January 7, 2010

The Honorable Christopher Dodd
Chairman, Committee on Banking,
Housing, and Urban Affairs
U.S. Senate
Washington, D.C. 20510

The Honorable Richard Shelby
Ranking Member, Committee on Banking,
Housing, and Urban Affairs
U.S. Senate
Washington, D.C. 20510

Dear Chairman Dodd and Ranking Member Shelby:

We write as organizations that strongly advocate requiring all those who offer investment advice to be held to the Investment Advisers Act fiduciary duty to act in the best interests of their clients. Section 913 of the "Restoring American Financial Stability Act of 2009" (RAFSA) accomplishes that goal in a straightforward and sensible fashion by eliminating the broker-dealer exclusion from the Act. As full service brokers have adopted an increasingly advice-based business model, this provision of the Advisers Act, misapplied by the Securities and Exchange Commission, has allowed them to escape appropriate regulation as fiduciaries.

Unfortunately, some in the industry who have for years actively marketed themselves to investors as trusted advisers are resisting regulation as advisers. SIFMA, for example, has recently embraced the fiduciary duty in concept, but its unfounded criticisms of the current fiduciary standard under the Investment Advisers Act suggest that its goal is to promote a new federal standard that will allow firms to continue conducting business as usual. Meanwhile, several insurance industry groups have launched a particularly virulent attack on the legislation aimed at eliminating entirely the provision requiring a fiduciary duty for financial professionals and replacing it with an unnecessary study at taxpayer expense. In the process, they have put forward arguments that reflect either a complete lack of understanding of the bill's basic provisions or a more deliberate attempt to confuse the issues.

While the brokers and insurance agents who offer investment advice will undoubtedly have to make changes in the way they do business – that is after all the point of imposing a new duty to act in the best interests of clients – the bill does not inappropriately limit their ability to offer beneficial products and services. For example:

- It does not limit their ability to charge commissions or require them to charge fees for advice.
- It does not limit their ability to sell proprietary products or to sell from a limited menu of products.
- It does not impose a fiduciary duty on self-directed accounts or limit the investment choices that clients can make.
- It does not impose an on-going duty to monitor the account when one-time, transaction-based recommendations are offered.

- It does not impose significant or inappropriate regulatory costs or burdens.
- It does not impose one-size-fits-all regulation.

Meanwhile, the potential benefits to investors are substantial. Investors would receive ample warning of conflicts of interest that may bias the adviser's recommendations. Additionally, the adviser would have a legal obligation to act in the best interests of the client – an obligation that cannot be satisfied, as the broker-dealer's suitability standard can, by recommending the least suitable of the generally suitable investment options available.

We have attached a document that identifies, and refutes with facts, the myths being circulated by some in the broker-dealer and insurance industry. While it would not be possible in this context to address every false argument in detail, we have attempted to provide brief answers to the most common myths. We stand ready to respond to any questions you may have regarding these issues.

For too long, brokers have been free to market themselves as trusted advisers and offer extensive advisory services without having to meet the fiduciary standard appropriate to that role. Section 913 of the "Restoring American Financial Stability Act of 2009" eliminates the legislative loophole that has allowed this dual standard to persist. Investors will only benefit, however, if Congress resists efforts to scale back and water down critical protections provided by the legislation, efforts that have been advanced through a campaign of misinformation and mischaracterization. We urge you to stand up for investors by standing up to those who would undermine these important investor protections.

Respectfully submitted,

Barbara Roper
Director of Investor Protection
CFA

Mercer Bullard
Founder and CEO
Fund Democracy

Denise Voigt Crawford
President
NASAA

Kevin R. Keller, CAE
Chief Executive Officer
CFP Board

David G. Tittsworth
Executive Director
IAA

Marvin W. Tuttle Jr., CAE
Executive Director and CEO
FPA

Ellen Turf
Chief Executive Officer
NAPFA

cc: Members, Committee on Banking, Housing, and Urban Affairs

There They Go Again:

Brokers and Insurance Agents Are Spreading Misinformation about the Senate Regulatory Reform Bill's Fiduciary Requirement for Investment Advice

Get the Facts

Since Chairman Dodd released the Committee Print of the "Restoring American Financial Stability Act of 2009," a great deal of misinformation has been spread about the likely effects of Section 913 of the draft bill. Section 913 benefits investors by eliminating the regulatory loophole that has allowed brokers who offer investment advice to escape regulation under the Investment Advisers Act and, with it, a fiduciary duty to act in the best interests of their clients. While it would be impossible in this format to respond to every baseless charge being leveled against this provision, this document is intended to set the record straight on the most common myths being circulated by those seeking to undermine the important investor protections contained in Section 913.

Myth: The bill imposes one-size-fits-all regulation on all financial services professionals, denying investors access to valued products and services.

Fact: Section 913 of the bill does one thing, and one thing only: it requires broker-dealers and broker-dealer sales representatives who act as investment advisers (providing advice about securities for compensation) to be regulated as investment advisers, closing a regulatory loophole that has led to substantial investor confusion and abuse. The legislation leaves financial services providers free to offer services that do not constitute investment advice without triggering regulation under the Advisers Act. It does **not** apply to either insurance sales or advice about insurance, even for individuals who also offer investment advice and would be regulated as advisers under Section 913 with regard to that advice. It does **not** apply to the many activities engaged in by full service brokers that do not entail advice about securities for compensation (*e.g.*, executing trades, underwriting securities, making markets). Where brokers and their sales representatives do offer investment advice, the bill applies a flexible principles-based standard that is adaptable to the many different contexts in which investment advice may be offered, with obligations that are determined by the nature of the service and relationship rather than by a set of rigidly defined rules.

Myth: The legislation would eliminate the ability of firms to charge commissions.

Fact: Regulating investment advice under the Advisers Act does not limit the ability of firms to charge commissions for product sales or require them to charge fees for advice. The Advisers Act does not dictate a particular method of compensation, and the fiduciary duty does not impose any such requirements. In fact, individuals who simultaneously operate as investment advisers, broker-dealer sales representatives, and insurance agents (including most financial planners) have charged commissions for years without facing legal or regulatory challenge based solely on that practice. In many cases, they charge commissions in addition to the fees they charge for advice, but in others they are compensated entirely through commissions. Furthermore, the bill clearly states that: "Nothing in this section prohibits an investment adviser from entering into an investment advisory relationship that provides for the payment of an asset management fee or commission." Anyone who continues to argue that the bill dictates a particular method of compensation is either unaware of the facts or is ignoring them.

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Myth: The legislation would prohibit firms from selling a limited menu of products and require instead that they base investment recommendations on all available securities.

Fact: Insurance agents who argue, for example, that they will lose their ability to sell only a few companies' variable annuities are again ignoring both the legislative language and the real life evidence. The claim that advisers are restricted from selling proprietary products is also false. The experience of financial planners provides ample evidence that the Advisers Act does not limit the ability of a firm to implement advice either through proprietary products or through a limited range of products. The legislation itself acknowledges the latter practice, specifying only that the adviser must disclose the range of products on which he or she offers advice and whether additional similar products exist about which the adviser does not provide advice. Very simply, the legislation does not limit, and is not intended to limit, the ability of advisers to offer advice on a limited range of products.

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Myth: The legislation would impose a fiduciary duty on self-directed accounts.

Fact: Regulation under the Advisers Act does not automatically extend the Act's reach to every operation of a firm. Today, for example, brokers that are dually registered offer both advisory accounts and brokerage accounts, and only activities related to the former are governed by the Advisers Act. That approach would be maintained under the legislation. Where a service does not constitute advice about securities – such as in a self-directed account where customers use a broker's custodial and trade execution services – that service would not be governed by the Advisers Act or subject to its fiduciary standard. Similarly, other operations of insurance agents and full service brokerage firms that do not constitute investment advice would not be affected. Advice about insurance, for example, would not be covered, nor would the availability of research reports on the company website that do not constitute a recommendation for a particular client. To the degree that there is need for clarification about what constitutes investment advice and when the fiduciary duty applies, the SEC has full regulatory powers to provide that clarification.

Myth: Under the bill, simply providing a one-time recommendation of a stock or bond would impose an ongoing duty to monitor the investment and the account.

Fact: The parameters of an adviser's fiduciary duty depend on the scope of the advisory relationship. Thus, a fiduciary obligation to monitor the account is triggered in circumstances in which there is a promise of ongoing account management or advice. Where no such promise is made or implied, no fiduciary obligation to provide on-going monitoring of recommended investments exists. Thus, brokers giving transaction-specific investment advice would not be subject to a duty to provide ongoing monitoring of the investment recommendation indefinitely, absent a promise to do so.

Although industry members expressing concern about this issue have failed to offer any concrete evidence to show there is a genuine basis for this concern, they continue to seek changes to the legislation to "clarify" that no such obligation exists. Accommodating their requested legislative language to address this non-issue – which limits advice to a moment in time – could eviscerate the investor protections the legislation is otherwise intended to provide. The language, for example, could limit the fiduciary duty to the investment planning itself and not extend it to the product recommendations to implement the plan.

If this approach were adopted, investors would have gained the appearance, but not the reality, of new protections, potentially leaving them more vulnerable than ever. A far cleaner and safer approach that would not entail the same risks for investors would be to provide report language addressing the issue and to direct the SEC to provide additional guidance as needed.

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Myth: Under the legislation, the adviser would not be permitted to engage in principal trading and thus would not be able to sell stocks or bonds from the firm's inventory to its customers or give them access to IPOs underwritten by the firm.

Fact: Principal trading – buying or selling from one's own account – clearly involves potential conflicts of interest (self-dealing). Because the Advisers Act imposes some limitations on principal trading to protect advisory clients, such transactions may be much more difficult to conduct absent other changes. This concern is fully addressed in the legislation, however, which specifically authorizes and clearly intends for the SEC to exempt advisers from this provision of the Act where the adviser has appropriate protections in place to deal with conflicts of interest and to ensure that the transaction is in the best interests of the client. As a result, investors would get the best of both worlds: access to products through principal trades where the trades are beneficial to them and protection from transactions that are not.

The benefits of such an approach can be seen in the events leading up to the current financial crisis, when some securities firms continued to sell customers toxic mortgage-backed securities from their own inventory while simultaneously reducing their own exposure based on concerns about the risks in the housing market. Under the approach outlined in the legislation, these firms would have had an obligation to ensure that their recommendations to customers were not unduly affected by conflicts of interest, such as a desire to move the securities out of their own inventory, and were in fact in the best interests of the customer.

Myth: In order to meet their fiduciary obligations, firms may be required to impose new limitations on client portfolios against the clients' wishes.

Fact: The Advisers Act does not limit the choices available to clients. While the adviser is required to give advice about securities that is in the best interests of the client, the client is free to ignore that advice. Where the client chooses to engage in conduct that involves inappropriate risks – such as holding concentrated positions in the stock of a current or former employer – the adviser would be expected to warn the client of the risks but would be under no obligation to constrain the client's fully informed choices.

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Myth: A new uniform federal standard is needed to address shortcomings in the Advisers Act fiduciary standard.

Fact: SIFMA has argued that a new standard is needed because the existing fiduciary duty under the Advisers Act and state common law has been inconsistently defined and unevenly applied by the courts, but there is no evidence to support this claim. On the contrary, the cases SIFMA cites in support of this argument relate to questions about *whether* brokers should be held to a fiduciary duty in particular circumstances, not *how* the fiduciary duty applies to investment advice. Similarly, the article SIFMA often cites in support of this argument notes an inconsistency in the nature of fiduciary duties that apply to different professions under various state laws, but not to any inconsistency in how states define the duties that are owed by investment advisers. The legislation would eliminate any ambiguity on these points by clarifying that brokers are required to act as fiduciaries when providing investment advice. Should any further clarification be needed on how the fiduciary duty applies in particular circumstances, the SEC has authority to provide that clarification.

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Myth: All regulation of broker-dealers and investment advisers should be "harmonized," not merely the fiduciary duty for advice.

Fact: It is ironic that broker-dealers simultaneously complain about "one-size-fits-all" regulation under the Advisers Act and then propose a regulatory approach – either in the form of a new uniform federal fiduciary standard or further "harmonized" regulation of brokers and advisers – that would create the one-size-fits-all regulation they criticize. While we agree with the principle that similar services should be subject to comparable regulatory treatment, and believe it is absolutely essential that the fiduciary duty is consistently applied, it does not follow that all regulation of investment advisers and broker-dealers should be identical when significant differences between these two functions remain. To the degree that the SEC identifies regulatory requirements that directly conflict – rather than simply imposing different requirements for different conduct – it should have adequate authority to resolve those conflicts and a clear mandate to adopt the standards that provide the highest level of investor protection.

Those who advance this argument typically also suggest that, in order to provide that harmonization, FINRA, the broker-dealer self-regulatory organization (SRO), should be designated as the SRO for investment advisers. FINRA lacks both the expertise and the background required to regulate investment advisers effectively. Moreover, it could be expected to bring solely a broker perspective to adviser issues. Indeed, until very recently, it adamantly opposed holding brokers to a fiduciary duty when they give investment advice.

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Myth: FINRA should be recognized as the SRO for investment advisers in order to eliminate the regulatory gap that led to its failure to detect the Madoff Ponzi scheme.

Fact: FINRA cannot credibly claim to have missed the Madoff Ponzi scheme because it lacked jurisdiction over Madoff's investment adviser operations. On the contrary, there was no Madoff investment adviser operation until 2006, when the SEC changed the rules governing commission-based discretionary accounts. Prior to that time, accounts of the type that Madoff purported to offer were deemed to be brokerage accounts exempt from regulation under the Advisers Act and thus squarely within FINRA's jurisdiction. Even after the rules changed, such accounts would have been subject to Exchange Act regulation and FINRA jurisdiction as brokerage accounts in addition to regulation as advisory accounts.

FINRA failed to uncover the Madoff Ponzi scheme because of its own internal failures. Specifically, Madoff lied on registration documents about the nature of his professional activities – claiming to engage exclusively in market-making and proprietary trading and to have no customers – and FINRA's inspection and oversight regimen was not sufficiently rigorous to detect the lie, even after articles in the personal finance media should have sent up red flags. While serious reforms of regulatory practices are needed at all the regulatory bodies with jurisdiction in this case, designating FINRA as the SRO for investment advisers is not the solution to this problem.

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Myth: Regulation under the Advisers Act imposes significant regulatory costs and burdens in the form of registration fees and testing requirements.

Fact: Some have argued against the Senate bill on the grounds that requiring brokers and their sales representatives to be regulated as investment advisers when they act as investment advisers imposes an unreasonable burden. In reality, however, for the many firms and individuals who are already dually registered, there would be little or no added burden. Brokers who are not dually registered but who regularly provide investment advice would face reasonable, cost of business requirements comparable to those under which currently dually registered individuals, including most financial planners, have successfully operated for years.

Specifically, firms would be required to register as investment advisers either at the federal level with the SEC or at the state level, depending on the amount of client assets under management. Firms that operate in multiple states can register simply by checking the appropriate boxes on the form ADV. Investment adviser representatives of SEC firms register in the state in which their principal place of business is located, while representatives of state registered firms register in the states where they conduct business. Finally, individuals must demonstrate that they meet minimum qualification requirements by either possessing certain professional designations or by passing the Series 65 or Series 66 exam.

While some who object to regulation under the Advisers Act claim the costs of registration would be excessive, these costs are quite low. For example, SEC-registered advisers pay initial and annual Investment Adviser Registration Depository (IARD) filing fees that range from $40 to $200. Similarly, state registration costs average just $200 per firm per year, and only $50 per individual adviser per year. By way of comparison, the $6,000 sales load typically paid by an investor on the purchase of a $100,000 variable annuity would cover the average cost of registering a firm in 30 states for a year. The $2,000 in annual expenses paid by an investor on a typical $100,000 variable annuity would cover the average cost of registering 40 agents operating in a single state for a year.

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Section 913 of the draft "Restoring American Financial Stability Act of 2009" is a strong, pro-investor piece of legislation. We urge you to support this provision of the financial regulatory reform legislation without amendments that would undermine its intended investor protections.

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