 'Conflicts of Interest' Proposal

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Good Morning. I am Ken Bentsen, president and CEO of the Securities Industry and Financial Markets Association ("SIFMA"). I would like to thank the Department of Labor for the opportunity to testify. SIFMA is a trade association, representing the broker-dealers, banks and asset managers whose nearly one million employees provide access to the capital markets, raising over $2.4 trillion for businesses and municipalities in the U.S., serving clients with over $16 trillion in assets and managing more than $62 trillion in assets for individual and institutional clients including mutual funds and retirement plans. Our members provide services to plans and IRAs across the country.

Our concerns are not with the best interest standard. SIFMA's members have long called for the implementation of a best interest or uniform fiduciary standard of care for brokers and advisors when providing personalized investment advice. On that the record is quite clear. Rather, we disagree with the process whereby one agency is developing yet another standard that will apply to only one sector of the retail investment market. As FINRA highlighted in its comment letter, the creation of yet another standard, and one that only applies only to retirement accounts, could lead to a customer's investment portfolio being governed by multiple sets of rules. It simply makes no sense that the government would not develop a holistic standard. We believe Congress recognized this when they adopted Section 913 of the Dodd-Frank Act (DFA), which SIFMA supported, and which authorized the Securities and Exchange Commission (SEC) as the primary market regulator to establish a uniform standard across the entire retail market. The bifurcation of standards will create confusion both for investors and the providers who must comply.

The process before us today represents a failure in public policy that will disserve the retail investors, particularly the retirement savers, that this rule aims to assist.

We believe the rule, as drafted, will reduce choice and increase cost, and individual savers will have a more complex and confusing landscape.

The proposal is also exceedingly complex and would establish an onerous compliance regime that conflicts with existing securities laws, while subjecting advisers to a new private right of action. In fact, the best interest contract (BICE) and principal trading exemptions are so complex that a number of firms have concluded that they cannot be made operational as designed. SIFMA commissioned a report by Deloitte analyzing the operational impact that found that the proposed rule package is so broad, subjective, and ambiguous in certain areas that it will be impossible to build operational systems and processes to ensure compliance.

Moreover, the Department's Regulatory Impact Analysis (RIA) fails to show how this proposal would benefit the public quantitatively, and also underestimates the potential harm it may cause to American investors. An analysis conducted by NERA Economic Consulting on SIFMA's behalf found that the Department's RIA produces estimates that vary widely over an incredible set of values, and the range of numbers is so wide as to suggest no scientific confidence in the Department's methodology. As a result, the estimates in the Department's analysis provide little confidence as to the actual benefits, if any, arising from the proposal. Further, in its analysis of the costs associated with compliance, the Department greatly underestimates the cost to implement and comply with the rule. Deloitte conducted a survey of SIFMA member firms to estimate the actual cost of compliance and found start up and ongoing costs to be almost double the Department's estimates.

Finally, beyond the complexity of the new BICE and principal trading PTE, the rule and attendant PTEs contain so many issues that either dramatically change existing structure, raise questions of interpretation or, as we've been told in meetings with the Department, are not what was intended, that we believe the rule is unworkable in its current form and question how the Department could move to a final rulemaking without substantial changes. In fact, the Secretary has publicly stated that the rule will be subject to "material changes." Its worth noting that as our industry has been working to implement hundreds of new rules prescribed under the Dodd-Frank Act, many which are equally complex and call for new regulatory architecture as that proposed by the Department, regulators have afforded significantly more time and flexibility in implementation, and utilized their exemptive authority to avoid market disruption. The Department's proposal sets an unreasonable, and unworkable, implementation schedule, and importantly lacks sufficient exemptive relief authority similar to that of the SEC and CFTC. If after reviewing the numerous substantive comments received, the Department chooses to proceed with a rule making, we believe the Department at the very least, should re-propose before going to a final rulemaking to avoid unintended market disruption.

Industry's Support for a Best Interest Standard

SIFMA and the broader financial services industry have long advocated for a best interests standard when providing personalized investment guidance. This included explicit support for Section 913 of the DFA during its initial consideration in the House of Representatives and subsequently in the final conference report. Further, SIFMA has filed numerous comment letters with the SEC, not only to furnish relevant data and information, but also to provide a roadmap on how to implement the uniform standard of conduct required under Section 913. Specifically,

- In November 2010, we submitted a joint SIFMA/Oliver Wyman study to the SEC to help assess the impacts of changing the existing standard of care.
- In July 2011, SIFMA submitted to the SEC a detailed framework for potential rulemaking under a uniform fiduciary standard.
- In May 2012, SIFMA provided the SEC with even greater detail about our proposed rulemaking framework under Section 913.
- In July 2013, SIFMA submitted detailed cost-benefit data to the SEC to inform their Section 913 analysis and to promote forward progress.
- And, most recently, in June 2015, SIFMA published a proposed best interests of the customer standard for broker-dealers that could be accomplished through amendments to FINRA rules.

Under the existing, comprehensive regulatory scheme administered by the SEC and FINRA, broker-dealers today are increasingly being held to a higher standard that includes many elements of a fiduciary or best interests of the customer standard. Plus, through the collective action of regulatory guidance, examinations and enforcement, and securities litigation and arbitration rulings, all of which apply to broker-dealers in a more robust and comprehensive manner than the investment advisor model, broker-dealers are running their businesses with a fiduciary standard in mind. In fact, the most common claim in FINRA arbitration is breach of fiduciary duty.

Although broker-dealer regulation and oversight is already quite strong, we nevertheless continue to strongly support the establishment of a best interests standard for all financial advisors that covers the entire retail market place, and not just one sector. While the DOL and the IRS have jurisdiction over retirement products such as 401k plans or IRAs, brokers' and advisers' conduct with respect to such accounts is primarily governed and regulated by the SEC and FINRA (which the DOL appears to recognize at least in its reference to the FINRA arbitration process as a means for investor redress under the rule). Thus, we continue to advise that the SEC, and not the DOL, is the appropriate and expert agency to establish a uniform standard of care for brokers and advisers. That said, however, we do not necessarily take issue with the DOL's definition of a best interest standard, which we believe is fairly consistent with SIFMA's long-standing advocacy in support of such a standard.

Rather, we take issue with the hundreds of pages of extraneous conditions, restrictions, and prescriptions on top of its proposed best interest standard that our members believe create an unworkable set of rules in their current form. The clear consequence of the Department's heavy hand is the explicit and implicit limitation on the types of investments individuals may choose to utilize with their retirement funds, as well as how they choose to pay for the services they seek. We question whether it is appropriate for the government to effectively substitute its judgment for that of every IRA owner, every plan fiduciary and every plan participant, and whether that is what Congress intended when it enacted ERISA.

<u>Concerns with the Rule</u>

We believe the rule as proposed has many issues. For instance,

- The Department seeks to turn sales pitches and "cold calls" into fiduciary conversations. The Department has made it clear that a recommendation by a financial professional to a total stranger, who has no expectation of a fiduciary relationship, and no expectation that he or she is getting “trusted investment advice”, will cause the financial professional to be a fiduciary if he or she is subsequently hired. It turns broadly disseminated research into fiduciary advice that is “specifically targeted to” an individual because he or she is one of the millions of people on a financial institution’s mailing list.

- The proposal so narrows “financial education” that only those already educated will understand what they are being told under the Department’s proposed regime. The proposed education exception is expanded to cover IRAs; however, it does not allow for the naming of individual investment options. The provider would only be able to provide guidance that includes broad asset classes. Giving asset classes without allowing examples will not help participants. The Department’s proposal would morph all of these educational and common sense conversations that are intended to help people prepare for retirement into “fiduciary” conversations, subject to a whole new restrictive, burdensome and liability-filled regime.

- The Department’s proposal would also pull in all distribution and “rollover” conversations. These are conversations that a provider has with an individual about moving their assets out of their old employer’s plan and into an IRA, which might help that individual keep better track of the funds, and take a more active role in managing their funds. SIFMA does not believe distribution recommendations are fiduciary advice. We do not believe that it is in the best interest of plan participants to discourage all conversations regarding distributions. By discouraging these conversations, leakage (dropping) out of the retirement system becomes far more likely.
- The proposed seller’s exception leaves out services entirely, making it impossible for a large plan, collective trust, or other admittedly sophisticated plan to buy futures, clear a trade, or trade securities or custody their securities. Small plans and all retail investors are left out. It is simply not reasonable, and is entirely inconsistent with the views of primary securities regulators, to assume that no amount or type of disclosure would be found sufficient to alert a listener to the fact that a conversation involves selling, that it is not “trusted advice”. The securities laws have been grounded on an understanding that most investments can be clearly explained and their fees clearly identified. Only the Department believes that clear and concise disclosure is not enough.

- Furthermore, neither the seller's exception nor the BICE are available to participant directed plans with fewer than 100 employees, an omission which could result in small plan sponsors electing not to offer retirement plans because they are unable to obtain meaningful assistance from advisers or service providers with respect to plan investment options. This could reduce the number of plans that are established, and possibly lead to termination of existing plans. For those plan sponsors who continue to sponsor plans, they will be selecting investment lineups for the plan participants with limited help.

<u>BICE and PTEs</u>

The proposed exemptions that are intended to allow plans and IRAs to continue their current access to the markets will have the opposite result. Virtually all of the new exemptions and the proposed amendments to existing exemptions are simply not administrable. We note that the Department's statutory authority to grant exemptions requires that they be administrable. These proposals simply don't meet the statutory standard.

The Best Interest Contract Exemption explicitly and implicitly limits client choices on the investments they can make, a dictate unprecedented in ERISA's 40-year history. It raises significant and in some cases insurmountable obstacles for broker-dealers including by inference the establishment of level fees between product providers and distributors, which has the effect of government setting fees and ignores market realities. It requires a disclosure regime that will not only overwhelm the customer with more information than the customer can possibly digest, but also impedes customer transactions, conflicts with existing securities laws such as FINRA Rule 2210 and in some cases may not be possible to construct. It will establish a new supplemental private right of action. And, it will require firms to establish duplicative and redundant compliance regimes, duplicative systems, training, client contracts, trade confirmations and periodic statements: one set for tax deferred accounts, and another for non tax deferred accounts.

The requirements of the Principal Trading Transaction Exemption cannot be met in the context of best execution. Retirement clients will get worse pricing and delayed execution. Financial market fluctuations will create situations where there are changes to prices, credit ratings or liquidity conditions in the time between the initial transaction disclosure recommendation and the customer's decision to execute the transaction. For a broker-dealer to stay in compliance with the exemption, and as securities fluctuate in liquidity and credit rating, the investment professional would be allowed to sell a security to a client but not allowed to buy it back, eliminating one of the hallmarks of an orderly securities market. Delays caused from performing such repetitive disclosures may have unintended harmful consequences to customers such as best execution requirements and pricing disparities. Broker-dealers would be required to create systems that identified fixed income securities by CUSIP based on liquidity and credit risk, and update the information continuously, many times a day, to make sure that the terms of the exemption were met all during the trading day and that no "impermissible" securities could be sold. And many securities currently sold on a principal basis could only be bought and sold on an agency basis, adding commissions to third party markups to the detriment of retirement savers.

Many of the requirements of both the BICE and the proposed Principal Trading Transaction Exemption are so broad, subjective, and ambiguous that it would be impossible to build systems and processes to ensure compliance or to create objective standards for surveillance. Terms are not defined, and when they are, new definitions have been proposed when a perfectly adequate definition exists in FINRA rules. Compliance with the terms and conditions of any, or all, of these exemptions, would impose significant additional costs and liability on brokers-dealers which could cause them to change their business models in an effort to avoid unnecessary risk and punitive excise taxes for failing to meet an entirely subjective or vague, undefined standard. These costs get passed on to the clients.

Further, to the extent that our members can build and implement the systems required, the duplication and costs are far greater than that the Department claims. Our members, most of whom provide both commission brokerage and investment advisor fee based accounts, believe that the proposed rule and particular the BICE are so complex and onerous and the liability risks so uncertain that they likely would elect not to utilize the exemption and instead migrate much of their IRA activity to managed accounts. This would result in greater costs because of the business and regulatory structure of such accounts, with retirement savers having to pay for services they have already chosen not to buy. Further, it may well conflict with concerns from the SEC, the primary markets regulator, that buy and hold accounts should not be in wrap or fee based accounts. But importantly, most firms set a threshold balance for their fee based accounts offered, usually around $50,000 AUM, because of the costs associated with managing such accounts. As most IRA's have balances below $50,000, many if not most would not be migrated. Further, those with higher balances have already chosen what type of account and services they wish to purchase and thus may not be inclined to be placed in a fee based account.

Impact on Asset Managers

SIFMA's Asset manager members are concerned that the expanded definition of investment advice will hamper their ability to act in the best interest of these clients. Asset managers will be less able to provide information and education than they are today. They may also be restricted in making available services and/or products or may only be able to do so at greater expense. In addition, because the proposal broadly imposes fiduciary obligations on market participants with whom asset managers transact on behalf of plans, those market participants will be less willing to engage in activities and services that assist in carrying out one's fiduciary duties, and will restrict information where providing it may transform their role into a fiduciary one. Moreover, asset managers and investors, already deemed sophisticated, will be burdened by standards designed for retail retirement savers.

Further, asset managers, separate and apart from their role as fiduciaries to plans, create and manage registered mutual funds, exchange traded funds, real estate investment trusts and hedge funds and other private funds that are purchased as investments for plans. Because different plans will have different investment objectives, different products and strategies will be best suited to help investors achieve their objectives. As drafted, the proposed rule and Best Interest Contract Exemption will result in substituting the variety of products currently available with a de jure or de facto "legal list," and make the burdens of offering many funds and products effectively prohibitive. Asset managers are concerned that both the proposed rule and the BICE will have the effect of limiting or restricting asset managers' products that are available to plans and promoting certain types of products (e.g., low-cost index products) over others.

Regulatory Impact

The Department's regulatory impact analysis fails to show how this proposal would benefit the public quantitatively, ignores potential costs to investors and greatly underestimates costs to providers. In its analysis of the "benefits" of the proposal associated with curtailing purportedly conflicted advice, the Department misapplied academic research that is key to its conclusions. And the range of estimates of benefits is so wide as to raise serious questions about its applicability and credibility.

The Department has no study data to compare the performance of accounts with a financial advisor who is a fiduciary to the performance of accounts with a broker or other financial advisor who is not a fiduciary, which is core to its asserted benefit. The Department cannot reasonably conclude that investors would be better off under an expanded fiduciary standard on the basis of the studies cited. In fact, NERA's analysis of actual account level data demonstrates that commission-based accounts do not underperform relative to fee-based fiduciary accounts.

To study the costs associated with the DOL proposal, SIFMA engaged NERA who collected account-level data from financial institutions in order to construct a sample of retirement accounts. The dataset includes tens of thousands of IRA accounts over the past four years. Based on member feedback on the proposal, it is highly likely that most firms that offer retirement account services will be unable to offer commission-based accounts to retirement savings customers under the proposal, even under the BICE. Based on that premise, NERA found that:

- Certain commission-based accounts would become significantly more expensive when converted to a fee-based account under the Department's proposal. The increased cost is approximately 50 basis points (bps) - about half a percent per year - for relatively small accounts - those with balances below $25,000;

- A large number of accounts do not meet the minimum account balance to qualify for an advisory account. If the account a minimum balance is $25,000, over 40% of commission-based accounts in our dataset would not be able to open or convert to fee-based accounts. Using a $50,000 threshold, over 50% of accounts would not meet minimum balance requirements for a fee-based account. The DOL proposal, beyond a passing reference to ROBO advisers, is silent on where these accounts would go for services;

- At the heart of the DOL proposal is the contention that commission based account holders face a conflict of interest that causes investment losses. When NERA looked at investment returns, the data showed no evidence that commission-based accounts underperform fee-based accounts. Over the time periods for which NERA has data, commission-based and fee-based accounts exhibit similar performance, when calculated net of fees;

- As is outlined in the earlier NERA white paper on the Department's economic analysis, the Department misinterprets the referenced academic literature.

In addition, a key finding of the NERA study is that customers currently can and do choose the fee model that best suits their needs and trading behavior. In the data sample, half the commission based accounts in 2014 traded less than seven times. They would have paid more for those six trades in a fee-based account. By comparison, most fee-based accounts traded more than 50 times each year. Thus, the data are consistent with the idea that investors who expect to trade often rationally choose fee-based accounts whereas those that do not trade often are likely to choose commission-based account.

We also question the Department's cost estimates for complying with its proposal. The Department's cost estimates rely primarily on data submitted by SIFMA to the SEC in response to a request for information related to Dodd-Frank Section 913 in 2013 (the "SIFMA Data"). Such reliance is inappropriate. The SIFMA Data was collected and submitted by SIFMA to the SEC for the sole purpose of estimating the costs of complying with a prospective SEC fiduciary rule established under Dodd-Frank Section 913, under specific assumptions that were applied to such a contemplated SEC approach. Although the Department concedes that "there will be substantive differences between the [DOL]'s new proposal and exemptions and any future SEC regulation that would establish a uniform fiduciary standard… ", the Department nevertheless elects to rely on the SIFMA Data as the basis for its cost estimates. The Department's stated reason for doing so is that there are "some similarities between the cost components" in the SIFMA Data and the costs that would be required to comply with the Department's proposal. We submit that based on the prohibited transaction provisions alone, they will look *nothing* alike. We note that FINRA's comment to the Department supports our view.

To help understand the costs of compliance related to the Department's proposal, SIFMA commissioned Deloitte to conduct a survey of SIFMA members' anticipated start up and ongoing compliance costs. SIFMA's Deloitte survey found that the estimated cost to comply with the Department's proposal is considerably greater than the estimates for the broker-dealer industry provided by the Department in its Regulatory Impact Analysis. The results of the survey estimate that, for large and medium firms in the broker-dealer industry, total start-up costs alone would be $4.7 billion and on-going costs would be $1.1 billion. This is nearly double the estimated cost provided by the Department in its analysis. This is not surprising, given that the Department's estimate was based on a narrow dataset that was never intended to measure costs for compliance with this proposal.

Conclusion

It is important to consider where others have tried similar proposals, most notably the United Kingdom. The UK put in place a rule known as the Retail Distribution Review ("RDR") in 2013 that sought to address perceived conflicts related to investment advice by banning commission brokerage accounts for retail investors. While the DOL proposal does not explicitly ban such accounts, we believe its prescriptions effectively do so.

According to a survey commissioned by the UK Financial Conduct Authority ("FCA"), several advisors stopped providing retail services and many have instituted account minimums, with some requiring approximately $80,000 or more. Recent reports estimate that 11 million investors have been priced out of the market due to decreased willingness of both financial advisors to provide advisory services and consumers to pay increased advisory costs. The result of the RDR has been the creation of an "advice gap" in the UK. On August 3, HM Treasury announced a new review to address this shortcoming and ensure the regulatory environment allows business models to include affordable and accessible advice. The Department's proposal risks the creation of a similar "advice gap" in the U.S.

SIFMA reiterates its longstanding support for the implementation of a best interests standard for brokers and advisors when providing personalized investment advice to retail clients for all of their accounts, not just their IRAs. Congress, very recently, determined that the SEC was the expert agency to take lead and we believe that is entirely appropriate. Our members feel very strongly that the Department's proposal is far too complex and prescriptive establishing a myriad of new requirements that will be difficult if not impossible to implement, and will result in less education, fewer choices and greater costs to investors which is not in their best interests. Thank you again for the opportunity to testify today.