Bond Dealers of America

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Submitted Electronically

Office of Regulations and Interpretations
Employee Benefits Security Administration
Room N-5655
U.S. Department of Labor
200 Constitution Avenue NW
Washington, DC 20210
Attention: Fiduciary Rule Examination

RE: Definition of the Term "Fiduciary" (RIN 1210-AB79)

Ladies and Gentlemen:

The Department of Labor's proposed rule to extend the applicability date of its regulation to amend the definition of "fiduciary" under section 3(21)(A)(ii) of the Employee Retirement Income Security Act of 1974 (ERISA) by 60 days (RIN 1210-AB79) requested comment on the policy issues raised by the Presidential Memorandum on the Fiduciary Duty Rule published on February 3, 2017. On behalf of the Bond Dealers of America ("BDA"), I am pleased to submit this letter in response to the Presidential Memorandum.

BDA is the only Washington, DC based trade association representing middle-market and regional broker-dealers active in the U.S. fixed income markets. The BDA appreciates this opportunity to provide comments on the Memorandum as middle-market dealers that service retirement investors have significant insight into how this rule will limit investor choice and, in many cases, increase costs, reduce returns, and limit investment strategies.

BDA disagrees with the policy choices the Department of Labor has made in approving the rule.

Individual corporate bonds, taxable and tax-exempt municipal bonds, mortgage securities, and certificates of deposit are bedrock fixed-income securities for U.S. retirement investors. Structuring a portfolio of fixed-income securities to match maturity dates with life events, including retirement and significant post-retirement dates, has consistently been a strategy that has served retirement investors well by returning the full invested principal plus interest income back to the retirement investor on the bond's maturity date.

The fundamental issue with the rule for broker-dealers in the fixed-income markets is that the rule is overly restrictive, from a regulatory and legal standpoint, and it will result in a reduction of services to retirement investors who routinely demand fixed-income securities and strategies. From the BDA's standpoint, the Department has fashioned a rule and exemptions that are unduly restrictive. It requires blanket prohibitions on principal transactions on certain securities, including municipal securities and it shrinks the amount of corporate and mortgage securities that are allowed to be recommended and sold to retirement investors.

In BDA's view, the Department has been motivated by an overly pessimistic and one-sided view of principal transactions and the associated conflicts that it has ignored the benefits to investors from principal transactions and the existing broker-dealer rules that effectively mitigate the conflicts associated with principal transactions. Investors benefit from principal transactions through access to unique inventory, the ability of the broker-dealer to offer price improvement to customers versus other prices offered or bid in the marketplace for the subject security. Additionally, investors benefit when capital-committing broker-dealers bid bonds during periods of market volatility when investors may need to liquidate a holding to meet a financial obligation or simply to raise cash. BDA does not think the rule strikes the proper balance between mitigating the risks associated with principal transactions and allowing retirement investors to benefit from principal transactions.

BDA believes that this rule will make the retirement brokerage model unsustainable for many client-broker relationships. Today, a customer seeking a $100,000, 10-year bond ladder with one maturity per year over ten years may pay $100 in a markup per $10,000 transaction (based on a one percent markup per transaction) for a total of $1,000 in aggregate markups for the ten transactions in year one. In each subsequent year the investor would pay another $100 markup for each maturing bond, for a combined total of $2,000 in markups over ten years on the ladder assuming a one percent markup per transaction. However, due to the restrictions and potential legal liability of the rule, many firms are moving away from the brokerage model to an investment adviser model. To construct this same ladder under the investment adviser model, the investor may pay one percent annually on its assets under management, plus any markup, for a total of $1,000 annually for ten years or $10,000. BDA members, who assess this rule from the perspective of broker-dealers active in the bond markets, do not think this is an optimal trend for investors.

Per the Presidential Memorandum, this comment letter outlines how investor access to fixed-income products is limited by the rule and specifically how investors will be harmed by these restrictions.

The rule and the exemptions unnecessarily prohibit access to the benefits of a dealer's inventory, including recommendations of municipal securities out of a firm's inventory.

BDA members are active participants in the municipal securities markets. As the BDA has stated in previous comment letters, the prohibition on recommending municipal securities out of inventory is not a necessary restriction. Retirement investors should not have their access to the dealer's principal inventory of taxable municipal securities denied by the rule. Furthermore, there are instances when recommending a tax-exempt municipal bond out of a dealer's inventory results in an investment that is in the financial best interest of the customer on the basis of yield and credit quality versus taxable securities even if the investor does not reap the benefits of the tax-exempt status.

The BDA has consistently raised the issue of the municipal securities principal transaction prohibition as a restriction that does not benefit investors. The municipal securities market is a regional marketplace where dealers in certain regions provide liquidity to the issuances that regional investors demand. By prohibiting principal transactions, retirement investors will lose access to regional expertise into both taxable and tax-exempt municipal bonds. The dealers that service retirement investors that demand municipal bonds will have to source those bonds from other dealers and will have to transact on an agency basis in a marketplace where many bonds trade relatively infrequently. This could result in inferior prices to retirement investors relative to the price the dealer who held the bonds on its balance sheet could have offered. In the BDA's view this prohibition on access to dealer municipal inventory will not benefit retirement investors.

The rule and the exemptions may result in situations when investors cannot have their securities immediately bid by dealers.

The problem with retirement investors being prohibited from being offered many bonds, including municipal bonds, out of inventory is compounded by how the rule limits access to bid-side dealer liquidity for retirement investors. The general rule and the Best Interest Contract Exemption represent a total prohibition on principal transactions, including a dealer engaging in a principal transaction in which the dealer bids and purchases a security from a retirement investor. Therefore, retirement investors that want to access dealer-supplied liquidity will be required to opt-in to the Principal Transaction Exemption, including the contractual requirements, in order for the dealer to provide liquidity on the bid-side to a retirement investor looking to sell bonds. For retirement investors, especially retirement investors seeking to sell bonds quickly and for fair market value, this requirement is an unnecessary restriction.

The Principal Trading Exemption's credit and liquidity standards will result in unnecessarily restricted access to certain corporate bonds and mortgage securities.

As BDA stated above, the Department's approach is too restrictive and the Department has strictly dictated to retirement investors what their investment portfolios should be. This is a mistake and a one-size-fits-all approach. If certain retirement investors have the investment profile that makes purchasing higher yielding bonds or mortgage securities that have greater than average risk appropriate, a dealer should be able to recommend securities that are suitable for that retirement investor. The rule is fashioned to assume that—in each and every case—these recommendations are a violation of the client's best interest. BDA does not believe the Department has struck the proper balance between protecting investors from undue risk and allowing investors, for whom it is suitable, to purchase riskier fixed-income securities.

The DOL should provide an updated enforcement memorandum due to the brevity of the 60-day delay.

BDA appreciates that the DOL published an enforcement memorandum prior to the 60-day delay of the April 2017 applicability date. BDA members believe that with the June 9, 2017 applicability date approaching greater certainty is needed for compliance purposes. As previously stated, BDA believes a longer delay is needed in order to study the issues raised by the Presidential Memorandum. However, dealers need to ensure they have sufficient time to ensure that they will be in compliance with the rule if it were to become applicable on June 9th. BDA urges the DOL to issue an updated enforcement memorandum that offers dealers time to react if the rule does become applicable on June 9th. Dealers should be granted a reasonable amount of time after June 9th to come into compliance without facing enforcement issues.

BDA reiterates that the rule's cost-benefit analysis is not based on retirement investors purchasing individual fixed-income securities.

BDA's membership actively engages with retirement and non-retirement investors to offer a wide variety of individual fixed-income securities, including tax-free and taxable municipal bonds, corporate bonds, mortgage securities, and CDs. It is important to reiterate, especially due to the fact that the rule was economically justified by focusing on mutual fund sales loads and fees, that when a retirement investor purchases a bond, that investor pays a commission or the dealer is compensated via a reasonable markup at the time of the transaction. Investors with brokerage accounts that buy bonds are not charged ongoing fees on their bond transactions that reduce future investment returns, as they are with mutual funds. For this reason, the cost estimates for investors outlined in the Department's analysis, which are based on mutual fund fees, do not apply to transactions in individual fixed-income securities. Therefore, the purported cost estimates for investor losses due to the lack of a rule during the 60-day delay period are overstated when analyzed relative to the costs of transactions in fixed-income securities.

Thank you for the opportunity to provide comments.

Sincerely,

Mike Nicholas
Chief Executive Officer