



NATIONAL ASSOCIATION OF INSURANCE AND FINANCIAL ADVISORS

Investor Protection Act of 2009

November 2009

The Issue: Congress is considering legislation, the Investor Protection Act of 2009 (H.R. 3817), that would impose a fiduciary standard of care on broker-dealers and harmonize the standards applicable to investment advisers and broker-dealers. The call for a harmonized fiduciary standard stems from a January 2008 SEC-commissioned Rand Corporation study, which reported that consumers do not clearly understand the differences between investment advisers and broker-dealers. The Rand study also found that investors are generally happy with their advisers and the services they provide. The latter point is critical to keep in mind as proposals for a uniform standard of care are considered so that the goal of harmonization does not damage the current, generally successful, nature of existing client-adviser relationships.

NAIFA Position: This issue is important to NAIFA because nearly three-quarters of NAIFA's members are registered representatives of broker-dealer firms, and many NAIFA members are registered investment adviser representatives (IAR's) under a corporate RIA, or have become their own Registered Investment Adviser (RIA); thus the outcome will have a significant impact on the millions of clients we serve.

NAIFA supports the efforts by the Administration and Congress to address consumer confusion about the roles of investment advisers and broker-dealers, and to better protect consumers from bad actors. However, we question whether imposing a new uniform fiduciary standard of care on all financial professionals will stop unscrupulous individuals. In our view, bad actors will continue to violate any standards of care that Congress or the SEC puts forth. Instead, NAIFA believes that the best way to help investors is to provide them with a clear and easy to understand disclosure about the respective roles of advisers, the nature of their contractual relationships, and the different products, advice, and services they provide. In our members' experience, disclosure engages clients in a constructive dialogue about their financial goals and objectives and what they can expect from their financial professional. In addition to clear disclosure, NAIFA believes it is important that Congress ensure there is adequate regulatory enforcement to ensure all financial professionals are held accountable for violating the law.

NAIFA has multiple concerns about legislative and regulatory efforts to address this issue by establishing a harmonized fiduciary standard of care for investment advisers and broker-dealers. We believe this "one size fits all" approach overreaches in addressing the problem of consumer confusion, and fails to recognize the inherent differences in the process of selling advice for a fee as opposed to selling financial products. However, if Congress is going to move to establish a harmonized fiduciary standard of care, we encourage Members of Congress to consider the following important factors to ensure the

standard both protects consumers and is practically workable for the financial professionals who serve them:

- The standard must preserve the ability of middle and lower income consumers to have access to and receive competent professional services and financial products. The key is preserving competitive cost-effective compensation arrangements that will enable consumers to pursue their financial objectives and financial independence.
- The standard must call for clear and easy-to-understand disclosure about the respective roles of financial professionals, the nature of their contractual relationships, and the different financial products and services available, so the investor is in a position to make an informed decision about the products and services offered by the financial professional.
- The standard must preserve the ability of financial professionals to sell only products made available by the company or companies with which they are affiliated and/or with which they have a contractual relationship/agreement.
- The standard must recognize the ability of financial professionals to be fairly compensated without restriction as to the manner or type of compensation arrangements, including, but not limited to commissions or fees. Compliance with a standard of care should not be determined by the manner or type of compensation received by the financial professional, but by the type of product or service provided to the consumer.

Action Taken: On Wednesday, November 4, 2009, the House Financial Services Committee favorably reported H.R. 3817, the Investor Protection Act of 2009. During the Committee's deliberations H.R. 3817 was significantly modified to address some of NAIFA's key objectives.

The Committee-reported version of H.R. 3817 includes the call for simple and clear disclosures to investors, and clarifies that registered representatives of broker-dealers selling a limited suite of products (because of their contractual relationships) cannot be held in violation of the fiduciary standard for that reason. The bill also allows for harmonized enforcement of broker-dealers and investment advisers. Currently, broker-dealers and their registered representatives are subject to regulatory audits every 1-2 years to ensure compliance with existing laws and regulations. In contrast, investment advisers are generally audited by the Securities and Exchange Commission once every ten years. NAIFA supports Congress' efforts to address the disparity.

NAIFA remains concerned, however, that the language of H.R. 3817 continues to threaten consumers' continued access to both affordable and competent professional services and financial products.

Our Ask: NAIFA encourages Congress to (1) reject language in Section 103 of H.R.3817 that would allow the SEC to issue rules to prohibit or restrict any "compensation schemes that are deemed contrary to the public interest"; and (2) reject language in Section 103 of HR. 3817 that directs the SEC to issue a rule that would require broker-dealers and their registered representatives, and investment advisers to act in the best interest of a client "without regard to financial or other interest of the broker, dealer, or investment adviser providing the advice."

(1) NAIFA is concerned that this language would allow for future regulatory action by the SEC to ban commission-based sales and thereby favor a fee-based compensation model.

- This issue is important to investors because Congress and the SEC must preserve the ability of middle and lower income consumers to have access to and receive competent professional services and financial products. The key is preserving competitive, cost-effective

compensation arrangements -- such as commissions -- that will enable consumers to pursue their financial objectives and financial independence.

- In the longstanding experience of NAIFA members, the vast majority of people seeking financial services will opt for the financial adviser who is paid commissions on the sale of products rather than an upfront fee. Why? Because most people cannot afford to pay an upfront fee for financial services – or they resist paying such a fee. This perhaps can explain why only 17% of Americans currently have a written financial plan – a fee-only service provided by investment advisers (Certified Financial Planners Board research, September 2009).
- Our concern that the SEC could take action to ban commission based sales is amplified because the United Kingdom already has moved to ban commissions for the sales of securities products. The ban takes effect in December 2012. U.S. officials have repeatedly stated the importance of coordinating with the UK on our respective regulatory reform efforts.

(2) The “without regard to the financial interest” language is extremely subjective and allows for retroactive interpretation of whether a registered representative or investment adviser recommended a financial solution or product that will achieve the consumer’s objectives based on just one factor—how they were paid.

- Registered representatives and investment advisers are highly educated and trained experts in their field. Because of their training, they understand that there are various factors that must be accounted for before recommending a product. For example, some products may pay a lower commission but will include features that perhaps are not favorable to the client. That is why these professionals make several considerations before recommending a product. Those considerations include but are not limited to:
 - Determining that the product(s) do what the customer wants done. Answering this question involves a multi-page questionnaire to assess the client’s income, risk tolerance, age, tax status, liquidity needs, financial time horizon, investment objectives, etc.
 - Underwriting risk classification of the client
 - Near and long term surrender charges built into the product
 - Investment experience and risk tolerance of client
 - Price of product relative to benefit
 - Internal expense structure of the issuing company
 - Financial strength of a company offering a product
 - Policy coverage features
 - Historic service standards of a company
 - Underwriting standards
 - Product performance over time
- Any determination by a regulator as to whether a financial professional has not acted in a client’s best interest should take into consideration all of the factors and not just one factor – compensation. Isolating compensation implies that the representative will always be thought guilty, until proven innocent, that they violated the standard because of just one factor of the sale.
- Just as in defensive medicine, this standard establishes a chilling effect in the marketplace and can increase liabilities for financial professionals. The danger is that:

(1) broker-dealers and their registered representatives, in an effort to avoid constant scrutiny, may feel compelled to offer the lowest paying products that will be deemed appropriate but

perhaps will not further the client's needs and wants as much as another product; and/or

(2) broker-dealers and their registered representatives will need to raise their professional liability coverages. This net result would mean significantly increased costs to consumers. The unintended consequence is that these financial professionals will be forced to serve only investors with significant assets to invest so that they can meet their business expenses and provide for their families.

About NAIFA: NAIFA comprises more than 700 state and local associations representing the interests of approximately 200,000 agents and their associates nationwide. NAIFA members focus their practices on one or more of the following: life insurance and annuities, health insurance and employee benefits, multiline, and financial advising and investments. The Association's mission is to advocate for a positive legislative and regulatory environment, enhance business and professional skills, and promote the ethical conduct of its members.

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