National Association of Insurance and Financial Advisors

March 12, 2019

The Honorable Maxine Waters
Chairwoman
House Committee on Financial Services
2129 Rayburn House Office Building
Washington, DC 20515

The Honorable Patrick McHenry
Ranking Member
House Committee on Financial Services
2129 Rayburn House Office Building
Washington, DC 20515

RE: NAIFA Statement for the Record
Hearing of the Subcommittee on Investor Protection
Putting Investors First? Examining the SEC's Best Interest Rule
March 14, 2019

Chairwoman Waters, Ranking Member McHenry, and Members of the Committee:

The National Association of Insurance and Financial Advisors (NAIFA) appreciates this opportunity to share our perspective on the Securities and Exchange Commission's (SEC) proposed Regulation Best Interest[1] (the "proposal") and how, if finalized, it will protect and advance the interests of investors. We commend the Committee for taking up this important issue and welcome future opportunities to work with you on consumer protection initiatives and measures to improve Americans' financial security.

Founded in 1890 as The National Association of Life Underwriters (NALU), NAIFA is the oldest, largest and most prestigious association representing the interests of insurance professionals from every Congressional district in the United States. NAIFA members assist consumers by focusing their practices on one or more of the following: life insurance and annuities, health insurance and employee benefits, retirement planning, multiline, and financial advising and investments. NAIFA'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.

NAIFA supports a best interest standard of conduct for securities-licensed firms and individuals. With its proposal, the SEC went to considerable effort to establish such a standard *without*

[1] SEC, Proposed Rule, Regulation Best Interest, 83 Fed. Reg. 21574 (May 9, 2018); SEC, Proposed Rule, Form CRS Relationship Summary; Amendments to Form ADV; Required Disclosures in Retail Communications and Restrictions on the Use of Certain Names or Titles, 83 Fed. Reg. 21416 (May 9, 2018).

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imposing unduly prescriptive or burdensome implementation or compliance requirements that ultimately could disadvantage low- and middle-income savers. The SEC's general approach, we believe, significantly strengthens the standard of conduct for financial services professionals while preserving choice and access to advice and investment products for consumers at all income levels and account sizes.

The SEC's principles-based proposal strengthens investor protections <u>and</u> will not discourage saving by low- and middle-income families.

The SEC's proposal contains a robust, substantive regime to protect investors by making sure the advice they receive is in their best interest, reducing confusion about financial professionals' obligations and potential conflicts of interest, *and* preserving all investors' access to financial professionals and products that will help them save. Notably, the proposal:

- Clearly requires that clients' interests be placed above firms'/advisors' interests when investment recommendations are given, and requires individualized and thorough analyses of the appropriateness of a recommendation to a particular client;

- Is product- and compensation-neutral, which allows for the recommendation and sale of diverse products under compensation arrangements that make sense for all types of investors;

- Contains simple and meaningful disclosure obligations, including disclosure of all material conflicts of interest, types of compensation involved, and the best interest standard to which the advisor must adhere;

- Calls for policies and procedures to be established at the firm level to address conflicts of interest; and

- Utilizes existing federal enforcement mechanisms, rather than the private plaintiffs' bar and state courts, to enforce and interpret the new standard and attendant requirements.

The focal point of the SEC's new structure—the best interest standard—enhances the professional standard of conduct for broker-dealers (BDs) and registered representatives (RRs) who advise retail customers. This heightened standard *requires* BDs and RRs to act in the best interest of their clients when making recommendations without placing their own interests ahead of their customers' interests. It also sets forth clear supporting obligations to ensure fulfillment of the standard:

- Disclosure Obligation – requires concise upfront disclosures regarding conflicts of interest and the nature and terms of the advisor-client engagement;

- Care Obligation – requires advisors to exercise reasonable diligence, care, skill, and prudence in evaluating recommendations and conducting individualized analyses on whether a recommendation is in the best interest of a particular client; and

- Conflict of Interest Obligation – requires firms to maintain *and enforce* policies and procedures to disclose, mitigate and/or eliminate conflicts of interest.

The SEC's proposed Form CRS also would require *additional* disclosures to address potential consumer confusion about the financial professionals with whom they are working. Form CRS would require financial professionals to provide a description of the relationship and services provided (including a plain-English explanation of whether brokerage or advisory services, or both, will be offered), as well as applicable standards of conduct, fees and costs, and potential conflicts of interest. All disclosures under the proposal are required to be concise, easy-to-understand descriptions of the important features of the financial professional-client relationship and the services and products being offered.[2]

NAIFA members serve Main Street investors who deserve advice that is in their best interest <u>and</u> choice and affordability in the marketplace.

NAIFA members work primarily with lower and mid-market clients – the average "Janes and Joes" who are often referred to as "Main Street America" – to help these consumers build a safe and sound financial future for their families. Vital to achieving this goal is maintaining consumer choice and access by small account holders to products they want to buy, professional advice and investment education, and advisor compensation arrangements that are realistic for and beneficial to the client. Consequently, while we support a strong best interest standard for licensed firms and individuals, it is important that regulations *not* impose unnecessary costs and burdens on businesses or consumers, be more prescriptive than necessary, or artificially force the market toward regulator-preferred (not consumer-driven) business models, products, or compensation arrangements that simply do not work for many American families.

According to a recent survey of NAIFA members, 83% of NAIFA members reported that a majority of their clients have household incomes of less than $150,000, while nearly one-third of NAIFA members reported that most of their clients have household incomes of $100,000 or

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[2] NAIFA has encouraged the SEC to revise its proposed titling restrictions (i.e., restricting the use of the words "advisor/adviser" for BDs and RRs) because that piece of the proposal, we believe, is unnecessary and actually has the potential to *add* consumer confusion. The proposed restrictions, for instance, would apply only to BDs and RRs and not the numerous other professionals using those words and delivering advice on a wide variety of financial topics (e.g., various insurance products, college funding, home ownership and real estate, risk management, estate planning, tax, charitable giving, etc.). Barring ubiquitous words for a particular segment of the financial services sector does *not* enhance consumers' understanding of the specific obligations and standards that apply to their advisor(s). Straightforward disclosures, which already are included in the proposal, are a far better and more direct way for consumers to gain such an understanding, as well as the products and services offered under what terms, regardless of title.

less.[3] With respect to liquid assets (including cash, stocks, bonds, and mutual funds, but excluding real estate and vehicles), more than two-thirds of NAIFA members said that a typical client's amount of liquid assets totals less than $250,000, while over 40% of our members reported that a typical client's liquid assets totals less than $100,000[4] – an amount well short of current account minimums for many fee-based investment accounts.

Indeed, traditional commission-based compensation models typically *benefit* low- and middle-income investors like NAIFA members' clients. Unlike for high-wealth consumers, the alternatives to commission-based compensation arrangements – upfront advisory fees with ongoing asset management fees, and wrap account arrangements – are not workable or palatable for many of our members' Main Street clients. In fact, a 2011 survey of 25.3 million IRA accounts found that a large majority of IRA investors opted for commission-based arrangements over fee-based arrangements, and low-balance account holders favored commission-based arrangements at an even higher rate – for good reason.[5]

As a fundamental matter, clients who are deciding whether they have the resources to save at all will be unable or unwilling to pay a substantial out-of-pocket fee that represents a significant portion of the assets they may have to invest. Further, fee-based arrangements are often not available to and/or do not make economic sense for many non-wealthy investors. An internal survey of NAIFA members revealed that for 78% of our members, *more than half* of their current clients would experience increased costs if their accounts were shifted from commission-based to fee-based arrangements; and for about 41% of our members, *more than 80%* of their clients would see such an increase (a strong argument against all advisors moving to an investment advisor (IA)/investment advisor representative (IAR)/fee-based platform).

Generally, under a brokerage model, investors pay a one-time commission when an asset is purchased or when "new money" is invested in the account. Under a fee-based model, on the other hand, investors pay regular (e.g., annual) fees for account "management" services based on the total amount of assets under management, not just "new money." Thus, for some investors, the fee-based arrangement will likely result in unnecessary or excessive charges – for example, investors who buy and hold assets for a long period and do not require any real level of "management" (e.g., annuity and target fund purchasers) or investors who simply transfer money between investments in the same fund family (a move for which many commission-based advisors receive no additional compensation).

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[3] NAIFA Survey: NAIFA Members Serve Main Street Americans, Feb. 2019, available at https://www.naifa.org/News-Publications/Research/NAIFA-Survey-NAIFA-Members-Serving-Main-Street-Am.

[4] *Id.*

[5] Milloy, Meghan, American Action Forum, *The Consequences of the Fiduciary Rule for Consumers* (Apr. 10, 2017), available at https://www.americanactionforum.org/research/consequences-fiduciary-rule-consumers/.

There simply is no one-size-fits-all investment scenario that is appropriate for all Americans. Flexibility and diversity of options are essential and attempting to drive all consumers toward particular products and/or business models via overly costly, prescriptive regulations is counterproductive. As described above, the SEC's proposal represents a principles-based approach with a high standard of conduct and clear obligations for financial professionals, but with a commonsense implementation framework that will allow diverse products and compensation arrangements to be offered in the marketplace.

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Ultimately, the entire SEC proposal is designed and has the substantive components necessary to minimize consumer confusion and harm, and to promote smart saving by all Americans. For the foregoing reasons, NAIFA supports the proposal and looks forward to a finalized Regulation Best Interest as soon as possible.

Sincerely,

Jill M. Judd, LUTCF, FSS
NAIFA President