IMCA Focus on Fiduciary
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Closing Remarks
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Good afternoon. It is a pleasure to join you today to discuss a proposed rule that will have a far reaching impact on retirement savings.

Let me start by telling you about SIFMA. We are a trade association of broker-dealers, banks and asset managers who offer plans and IRAs to countless families, individuals and small businesses throughout the country. They include financial professionals who work as broker-dealers providing commission-based brokerage services who are overseen by FINRA, as well as fee-based investment advisors who are registered with the SEC. The rule we have been discussing today will impact them all.

I was speaking to my mother the other day about this rule. She had just read an article about some individuals who acted on advice that did not turn out well. She expressed her concern about the individuals, and expressed her support for the Department of Labor. She asked me why I would fight this. So I asked my mother who handles her money and how she pays them. She said that she works with an adviser who she pays with a percentage of the assets. She added that this way she doesn't have to think about it. I agreed that it was a perfect solution for her.

Then I noted my knowledge about investments and the fact that most of my assets are purely buy and hold, since I still have quite a few years until retirement. I have a broker who I only pay when I make a trade. My mom agreed that made sense for me. I then told her that under this rule, I will no longer be able to work with a broker and pay her only when I trade. Instead, I would have to pay her based on my total assets, or only use the internet to get information about investments. She said that was not right, since I should have the choice to continue to work with my broker and pay her only when I make a trade. She recognized that I should have the CHOICE to work with who I wanted to work with, and pay them the way I choose to pay them.

Now she understands the proposal and no longer supports it.

A Best Interest Standard

We have just heard a lot of back and forth about whether or not this proposal really will lead to brokers not being able to provide their current services. The Department points to its proposed Best Interest Contract exemption as to how a commission-based model would continue to work. It is a nice idea, and certainly has a nice title. However, it does not work. We'll get into some of our biggest criticisms, but what matters is that the brokers are saying they will not use it because of these problems, and if they will not use it, then the commission-based model will no longer be a choice for individuals planning for retirement.

When folks first criticize the industry, they start by saying that all this calls for is that advisers need to look out for their client's best interest. We share that goal. Advisers and brokers should all be looking out for a client's best interest and we continue to strongly support the establishment of a best interest standard for all financial advisers that cover the entire retail market place, as oppose to just one sector.

For that reason, we have been calling for the SEC to put in place just such a uniform standard for quite a few years. Actually, from before the time the DOL came out with its proposal. Because while the DOL and the IRS have jurisdiction over retirement products such as 401k plans or IRAs, the brokers' and advisers' conduct with respect to such accounts is primarily governed and regulated by the SEC and FINRA. Under the DOL's approach we will end up with a bifurcated system and different set of rules that will confuse investors and advisors alike.

That is why 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.

In 2010, Congress passed the Dodd Frank Act directing the SEC to look at this issue. They have been, and we continue to encourage the SEC to figure out a way to move forward. It is complicated, and the SEC is trying to ensure there is no harm when they move forward.

On the flip side, the Department of Labor has moved forward on a proposal that will limit choice, reduce access to advice and ultimately raise the cost of saving for retirement. This impact will be felt hardest by low and middle-income savers who will be forced to pay more for the same level of advice or be forced to go it alone.

The Proposal Must be Reproposed

This is a very complex rule where the details and the fine print matter. Over the course of four days of hearings in August, and after reviewing only some of the 2,300 comment letters on the Department's website, one can see how many issues remain unresolved. While the Department did a better job rolling the proposal out this time by including some prohibited transaction exemptions, even if unworkable, it is still so far afield from where it needs to be to make it work for the savers of this country, that the Department needs to give everyone another chance to review it once they have taken into account the many issues that have been raised. That look can only happen by proposing the rule again once they have crafted a new version. Even the supporters of this effort found many issues that remain unresolved. With so much at stake, we want to ensure the Department protects investor choice and does not unnecessarily reduce access to education or raise costs, particularly for low and middle income savers who can least afford it.

The Rule is Complex

The proposal is 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 many aspects of the proposed rule package are so broad, subjective, and ambiguous that it will be impossible to build operational systems and processes to ensure complete 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 analysis 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 the Department stated a couple times in the hearing, 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." It's 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 relief authority, similar to that of the SEC and CFTC, which means that if the rule proves to be problematic once finalized, it cannot be altered without another lengthy rulemaking process, at which point damage to the retirement security of millions of Americans may already be done

Concerns with the Rule

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. Imagine being given a list of categories – small cap fund, large cap fund, muni bonds – when you look at the list of a hundred options to choose from, you need to know which fund is which category to make sense of it.

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.

There are so many reasons that an individual may be leaving a 401(k) plan that make perfect sense for the individual. Some individuals roll out because they were just fired from their job and would rather not be tired to that former employer. Or, they roll out because they want to consolidate their assets, expand their investment options, or expand their distribution options. I have rolled out of two 401(k) plans so far, and I expect I will roll out of many more in the future. I did it so I could keep track of my money, and be the person choosing my investment options, as oppose to having a former employer choose what I can invest in.

Among the other problems with the proposed rule is the proposed seller's exception which 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 of the seller's exception completely. 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 best interest contract exemption 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.

Its worth noting that a common comment is that plans are SOLD to small plan sponsors, not BOUGHT. The reason is that the small business owner is focused on all the things that a new small business owner needs to think about – such as ensuring the shipment of dry goods came in, or making sure they have enough hired help to manage the cash register during busy times or managing the marketing of the business. They are not thinking about a 401(k) plan. Today, providers walk in the door of many small businesses to tell them that they can help set up a plan for them, and they can do it at minimal cost to the owner – that the costs will be borne by the employees who choose to participate in the plan. The benefit to the employee is they get a plan, even if some of the cost of running that plan is covered by that employee. The numbers are pretty clear that individuals are more likely to save, and save more when it is through their employer. We need service providers acting as the foot soldiers to expand retirement to the small business market.

BICE and PTEs

Let me turn to a couple of the exemptions that the Department is proposing. The proposed exemptions that are intended to allow plans and IRAs to continue their current access to the markets will not work.

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 Exemption cannot be met in the context of best execution, which is a securities law requirement. Retirement clients will get worse pricing and delayed execution. Under the proposal a provider needs to get two bids from outside competitors before being able to sell anything in the firm's inventory. After getting those two bids, then the provider needs to get approval from the client before executing the trade.

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.

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, 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.

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.

Precedent in the UK

Before I wrap up, I would to point out the impact of a similar rule in 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.

Conclusion

In concluding, I'd like reiterate SIFMA's 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.

Like the Department, we believe that advisors should act in their clients' best interests. However, the DOL'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.

Given the volume of comment letters from both opponents and proponents, the complexity of the rule, and the mounting concerns from lawmakers on both sides of the aisle, it is imperative to get this right. In order to do so, we urge the DOL to engage the industry throughout the rule-making process and allow us to have another look, before it becomes final.

Thank you again for inviting me to speak to you today.