BDA Bond Dealers of America

21 Dupont Circle, NW • Suite 750
Washington, DC 20036
202.204.7900
www.bdamerica.org

STATEMENT OF WILLIAM DALY
SENIOR VICE PRESIDENT
GOVERNMENT RELATIONS
BOND DEALERS OF AMERICA

SUBMITTED FOR THE RECORD BEFORE THE HOUSE FINANCIAL SERVICES SUBCOMMITTEE ON CAPITAL MARKETS AND GOVERNMENT SPONSORED ENTERPRISES

Ensuring Appropriate Regulatory Oversight of Broker-Dealers and Legislative Proposals to Improve Investment Adviser Oversight

2128 Rayburn House Office Building

Tuesday, September 13, 2011

Chairman Garrett, Ranking Member Waters and members of the Capital Markets and Government Sponsored Enterprises Subcommittee:

Thank you for the opportunity to submit for this statement from the Bond Dealers of America the record.

The Bond Dealers of America (”the BDA”) is the only trade association exclusively focused on U.S. fixed income markets and represents middle-market brokers and dealers who are headquartered in cities all over the country, doing business throughout the United States coast to coast. Our members are the “Main Street” firms, not the Wall Street firms. They help communities around the country finance their schools, roads and bridges. They also provide liquidity for the investors in those communities.

We do not see a need to impose a so-called “fiduciary” standard on the relationship between broker-dealers and their clients. Broker-dealers are subject to strict standards of conduct that in many ways provide more protection to our clients than the vague fiduciary standard. No one, including the staff of the Securities and Exchange Commission in their report earlier this year, has pointed to any specific difference in these standards of conduct that would benefit investors.

The BDA opposes the imposition of a fiduciary standard on broker-dealers because it will expose broker-dealers to the risk of litigation and increased liability. This exposure will cause broker dealers to restrict their activities and will result in less liquidity for investors. In fact, the term “fiduciary” does not appear in either the statute or regulations. It is a court-imposed standard.

Moreover, a fiduciary standard is not what investor want or need.

The Securities and Exchange Commission and others have repeatedly expressed concern that investors do not understand the difference between the “suitability” standard required of broker-dealers versus the “fiduciary” standard required of registered investment advisors.

A recent study by J.D. Powers and Associates, however, casts new light on investor concerns. The study found investors indeed are confused about the fiduciary and suitability standards but are more concerned about receiving clear information, especially about fees and investment performance.

There’s no dispute that information provided by dealers and investment advisors should be true and accurate. The information must include whatever is material to an investor’s decision and match the investor’s financial situation and risk tolerance. Further, investors should understand the different roles played by broker-dealers and investment advisors. All of that is required today of both broker-dealers and investment -advisors.

Last January, the SEC highlighted two key differences between the standards applied to broker-dealers on the one hand and investment advisors on the other. The first was the timing and required disclosure of conflicts of interest. This is easily resolved. The second, and more fundamental difference, though, is the burdensome and time consuming process imposed on advisors who act as a principal when buying and selling securities from clients.

Investment advisors generally do not encounter this problem because they usually do not act as principal. Broker-dealers, on the other hand, often act as principal, providing better liquidity to their clients. Applying the fiduciary standard to dealers could restrict this critical flow of capital by making the activity overly burdensome.

There is also the practical impossibility of applying the fiduciary standard to dealers. "Fiduciary" is a vague legal concept meaning someone is supposed to act in someone else's best interest. It is actually not mentioned in the statute or the regulations governing investment advisors.

So just what does "fiduciary" mean when a broker-dealer has been engaged by a client to buy or sell securities from that client? In these transactions, the dealer is by definition a counterparty. The problem is even thornier when the dealer is acting as an intermediary between two parties, a buyer and a seller, and both are the broker-dealer's clients. How can the broker-dealer owe a fiduciary responsibility to both?

Fundamentally, the dealer's role is incompatible with being a fiduciary. That does not mean that dealers can do whatever they want. They are bound by rules of fair dealing, best execution and other obligations that ensure they cannot take advantage of their clients.

If the SEC were to apply the "fiduciary" standard to broker-dealers, they would have to take into account the risk that if a client loses money on an investment, the client will sue and a court will impose a settlement.

Broker-dealers are already exposed to that risk today but, as a fiduciary, the risk would be immeasurably increased. Dealers would respond by offering clients less or charging

more, resulting in fewer choices, lower liquidity and higher costs for investors.

Investors need clear communication. They also need choice and liquidity. The SEC should not take steps that reduce investor choice or liquidity or increase investor costs.

Earlier this year Congressman Barney Frank wrote to SEC Chairman Mary Shapiro that Congress had looked at applying the fiduciary standard to broker-dealers and rejected it. He cited two specific sections of the Investment Advisor Act that effectively already apply to dealers — one that says don't defraud your clients and the other that says don't lie to them.

Congressman Frank further said if Congress had intended to copy the Investment Act and apply it to dealers, it would have done so. He believes there should be a new standard for dealers and not the old Investment Act standard. The Bond Dealers of America agree.

The new rules should be practical and clear. Vague labels like "fiduciary" will only confuse investors. The rules should focus on specific disclosure of the role and obligations of dealers and take into account there is not any substantial difference between the regulatory obligations of dealers and investment advisors, only differences in the timing and content of disclosures.

Dealers should not be labeled fiduciaries, because that term does not recognize the differences between dealers and investment advisors. The use of this entirely inappropriate term will surely bring about harmful, unintended consequences.

Finally, the new rules should not impose cumbersome requirements on dealers for buying and selling securities for

clients. The approach won’t work and would not recognize the fundamental differences between dealers and investment advisors.

Instead, regulators should consider what investors want: clear information about their investment choices and the role of their investment professionals. If there are deficiencies in what dealers are disclosing to their clients, we should fix that and not impose an impractical new standard.