House Education & Workforce Committee hearing on "Redefining Fiduciary"

Testimony of Kenneth E. Bentsen, Jr. on behalf of the

Securities Industry and Financial Markets Association

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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 Committee's decision to hold a hearing on the Department of Labor's proposed revision to the definition of fiduciary.

The Proposed Regulation

However well intentioned, we believe the Department's proposed regulation has far broader impact than the problems it seeks to address. This proposed rule would reverse 35 years of case law, enforcement policy and the understanding of plans and plan service providers as well as the manner in which products and services are provided to plans, plan participants and IRA account holders, without any legislative direction to move 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.

After months of discussion with the Department, both in anticipation of the proposed rule, and following its publication, we strongly believe the proposed regulation should be re-proposed and in particular, re-proposed without IRAs. Many groups and individual entities representing plan sponsors,

[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.

service providers, the financial services industry and investor advocates have raised issues about the proposed rule's impact on plans and participants and individual savers. The breadth and complexity in the provisions, the many significant changes that need to be made, and the uncertainty regarding the exemptions that will be required based on the final language, underscore the need for the Department to go back to the drawing board. Further, based on our numerous conversations with the Department, and their acknowledgment of the need for significant changes to the draft, we believe such changes in and of themselves would require re-proposal under the Administrative Procedures Act. In addition, the proposed rule lacks sufficient cost benefit analysis, and absolutely no cost benefit analysis related to its impact on IRA owners. We cannot think of a single reason barring re-proposal of this regulation, especially when the Securities and Exchange Commission will almost certainly be proposing a uniform fiduciary standard of conduct for brokers and advisors pursuant to Section 913 of the Dodd-Frank Act in the fall, an action that SIFMA strongly supports.

By upending 35 years of established precedent and imposing a fiduciary status on a service provider who may have no relationship to a plan, the rule 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 selling exception in the proposal does not even cover commission based sales or the selling of services, let alone common investment transactions such as agency trades, futures, repurchase agreements, swaps and securities lending. It requires the seller to announce it is adverse to the client, contrary to where the SEC is likely to go based on their Section 913 fiduciary study. Absent a re-proposal to address such concerns and the advance promulgation of prohibited transaction exemptions, our member firms will be forced to alter, and, in many cases, curtail services to their clients upon final publication of this rule. To be clear, extending the implementation timeline of any final rule in order to consider, draft and promulgate exemptions, as some have suggested, will not forestall the necessity of firms to adjust their business planning, operations and service delivery based on the rule as drafted.

Firms must operate their businesses on the rules as written, not based on the possibility of exemptions to come in the future.

While the Department asserts that IRA owners, participants and beneficiaries would directly benefit from the Department's more efficient allocation of enforcement resources than are available under the current regulation, no example or explanation of such benefits is provided that would justify these sweeping changes nor the unintended negative consequences to IRA owners, plans and their participants. Instead, we believe the individual investors who hold them will suffer increased costs, significantly fewer choices and greatly restricted access to products and services – 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. Absent a re-proposal, we have no confidence that these fundamental flaws will be fixed. Nor are we confident that the necessary exemptions will be in place before the effective date. Millions of savers will find that they cannot invest in the products and services that they have been accustomed to having available in their retirement accounts and that the cost of such products will dramatically increase.

Costs of the Change to Plans and Participants

The proposed regulation states that the Department is uncertain about the cost of the proposal in its preamble. Promulgation of a broad and far reaching regulation, with no change in the law to prompt such change and no indication from Congress that a change is needed should not be done without adequate cost analysis. The Department's cost estimates focus on certain costs to service providers, and not the cost to plans, beneficiaries and IRA holders. While we believe the Department greatly underestimated such costs to service providers, 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 while the Department's cost analysis leaves alarming gaps in what it does

appear to understand or be certain about, its list of uncertainties does not even 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 total lack of analysis on the effect on these accounts is very hard to understand.

The costs to such account holders would be significant. From data pulled quickly from a handful of our member companies, there are over 7 million accounts that are under $25,000 and use a commission-based model. In addition, over 1 million of those accounts are under $5,000. These are currently commission-based accounts, not advisory fee accounts. This proposal will push them to an advisory model. And, most firms require a minimum account balance for advisory accounts that could result in millions of IRA account holders being dropped.

While current exemptions to the prohibited transaction rules of ERISA (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. Lack of exemptive relief in this area is contrary to what Congress explicitly stated in authorizing the SEC to promulgate a uniform fiduciary standard of care for brokers and advisers providing personalized investment advice under Section 913 of Dodd-Frank. The result of that conflicting prohibition is that the broker would not be able to execute a customer's order from his own inventory but rather purchase the order from another dealer, adding on a mark-up charged by the selling dealer. That mark-up would result in an added cost for these self-directed accounts, and would disproportionately fall on smaller investors, such as small plans and IRAs. And of even more concern, it would eliminate the most obvious buyer when a plan wants to sell a difficult to see security. Further, given that the rule would eliminate a clear understanding when a broker is acting as a fiduciary, and thus increase liability risk, it is likely that brokers will transform such accounts into asset based fee arrangements or wrap accounts with their brokers so the brokers can comply with the prohibited transaction rules that govern fiduciaries under ERISA and the Code. Asset based fee accounts or wrap

accounts are designed to provide on going advice at a higher fee than traditional self-directed commission based accounts. However, most individual investors with IRA accounts and most personal brokerage accounts are lower cost self -directed commission based accounts. The result would be imposing higher costs and less choice on investors.

This is particularly critical in assisting small businesses when they start up new plans. Many broker dealers help small business owners in their local communities establish retirement plans for their employees by educating them about the benefits of plans. By prohibiting commission-based sales, the proposal would make it economically unfeasible for most brokers to continue to offer this service. Payment of a separate advisory fee to set up a plan will likely deter many small businesses from providing this important employee benefit.

Intersection with Dodd Frank

As I stated, the Department's rule is in conflict with Section 913 of Dodd-Frank that authorizes the SEC to establish a uniform fiduciary standard of care for brokers and advisors when providing personalized investment advice. SIFMA strongly supported that provision of Dodd-Frank and we recently submitted a letter to the SEC encouraging the Commission to move forward with such a rule. I have submitted our letter with my testimony for the record.

Also, during consideration of the Dodd-Frank Act, Congress considered the question of a counterparty providing a fiduciary duty to plans engaging in swaps and it rejected such an approach because it wanted to be sure that plans could continue to engage in such activities principally for hedging purposes. However, as currently drafted, the Department's proposed rule would result in a counterparty being deemed a fiduciary, which would eliminate the ability for plans to enter into swaps. Again, the SEC and the Commodities Futures Trading Commission ("CFTC") were directed by Congress to establish business conduct rules for dealers engaging in swaps with plans, and yet the Department's rule would conflict with those rules, which are currently in the proposal stage. Absent a significant change in

the Department's final rule, or better a re-proposal, the Department's proposed rule will directly conflict with Congress expressed intent in Dodd-Frank.

Conclusion

Finally, while financial services providers continue to express grave concerns about the proposed rule's impact, I would point out that similar views regarding the far reaching and unintended consequences have been voiced by leading investor protection and consumer advocates. Barbara Roper of the Consumer Federation of America, in testimony before Congress last week also called for a re-proposal and asserted that the proposed rule would conflict with the business conduct provisions under Dodd-Frank. Also, University of Mississippi law professor and investor advocate Mercer Bullard, both in a published article and testimony has said the rule is bad for investors and should be re-proposed.

Mr. Chairman, Members of the Committee, SIFMA and its members have provided substantial comment and data to the Department as to why this rule must be withdrawn and re-proposed and that necessary exemptions must be promulgated in advance of any final rule. Further there must be sufficient coordination with and consideration of the SEC's likely action under Section 913. Otherwise, this proposal will have significant negative impact to millions of accountholders.

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