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Submitted Electronically: e-OED@dol.gov

Office of Regulations and Interpretations
Employee Benefits Security Administration
Attention: Conflicts of Interest Rule
Room N-5655

Office of Exemption Determinations
Employee Benefits Security Administration
Attention: D-11712 and D-11713

U.S. Department of Labor
200 Constitution Ave., NW
Washington, D.C. 20210

Re: Definition of the Term "Fiduciary"; Conflict of Interest Rule—Retirement Investment Advice (RIN 1210-AB32); Proposed Best Interest Contract Exemption (ZRIN 1201-ZA25); Proposed Class Exemption for Principal Transactions in Certain Debt Securities between Investment Advice Fiduciaries and Employee Benefit Plans and IRAs (Z-RIN 1201-ZA25)

Ladies and Gentlemen:

On behalf of the Bond Dealers of America ("BDA"), I am pleased to submit this letter in response to the Labor Department's notice of proposed rulemaking (RIN 1210-AB32) (the "Notice") and its associated proposed exemptions from prohibited transactions (ZRIN 1201-ZA25), requesting comment on a proposed definition of a fiduciary under the Employee Retirement Act Income Security Act of 1974, as amended ("ERISA"), a proposed prohibited transaction exemption related to certain principal transactions in debt securities ("Principal Transaction Exemption"), and the proposed Best Interest Contract Exemption. BDA is the only DC based group representing middle-market securities broker-dealers and banks focused on the U.S. fixed-income markets, and we welcome this opportunity to present our comments on the Notice.

While BDA applauds the Department's efforts to strengthen investor protections, it echoes many of the concerns expressed by the investment community regarding the proposed expanded definition of fiduciary and proposed prohibited transaction exemptions. Below, we briefly discuss our belief that the disparate standards of care that the Department's rulemaking and proposed exemptions create for broker-dealers, the additional costly burdens on broker-dealers and the increased limitations on asset classes

that broker-dealers can recommend to their customers will have an overall negative impact on the ability of investors to diversify and obtain adequate returns on their investments. BDA supports a more harmonized multi-agency approach to developing standards of care for broker-dealers and outlines its recommendations for the Labor Department and Securities and Exchange Commission ("SEC") in achieving this harmonization. BDA will then specifically focus on the negative impact that the proposals will have on the investors' ability to invest in municipal bonds and certain other investment classes. Finally, BDA will address the Department's proposed requirements for the principal transactions that would have an adverse effect on investors, broker-dealers, and market liquidity.

BDA Supports a Rule-Based, Harmonized, Approach and Its Vigorous Enforcement

BDA appreciates that the U.S. retirement investment landscape has undergone a long-term transition to widespread investments through IRAs and 401(k) plans and the need for protecting investors, especially less sophisticated investors. However, BDA cannot support the proposed rule or the associated exemptions in their current form. BDA believes the proposed fiduciary definition and exemptions represent the wrong approach for improving investor protection regulation and will ultimately limit investor choice, retirement portfolio diversity, and investment returns. The proposals would increase existing investor confusion and regulatory complexity by creating differing standards of care for advisers and investors. Unlike the Department's principle-based approach, BDA supports a rules-based, harmonized approach in which the Labor Department and SEC work together to develop a uniform best interest standard of care for retirement and non-retirement investment accounts. Additionally, BDA strongly favors vigorous enforcement of the recommended rules-based, uniform, best interest standard of care so that bad actors are effectively sanctioned and deterred from wrongful conduct.

BDA Supports a Uniform, Harmonized Best Interest Standard of Care

BDA supports the Labor Department's efforts to devise a rule that best protects retirement investors. However, the expansive nature of the proposed definition of fiduciary would eliminate the brokerage model for municipal bonds and many other asset classes. Consequently, broker-dealers would be effectively precluded from providing valuable investment recommendations and general investment education to investors while earning commission-based compensation.

BDA believes the brokerage model must be protected so that investors are able to retain the ability to receive low-cost, transaction-based services and recommendations. Applying a trust law standard to a brokerage account would trigger an ongoing duty to monitor investments in retirement accounts. The cost of this type of monitoring is incompatible with the low-fee, transaction-based brokerage model that many retirement investors currently benefit from. BDA urges the Department to ensure that any future best interest standard of care proposal that would be applicable to recommendations made by advisers to their retirement brokerage customers contains explicit language that states broker-dealers do not have an ongoing duty to monitor investments.

BDA urges the Labor Department and the SEC to work together to craft a uniform best interest standard of care for retirement and non-retirement investors that builds upon existing suitability and compensation rules and FINRA Rule 2010 which states, "A member, in the conduct of its business, shall observe high ethical standards of commercial honor and just and equitable principles of trade."

Recommended Principles for Developing Uniform Standards of Care

BDA recommends the following principles as a guide to the Labor Department and the SEC's efforts in harmonizing the agencies' rulemaking. BDA believes that developing a harmonized best interest standard of care for broker-dealers will best serve the needs of all investors and meet the goal of strengthening the investor protection regime.

- **Fee Disclosure**: Require firms to develop policies and procedures to govern the clear disclosure of investment fees and inherent conflicts.
    - Ensure that the receipt of fees and commissions does not trigger a violation of the best interest standard of care thereby restricting the flexibility of investors to receive advice and chose from a wide variety of securities that may suit their investment needs or restrict the provision of financial advice in general.
    - Require broker-dealers to make policies and procedures readily available for inspection by the Labor Department and SEC.
- **Conflicts of Interest Disclosure:** Disclose material conflicts to investors and obtain acknowledgement and consent related to a recommendation.
    - Require disclosure and consent at account opening.
    - Prominently display the conflict disclosure on the website.
    - Require disclosure and confirmation of consent annually through company-based web disclosure, or, at the client's request via the delivery of hard copy material.
- **Principal Transactions Disclosure:** Allow advisers to recommend securities out of inventory only if accompanied by disclosure to the customer.
    - Disclose the conflicts generally at account opening, specifically referring to trading out of inventory.
    - Disclose the conflicts pre-trade by settlement on a principal transaction and require pre-trade consent by the investor.
- **Preserve Investor Choice:** Harmonization should not simply apply an Advisers Act standard of care on broker-dealers. As former Representative Barney Frank wrote in a May 2011 letter to the former SEC Chair Mary L. Schapiro, "If Congress intended the SEC to simply copy the '40 Act and apply it to broker-dealers, it would have simply repealed the broker-dealer exemption—an

approach Congress considered but rejected."[1] The joint efforts of SEC and Labor Department should allow investors to retain the flexibility of having both fee-based and commission-based accounts.

- **Cost-Benefit Analysis**. Any harmonized rulemaking should be subject to a rigorous cost-benefit analysis, including a harmonized effort to assess and anticipate the full scope of technological changes on dealer systems, especially for smaller dealers.

Specific Policy Comments on Prohibited Transaction Exemptions

BDA's specific policy comments and recommendations related to the Notice will focus on the impact of the Proposed Best Interest Contract Exemption and Proposed Class Exemption for Principal Transactions in Certain Debt Securities between Investment Advice Fiduciaries and Employee Benefit Plans and IRAs on broker-dealers and retirement investors in the U.S. fixed-income markets.

Proposed Best Interest Contract Exemption

Exclusion of Municipal Bonds from the Exemption's Coverage will Harm Investors

The Best Interest Contract Exemption, necessitated by a broader definition of a "fiduciary," is designed to allow current compensation methods, including broker-dealer commissions, to continue without triggering the prohibited transaction penalties. However, the exemption only applies to a very limited subset of assets that unnecessarily excludes tax-free and taxable municipal bonds. In fact, it limits fixed income investments covered by the exemption to certain corporate bonds, agency debt securities, and U.S. Treasury bonds. Municipal debt securities can only be obtained if they are an asset class held by a mutual fund or collective trust. The Labor Department requested comments on additional asset classes that are common investments for retail investors and should be included within the scope of the exemption. BDA believes that for the following reasons municipal bonds should be covered by the Best Interest Contract Exemption.

- **Superior Credit Strength of Municipal Bonds**. The restriction on covered bond obligations would deny investors the benefits of investing in specific municipal bond issuances—an asset class with a lower historical default rate than identically rated corporate bonds.[2]

- **Common Retail Investments**. Currently, retail investors hold 75% of municipal bonds—directly or through mutual funds. Municipal bonds are common and stable enough to warrant a class exemption rather than be available only if the advisor obtains an individual prohibited transaction exemption. A class exemption

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[1] Letter from Barney Frank, Ranking Member , U.S. House of Representatives, Committee on Financial Services, to Mary L. Schapiro, Chairman of the Securities and Exchange Commission (May 31, 2011), http://media.advisorone.com/advisorone/files/ckeditor/Barney%20Frank%20Letter.pdf.

[2] Robert Slavin, *The Bond Buyer,* "Muni Default History Poses a Ratings Riddle," May 6, 2015, Accessed July 21, 2015. Available at: http://www.bondbuyer.com/news/markets-news/muni-default-history-poses-a-ratings-riddle-1072901-1.html

for municipal bonds should cover at the very least participants and beneficiaries, IRA owners and small retirement plans. However, BDA would like to point out that the Best Interest Contract Exemption should cover larger participant-directed ERISA retirement plans that cover more than 100 participants.

BDA acknowledges the Department's stated rationale for the limited list of assets, namely, ensuring that a retirement investor has access to the asset classes that would ensure the construction of a diversified portfolio and that are "relatively transparent and liquid." BDA believes that the best approach to achieve the goal of developing a retirement portfolio that would serve the best interests of a retirement investor would be to allow retirement investors to transact in the widest variety of assets. In addition to, and indeed regardless of the foregone tax benefits of investing in a tax-free municipal bond in a tax-advantaged retirement account, there will be instances when the investment makes sense for a retirement investor from the standpoint of capital appreciation. Additionally, there will be instances where a retirement investor may want to invest in a tax-free municipal bond because the yield on that municipal bond is higher than a comparable corporate bond yield, even before computing the taxable equivalent yield of the municipal bond. Ultimately, the new fiduciary rule and the limited nature of the Best Interest Contract exemption would end the brokerage model for municipal bonds. This would deny investors the opportunity to invest in municipal bonds in anticipation of rising bond prices or on a comparative yield basis. This would defeat the very purpose of the proposal to protect the best interests of investors.

The Exemption will Naturally Incentivize Advisers to Recommend the Lower-Cost Investment in Order to Avoid Legal Liability.

The proposed language of the Best Interest Exemption states that advisers would be required to provide investment advice "without regard to the financial or other interests" of the adviser or institution. The ambiguity of this language—especially the meaning of "without regard"—may naturally preference certain lower-fee bond funds, which include ongoing fees, and low-fee exchange-traded funds ("ETFs"), that expose investors to significant market and liquidity risks, over investments in individual corporate and municipal bonds. While fees to enter into a transaction in an ETF or certain bond funds may be low, there are other costs and risks that the Department must acknowledge. Furthermore, the Department must acknowledge the benefits of investments in a single municipal or corporate credit relative to an ETF or fund in a rising rate environment. A more holistic analysis that includes market and liquidity risks of ETFs or a relative value analysis of bond funds versus investments in individual fixed-income securities from a long-term return perspective is needed.

The overall result of the current structure proposed in the exemption is that broker-dealers will be naturally inclined to assume that recommending a lower fee investment is the best way to comply with the exemption, despite the fact that a single bond would likely be in the investor's best interest over the total holding period. This would deny investors of the ability to chose from the widest variety of suitable investments that could meet the variety of investment objectives that investors with

different ages, incomes, and risk tolerances have. This is the clear downside of having a rule where brokerage compensation is explicitly defined to be a violation of the customers' best interest.

Proposed Class Exemption for Principal Transactions in Certain Debt Securities between Investment Advice Fiduciaries and Employee Benefit Plans and IRAs

BDA Believes that Exclusion of Municipal Bonds and Other Asset Classes from the Exemption would Harm Retirement Investors

BDA agrees that conflicts of interest may arise when a broker-dealer recommends that an investor purchase a security out of a dealer's inventory (i.e., "principal transactions"). Similar to the Best Interest Contract Exemption, the Principal Transaction Exemption limits classes of securities that broker-dealers may sell to retirement investors out of their inventory. The exemption and the fiduciary definition would result in an outright prohibition on principal transactions involving taxable and tax-free municipal bonds, CDs, unit investment trusts (UITs), and mortgage-backed securities ("MBSs"). BDA believes that with appropriate disclosures of the inherent conflicts of interest at account opening in addition to specific transaction-based disclosures about the conflicts associated with a dealer trading in principal capacity the Labor Department's concerns could be addressed efficiently while benefiting retirement investors.

Prohibition assumes that the conflicts that arise due to principal transactions are unable to be mitigated via disclosure. This logic is contrary to the design of the Department's exemption and current regulations applicable to broker-dealers. This exemption will negatively impact market liquidity for the non-exempt assets. Furthermore, if this standard were to be applied broadly—across retirement and non-retirement accounts—it would drastically harm fixed market liquidity and would impair the ability of a dealer to use its balance sheet to provide liquidity in the service of their retail customers.

Providing active liquidity in debt instruments is a fundamental broker-dealer activity. When a dealer buys a debt instrument into inventory from an investor the price paid is based on the potential to sell the asset at a higher price in the future. The compensation to the dealer is not guaranteed and limited and governed by current broker-dealer rules that apply to reasonable compensation, fair pricing and markups, and best execution. If the Department proceeds with this proposed rule in its current form, liquidity providers will be hesitant to provide liquidity for the benefit of investors and the marketplace generally. Ultimately, the lack of liquidity would harm the very group of retirement investors that the proposals aim to protect.

Prohibiting Underwriters from Selling Debt Securities to Retirement Investors as part of Primary Offering Will Harm Investors and Issuers

Retail investors, including retirement investors, are active participants—as suppliers of market demand—in primary offerings of debt securities. The proposed exemption prohibits the participation of retirement investors in primary offerings. This

will negatively impact investors and may increase interest rates for issuers, especially smaller issuers and municipal issuers, whose primary issuances would be impacted by less demand from retirement investors. By excluding retirement investors from transacting in a primary issuance, the proposal would require retirement investors to transact in the secondary market—after the primary issuance—when the market price to purchase bonds may be higher than the issue price.

The Requirement to Obtain Two Comparable Quotes for a Principal Transaction Would Hamper the Ability of an Investor to Attain the Most Favorable Price

The Department's exemption requires an adviser to get two contemporaneous market quotes from an unaffiliated institution and to transact at a price that is at least as favorable as a market quote for a non-principal transaction. Clearly, the purpose of this specific part of the proposal is to ensure that a retirement investor gets a fair price for a fixed income investment. Unfortunately, the proposal is an overly prescriptive duplication of the effective, existing best execution regulations that achieve this precise goal and of proposed regulations to disclose same day, retail-size, principal-trade mark ups and mark downs on customer confirmations.

The proposal endeavors to create an unnecessarily complex regulatory regime for investor-broker interaction. A better approach would be to rely on existing best execution standards. The existing FINRA and MSRB rules allow for brokers to execute transactions in a wide variety of fixed income securities irrespective of market conditions and allows for differences in execution price based on differences in trade sizes—something the Department's standard does not do.

Market liquidity ebbs and flows. In a volatile market, when an investor wants to buy or sell a bond, transacting quickly and at the most favorable price is critical. Unnecessarily slowing the trading process down by requiring a broker to identify two bids or offers on the identical security would hamper the ability of an investor to attain the most favorable price. This would especially be true for securities issued by smaller corporate and municipal issuers that trade less frequently and are issued in smaller quantities than larger corporate bond issuances. BDA believes a uniform, harmonized, and rules-based approach based on FINRA's best execution standards is the most logical standard for the Department to follow.

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In conclusion, 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 minimal invested funds. 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.

Thank you again for the opportunity to submit these comments.

Sincerely,

Michael Nicholas
Chief Executive Officer