

**NAIFA Comments on the October 26, 2009 Revised Manager's Amendment to Sec. 103 of the Investor Protection Act:**

- 1) We strongly support the provisions for simplified disclosure to investors.

NAIFA believes that the best way to help investors is to provide them with 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 what they can expect from their financial professional.

- 2) We strongly support language that recognizes that the receipt of compensation based on commission or other standard compensation for the sale of securities shall not, in and of itself, violate the standard.

The inclusion of this language recognizes the inherent principle that broker-dealers, and their registered representatives, being paid for their services is not, by itself, a conflict of interest.

- 3) We support the language requiring brokers or dealers who sell "only proprietary or a limited range of products" to be required to provide notice to the customer and obtain consent or acknowledgement for the disclosure. However, we request additional clarification that sale of a limited suite of products does not, in and of itself, violate the standard.

The inclusion of the limited suite of products language acknowledges the respective roles of financial professionals, the nature of their contractual relationships, and the different financial products and services available. Through this disclosure, investors will be better positioned to make an informed decision about the products and services offered by the financial professional.

However, we ask for the following clarification (in bold below) regarding the sale of a limited number of products:

Page 2, lines 11 – 17, "DISCLOSURE OF RANGE OF PRODUCTS OFFERED. – Where a broker or dealer sells only proprietary or other limited range of products, as determined by the Commission, the Commission shall by rule require that such broker or dealer provide notice to each retail customer and obtain the consent or acknowledgment of the customer. **The sale of only proprietary or other limited range of products by a broker or dealer shall not, in and of itself, be considered a violation of the standard set forth in subparagraph (1) hereof.**"

- 4) We strongly support the provisions for harmonized enforcement for Investment Advisers and Broker Dealers and their Registered Representatives.

Currently the SEC and FINRA examine broker-dealers firms once every two years to ensure compliance with existing laws and regulations. Registered representatives are audited annually by their broker-dealer firms to determine

compliance with all existing laws and regulations. By contrast, registered investment firms are audited approximately once every 10 years by the SEC.

- 5) We request language to clarify that the scope of the Investor Protection Act only applies to securities.

This clarification needs to be made in the following four places:

Page 1, line 18, insert the following language: "when providing personalized investment advice **about securities** to a retail investor;

Page 2, lines 22 and 23, insert: "receives personalized investment advice **about securities** from a broker or dealer;"

Page 3, lines 21 and 22, insert: "when providing personalized investment advice **about securities** to retail customers;"

Page 4, lines 13 and 14, insert: "receives personalized investment advice **about securities** from a broker, dealer, or investment adviser;"

- 6) We request language that would prohibit future regulatory action by the SEC that would favor one type of compensation over another.

The standard of care 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 advisor that is paid commissions on the sale of products rather than an upfront fee. Why? Because most people cannot afford paying 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).

NAIFA's concern is amplified by action taken in June of this year by the United Kingdom's Financial Services Authority (FSA) to ban commission payments to investment advisers from investment firms and product providers. The UK ban will go into effect the end of December 2012.

We therefore request the Manager's amendment be changed in the following way to address this concern:

Page 3, lines 7-12; Page 4, lines 24 and 25; and Page 5 lines 1-4, add the following language: "examine and, where appropriate, promulgate rules prohibiting or restricting certain sales practices, conflicts of interest, and compensation schemes for brokers, dealers, and investment advisers that the Commission deems contrary to the public interest and the protection of

investors. **Any rules promulgated hereunder shall not prohibit or require a specific type or form of compensation."**

- 7) We recommend deleting the text on Page 3 lines 24 and 25; and Page 4, line 1: "without regard to financial or other interest of the broker, dealer, or investment adviser providing the advice."

The "without regard" standard is extremely subjective. Further, it fails to take into account the laundry list of considerations registered representatives of broker-dealers take into account before recommending a product. Those factors include but are not limited to:

- a. Determining that the product(s) do what the customer wants done. Answering this question involves a multi-page questionnaire to assess the clients' income, risk tolerance, age, tax status, liquidity needs, financial time horizon, investment objectives etc.
- b. Underwriting risk classification of the client
- c. Near and long term surrender charges built into the product
- d. Investment experience and risk tolerance of the client
- e. Price of the product relative to benefit
- f. Internal expense structure of the issuing insurance company
- g. Financial strength of the insurance company offering a variable insurance product
- h. Policy coverage features
- i. Historic service standards of the company
- j. Underwriting standards for the product
- k. Product performance over time

If a registered representative does all of his/her due diligence and follows the steps and thought processes noted above, and then recommends and sells a product that happens to pay a higher commission, this section allows for subjective and retroactive interpretation of whether that representative recommended a solution that will achieve the buyer's objectives based on just one factor—how they were paid. Further it 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. The danger is that broker-dealers and their registered representatives, in an effort to avoid constant scrutiny, may feel compelled to recommend products that are perhaps likely to be deemed appropriate but perhaps will not further the clients' objectives as much as another product simply due to the compensation structure involved.