



Testimony of Mike Nicholas, CEO, Bond Dealers of America

before the United States Department of Labor

Public Hearings on 'Conflicts of Interest' Proposal

August 13, 2015

Good Afternoon. I am Mike Nicholas, CEO of the Bond Dealers of America. I would like to thank the Department of Labor and its staff for the opportunity to testify today. The Bond Dealers of America is the only DC based trade association exclusively representing middle-market and regional securities firms and banks active in the U.S. fixed-income markets.

A core mission of the BDA since our founding in 2008 has been investor education and protection, and fostering competitive capital markets that benefit all participants.

Through our previous comment letter and in today's testimony, I will explain why the BDA does not believe the proposed rule or the associated exemptions represent the right approach for improving the market for retirement investment advice and services. BDA believes the proposal naturally favors an investment advisory business model over a commission-based brokerage model.

Therefore, BDA does not believe the proposal, as written, is in the best interest of investors because it will reduce investor choice and access to advice. Yet, we do believe, as others have testified and commented, that there are more suitable solutions that will achieve the DOL's objectives to create an enforceable standard.

To start with:

**The BDA encourages and supports a harmonized multi-agency approach in which the DOL and SEC develop a uniform best interest standard of care.**

The Department's proposal would create differing standards of care for retirement and non-retirement accounts that would ultimately confuse the overall adviser-investor relationship.

As Janney Montgomery Scott states, the proposal will create, "*three standards of care applicable to investment accounts:*

*(1) A FINRA suitability standard,*

*(2) A fiduciary standard for advisory accounts operating under the SEC's Investment Advisers Act of 1940, and*

*(3) A DOL promulgated ERISA fiduciary standard of care for IRAs.*

*We question whether that outcome makes sense for retirement investors."*

BDA agrees.

BDA supports a harmonized best interest standard of care for broker-dealers based on the following principles:

- **Disclosure of conflicts:**
  - Advisers should disclose material conflicts of interest to investors and obtain acknowledgement and consent of conflicts related to a recommendation.
  
- **Disclosure of fees:**
  - Require firms to develop policies and procedures to govern the clear disclosure of fees
  
- **Disclosure related to principal transactions:**
  - Allow advisers to recommend securities out of inventory only if accompanied by disclosure to the customer of the conflicts associated with principal transactions.
  
- **Rigorous enforcement of the best interest standard of care**
  - Additionally, BDA strongly favors vigorous enforcement of the recommended uniform, best interest standard of care so that bad actors are effectively sanctioned and deterred from wrongful conduct and investors have the ability to recover losses due to a violation of the best interest standard.

## **Second:**

### **The BDA believes the Best Interest Exemption is not in the best interests of investors for the following reasons:**

- The proposed legal liability associated with the proposed definition of fiduciary and the best interest exemption will make commission-based advisory business economically and legally impossible for broker-dealers.
- *As Raymond James notes in its comment letter, “given the uncertainty of financial markets, the odds of an alternative [lower fee] product outperforming the selected product are quite high. This makes plaintiffs’ attorneys cases significantly easier....Our potential legal exposure will increase exponentially if the recommended products costs more than a possible alternative.”*
- Additionally, the best interest exemption unnecessarily restricts the assets available to retirement investors. Investors cannot transact in taxable or tax-free municipal bonds under the terms of the exemption and brokers cannot earn a commission related to a municipal bond transaction under the terms of the general rule.
- Ultimately, the impact of the best interest exemption is that advisers will feel compelled to either recommend the lowest-fee investment no matter what or to shift from brokerage accounts to more expensive fee-based accounts.
- *As Stifel CEO, Ronald Kruszewski stated, moving non-managed IRAs to Stifel’s advisory program would cost those investors in excess of \$150 million annually in increased fees.*

### **Third:**

**The Principal Trading Exemption explicitly restricts investor asset choice and ignores the existing broker-dealer regulatory regime.**

- BDA believes that the assets listed in the principal trading exemption are too limited. The exclusion of taxable and tax-free municipal bonds, unit investment trusts, and non-agency mortgage-backed securities, are especially problematic.
- BDA believes that advisers should be permitted to recommend securities out of inventory if the adviser discloses the conflicts inherent in principal trading to the investor as part of a harmonized best interest standard of care.

Finally,

- The exemption's requirement to get two comparable quotes for a principal transaction ignores existing "best execution" standards which require broker-dealers to execute transactions at the best price possible given market conditions.
- The two-quote requirement would unnecessarily slow the trading process down and may not result in transactions at the best possible price for investors.
- BDA agrees with what Wells Fargo states in their comment letter, *"We believe the Department's assumption that it will only take "five minutes" to get the two quotes, based on our experience, is faulty in many instances and that retirement investors will be harmed if they are forced to wait the*

*duration of time that it will take to accumulate the necessary information.”*

- BDA believes a uniform, harmonized, and rules-based approach based on existing best execution standards is the most logical standard for the Department to follow.

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In conclusion, the BDA understands the need for the Department to fortify the rules applicable to retirement investors and investment recommendations. However, BDA believes that the Department’s approach is not in the best interest of investors, especially investors with fewer resources for retirement savings.

As stated above, BDA urges the Department to act in concert with the SEC in order to best protect all investors by designing a harmonized best interest standard of care and expanding the universe of permissible investments.

*As FINRA notes, “A best interest standard would align the interests of intermediaries with those of their customers; better protect investors by providing a more consistent set of obligations across financial service providers; help ensure that intermediaries eliminate or manage conflicts of interest; and help ensure that intermediaries establish an ethical culture throughout their firms.”*

BDA agrees.

Thank you again for the opportunity to provide these remarks.