NATIONAL ASSOCIATION OF INSURANCE AND FINANCIAL ADVISORS

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August 30, 2010

Elizabeth M. Murphy
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, D.C. 20549-1090

Re: Study Regarding Obligations of Brokers, Dealers, and Investment Advisers

FILE NO. 4-606

Dear Ms. Murphy:

This letter will present the views of the National Association of Insurance and Financial Advisors ("NAIFA") in response to the Securities and Exchange Commission's ("SEC" or the "Commission") invitation to submit comments on the issues raised by the Commission's forthcoming study regarding obligations of brokers, dealers, and investment advisers.

NAIFA comprises more than 700 state and local associations representing the interests of 200,000 members 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. Founded in 1890 as The National Association of Life Underwriters, NAIFA is the nation's largest financial services membership association. The vision of NAIFA is to protect and promote the critical role of insurance in a sound financial plan and the essential role provided by professional agents and advisors. NAIFA's mission is to advocate for a positive legislative and regulatory

environment, enhance business and professional skills, and promote the ethical conduct of our members who assist the public in achieving financial security and independence. Approximately 80 percent of all NAIFA members are licensed as Registered Representatives of broker-dealers ("Registered Representatives") and market and service mutual funds, and a representative percentage are Investment Adviser Representatives.

Our members and our organization take great interest in the study the SEC is conducting pursuant to Section 913 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Pub. L. No. 111-203) ("Dodd-Frank" or the "Act"). Like consumers, the financial industry, and the economy as a whole, our members over the past several years have lived through a turbulent and destabilizing period in their profession, and are encouraged that the SEC is working to ensure that investors are protected. With these comments, and our future interactions with the Commission, NAIFA hopes the practical experience and knowledge of our members can be a helpful resource as the SEC continues to examine how regulations are working to protect the investing public.

In the comments that follow, we seek to not only respond to the questions on which the Commission seeks comment, but also to provide the Commission with a clear understanding of the financial products and services NAIFA members provide for their clients – the investors the Commission seeks to protect, which include the individuals, families, and small businesses that NAIFA members serve every day, and without whom NAIFA members would have no livelihood. We cannot emphasize enough the importance of the development and maintenance of a long-term relationship of trust between NAIFA members and their clients. As small business owners, NAIFA members are Middle America and serve Middle America. They are from communities, small and large, across the country, and see their clients every day – at places of worship, schools, grocery stores, and as neighbors. Unless there is a relationship of trust and ethical behavior on the part of the financial professional, there is no way their business can survive. Together with current statutory and regulatory requirements, as well as the best practices required under the compliance programs of their affiliated broker-dealers, the need (and desire) of NAIFA members to serve clients ethically and in their best interests ensures a vigorous level of investor protection that rivals any new standards that may be put in place.

Beyond describing our members' industry, these comments will also address a number of more substantive issues we hope the Commission will consider as you craft and conduct the study. First, we hope the Commission will keep in mind that our members, who are Registered Representatives of the broker-dealers they represent, are currently subject to a comprehensive regulatory regime. NAIFA members hold insurance producer licenses in one or more states and a great majority of them also hold one or more securities licenses, including the Series 6, Series 7, Series 63, and Series 24. A sizable percentage of them are Series 65 licensed investment adviser representatives, as well. NAIFA members spend a great deal of time and resources complying with a myriad of state and federal regulations that seek to ensure that: they are sufficiently trained in the products they sell; they are appropriately licensed; and they only recommend to their clients courses of action that are appropriate for their clients' needs and objectives.

We encourage the Commission to recognize that most of our members are community-based small business owners, many working as sole practitioners, who provide affordable insurance and financial services to the middle-market. In doing so, our members currently adhere to significant compliance requirements that provide an abundance of upfront investor protection through adherence to and vigorous enforcement of various rules imposed by FINRA and, in turn, implemented by broker-dealers. Because our members are insurance licensed professionals, they also must adhere to regulations imposed by the various state insurance departments. As a result of these multiple regulatory layers, NAIFA members are some of the most comprehensively regulated individuals in the financial services industry. Therefore, it is critical that before any new regulations are promulgated or standards imposed, careful consideration is given to the impact such requirements would have on these small businesses and the middle-market investors they serve.

Thus, as you work to achieve our mutual goal of ensuring that all Americans have access to affordable financial advice and financial products backed by strong investor safeguards, we urge the Commission to consider the following comments.

I. Overview of NAIFA Members and the Regulations That Govern Them

NAIFA members are financial professionals who serve the middle-market and recommend financial products that are appropriate for their clients' specific goals and situations. They serve their clients best interests by adhering to comprehensive regulatory requirements imposed by both federal and state governments and self-regulatory organizations.

NAIFA members help their clients address the wide spectrum of long-term financial needs faced by individuals and families. The scope of their services are focused on the client's individual needs, taking into consideration the client's goals and situation, including anticipated retirement plans or other employee benefits. These services can include insurance, savings, tax and estate planning, and investments. Because they are insurance professionals, the approach taken by NAIFA members always involves an assessment of risk management in order to provide the client options for mitigating potential market declines or unexpected life events and contingencies.[1]

Under current law, NAIFA members who are Registered Representatives of a broker-dealer have an obligation to recommend only those approved specific investments or overall investment strategies that are suitable for their clients. The concept of suitability appears in specific self-regulatory organization ("SRO") rules, such as NASD Rule 2310 (updated in Financial Industry Regulatory Authority ("FINRA") proposed rules 2090 and 2111)[2] and FINRA Rule 2330[3], and has been interpreted to be an obligation under the antifraud provisions of the federal securities laws. The suitability requirements compel a Registered Representative to have an "adequate and reasonable basis" for any recommendation that the Registered Representative makes. Whether a recommendation is "reasonable" relates to the particular securities or strategies recommended. Thus, NAIFA members have an obligation to investigate and obtain comprehensive information about the course of action they

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[1] Anecdotally, given the events associated with the current poor economic conditions, NAIFA members have recognized an uptick in clients asking for products that guarantee against market declines – particularly as they approach retirement.
[2] NASD Rule 2310 (2010), *available at* http://finra.complinet.com/en/display/display_main.html?rbid=2403&element_id=3638.
[3] FINRA Rule 2330 (2010), *available at* http://finra.complinet.com/en/display/display_main.html?rbid=2403&element_id=3645.

recommend.[4] Additionally, NAIFA members are obligated to determine "customer-specific" suitability, taking into account every client's particular financial situation, needs, and other security holdings.

Thus, in order to fulfill their current ethical and legal obligations, NAIFA members must spend a great deal of time getting to know their clients. In fact, the know-your-customer obligation is a specific due diligence process required by FINRA[5] and designed to require Registered Representatives to gather the essential facts about the client in order to ensure that any products recommended are appropriate for the client's personal and financial circumstances. For NAIFA members, compliance with the "know-your-customer" obligation generally involves the client completing a suitability questionnaire designed to assess the customer's age, marital status, annual household income, financial situation and needs, investment experience, investment objectives, investment time horizon, existing assets, liquidity needs, liquid net worth and risk tolerance. The client is asked to provide the Registered Representative with extensive documents to support the answers to the questionnaire. These documents can include tax returns, wage statements, account statements for savings and investments, trust agreements, wills, bank statements, powers of attorney, retirement account statements, stock purchase agreements, employee agreements, insurance policies, employee benefit booklets, prenuptial agreements, divorce decrees, gift tax returns, and descriptions of real and personal property.

The "know-your-customer" process provides information necessary to help determine which products will assist the client in achieving the client's financial goals and objectives. Because there are thousands of product options available in the marketplace, when recommending a financial product to a client NAIFA members consider a number of factors to narrow the selection to a group of financial products[6] that they believe are most appropriate for the client's objectives:

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[4] *See, e.g.*, SEC, *Guide to Broker-Dealer Registration* (2008), *available at* http://www.sec.gov/divisions/marketreg/bdguide.htm.
[5] *See* Notice of Filing and Immediate Effectiveness of Proposed NASD Rule Change Relating to Suitability Rule, 66 Fed. Reg. 20697, 20698 n.7 (Apr. 24, 2001).
[6] According to NAIFA members, they generally limit the number of products offered for a client's consideration to five or fewer. This number may vary, but is based on the NAIFA member's understanding of the client's wants and needs in an effort to avoid confusion and overwhelming a client.

Proprietary products: Because the overwhelming majority of Registered Representatives represent a single broker-dealer they are limited to offering the products for which the broker-dealer has performed due diligence and reached a selling agreement with the product manufacturer;

Amount of investment: The amount of money a person has to invest will limit the product choices from which the person may choose. Typically, a person with $10,000 or less to invest is limited to mutual funds, variable annuities, and liquid short-term investment accounts.

Best practices: There are a number of other "best practices" that NAIFA members generally use to determine whether or not a product is appropriate for a client, including: assessment of the premium relative to the benefit of the product; assessment of the historic underwriting service standards of the product manufacturer; and assessment of the performance of the financial product over some specified time horizon.

Throughout the client relationship, Registered Representatives are also required to make numerous disclosures to clients. Disclosure requirements can be organized generally into four categories:

- Transaction confirmation requirements contain a number of compensation disclosure components. The SEC's transaction confirmation rule, Rule 10b-10, requires broker-dealers to disclose specified information known as "confirmations" in writing to customers either upon completion of a transaction, or before the transaction is completed. The SEC also has adopted other rules mandating compensation-related disclosures for particular situations that are generally given in conjunction with confirmations. SRO confirmation rules also contain various compensation disclosure requirements that apply to transactions effected in securities subject to their rules. [7]

Comment [JE1]: ?

- In addition to confirmation rules, securities purchased in the context of a public offering require broker-dealers to use various registration forms depending on the types of issuers and securities, and embedded in these forms are various compensation disclosure requirements. These generally call for

[7] *See generally* SEC Rule 10b-10, 17 C.F.R. 240.10b10 (2009).

information relating to the compensation payable to the principal underwriter for the offering and members of the selling syndicate. Additionally, several FINRA (NASD) rules impose disclosure requirements for offering documents distributed by member firms participating in certain corporate offerings or financings, or offerings of investment company securities.[8]

- Municipal Securities Rulemaking Board (MSRB) rules require disclosure of underwriting arrangements in an "official statement" if any broker-dealer registered with MSRB participates in the offering.[9]

- Inherent in antifraud provisions of federal securities laws and SRO rules are standards regarding compensation arrangements. Although it does not appear that these statutes impose any requirements above and beyond the SEC and SRO rules and regulations that directly address compensation disclosure, both courts and the SEC have indicated that failing to disclose compensation could, in certain situations, amount to violations of these antifraud provisions.[10]

Beyond governmental and SRO requirements, the broker-dealers with whom NAIFA members work generally require additional assurances that the advice provided to clients is suitable to the clients' needs, goals, and circumstances. These "best practice" policies require Registered Representatives to justify to the broker-dealer both the courses of action they recommend and why they recommend them. All broker-dealers have compliance officers, many of which are in-house, conducting audits (both pre-planned and unannounced) to ensure the adequacy of a Registered Representative's recommendations to clients. Detailed records of both what Registered Representatives recommend and why they recommend it, as well as all disclosures made to clients, are created, maintained, and reviewed at least annually by

[8] *See generally* 17 C.F.R. 229.508 (2009)
[9] *See generally* Municipal Secs. Rulemaking Bd. General Rule G-32 (2009), *available at* http://www.msrb.org/Rules-and-Interpretations/MSRB-Rules/General/Rule-G-32.aspx.
[10] *See generally* SEC Rule 10b-5, 17 C.F.R. 240.10b10 (2009)*; see also* 15 U.S.C. 77q(a) (2006); and NASD Conduct Rule 2120 (2010), *available at*].

our members' affiliated broker-dealers office inspections and/or FINRA representatives.[11]

Beyond the requirements and obligations already described, there are a number of additional compliance requirements imposed by either FINRA or affiliated broker-dealers on Registered Representatives. These include:

- All Registered Representatives and associated office personnel who assist with transactions or open mail must be fingerprinted;
- Quarterly client account statements must be reviewed and signed by the Registered Representative;
- All marketing materials must be preapproved by the broker-dealer compliance department;
- Any financial publication that comments on a particular product – even without recommending one – must be preapproved by the affiliated broker-dealer;
- All prospective client seminar materials must be preapproved by the broker-dealer;
- All Registered Representatives must maintain detailed trade order, securities certificate, and check registries;
- All website changes must be preapproved by the affiliated broker-dealer;
- Some broker-dealers require all Registered Representative business bank records to be subject to inspection;
- All Registered Representatives must attend an annual face-to-face compliance meeting and reaffirm that they understand all existing rules and regulations governing Registered Representatives and Investment Adviser Representatives;
- All Registered Representatives must visit an independent testing center every 3 years and take a 3 ½ hour long FINRA Regulatory Element test that must be passed with 100% competency; and

[11] For example, to ensure compliance, all broker-dealers conduct annual office inspections of their Registered Representatives, which include pulling a random selection of files and reviewing them for compliance. The findings are submitted to the broker-dealers' Office of Supervisory Jurisdiction (OSJ) for review.

- All print and electronic communications a Registered Representative receives or sends is monitored by the broker-dealer and must be archived.

In addition to being a broker-dealer Registered Representative and, in some cases, an Investment Adviser Representative, as insurance producers NAIFA members are also subject to comprehensive regulation by the various state insurance departments. A brief overview of the insurance regulatory framework applicable to insurance producer licensing, examination, market conduct, and other requirements is attached hereto as Attachment A.

In addition to the compliance requirements described above, broker-dealers also track and monitor the activities of their Registered Representatives for certain patterns that could trigger a surprise audit. Suspicious patterns are determined by market activity but can include placing too many clients in a financial product that pays only high commissions, switching clients too often from product to product, or not reviewing investment breakpoints for sales charges on mutual funds.

Despite the prevalence of documentation and disclosure, it is our members' experience that clients do not always read all the disclosure documents and instead rely on their financial professional to describe the financial products and the *consequences* of undertaking certain courses of action. The relationship between NAIFA members and their clients revolves around this consequential dialogue and understanding. Thus, the continued availability of these financial services and financial products through financial professionals like NAIFA members is critical. Current legal requirements and best practices help to foster good behavior, but it is the on-going relationships that ensure it. As indicated above, because our members are small business owners who serve the middle-market in their communities, they have an extra incentive – beyond regulatory requirements – to provide honest and ethical services to their clients. They simply could not stay in business without depending upon referrals and repeat business from satisfied clients.

II. Overview of Investment Advisers and the Regulations that Govern Them

Investment advisers play a different role in the financial industry than that of Registered Representatives. Investment advisers sell advice that is not product- specific and they manage assets for a fee. Because of the scope of their services and their compensation structures, investment advisers typically serve wealthier investors. Registered Investment Advisers and their affiliated Investment Adviser Representatives owe a fiduciary duty to act in their clients' best interests. This duty reflects the different types of relationships investment advisers have with their clients compared to those of Registered Representatives and their clients. The fiduciary duty has evolved over time as a result of judicial decisions and SEC enforcement actions, but remains somewhat vague.

The Investment Advisers Act of 1940 (Pub. L. No. 76-768, 54 Stat. 847 (1940) (codified as amended at 15 U.S.C. §§ 80b-1 – 80b-21 (2006))) (the "Advisers Act") defines an investment adviser as "any person who, for compensation, engages in the business of advising others...as to the value of securities or as to the advisability of investing in, purchasing, or selling securities."[12] Although not specifically stated in the Advisers Act, judicial decisions and SEC actions indicate that investment advisers owe a fiduciary duty to their clients.

The foundation for investment advisers' fiduciary duties lies in Section 206 of the Advisers Act. Under Section 206(1), an investment adviser is prohibited from employing "any device, scheme, or artifice to defraud any client."[13] Section 206(2) precludes an adviser from "engaging in any transaction, practice, or course of business which operates as a fraud . . . upon any client."[14]

In *SEC v. Capital Gains Research Bureau, Inc.*,[15] the Supreme Court held that the SEC did not have to show that a registered investment adviser had met the common law elements of fraud in order to sustain a cause of action under the Advisers Act. Prior to *Capital Gains*, it was unsettled whether

[12] 15 U.S.C. 80b-2(a)(11) (2006).
[13] *Id.* § 80b-6(1).
[14] *Id.* §80b-6(2).
[15] 375 U.S. 180 (1963).

Section 206 merely codified the common law elements of fraud, or required from advisers a heightened standard of care beyond those elements. In that case, however, the Court was very clear that investment advisers owe their clients "an affirmative duty of 'utmost good faith, and full and fair disclosure of all material facts,' as well as an affirmative obligation to employ 'reasonable care to avoid misleading'" their clients.[16]

Since the Court handed down its decision in *Capital Gains*, the SEC has brought enforcement cases alleging investment advisers violated Section 206 for engaging in conduct not specifically precluded by that section. While the precise scope of the "fiduciary" duty that investment advisers owe their clients has never been fully defined, registered investment advisers clearly have a duty to serve the interests of their clients with undivided loyalty. An adviser that has a material conflict of interest must either refrain from acting upon that conflict, or it must fully disclose all material facts relating to that conflict, and obtain the consent of its clients, before acting.[17] In addition, an investment adviser has the duty to seek best execution,[18] to make suitable recommendations,[19] and to have a reasonable basis for the investment advice that is provided to clients.[20]

After decades of judicial decisions and SEC enforcement actions, the fiduciary standard continues to be recognized as relatively ambiguous. It remains unclear to many in the investment adviser community what the standard requires of them. As a former Director of the SEC's Division of Investment Management has said, the fiduciary duty obligations are "unclear as to their scope and often leave significant practical questions unanswered. Investment advisers and their counsel are left to divine, if not guess, the application in every day business life of basic fiduciary obligations."[21]

[16] *Id.* at 194
[17] *Kidder Peabody & Co., Inc.,* Advisers Act Release No. 232 (Oct. 16, 1968).
[18] *Id.*
[19] Suitability of Investment Advice Provided by Investment Advisers; Custodial Account Statements for Certain Advisory Clients, Advisers Act Release No. 1406 (March 16, 1994).
[20] *See, e.g., Alfred C. Rizzo,* Advisers Act Release No. 897 (Jan. 11, 1984).
[21] Barry P. Barbash & Jai Massari, *The Investment Advisers Act of 1940: Regulation by Accretion*, 39 Rutgers L.J. 627 (2008), *available at* http://org.law.rutgers.edu/publications/lawjournal/issues/39_3/03BarbashVol.39.3.r_1.pdf.

Enforcement of the fiduciary standard is shared by state securities regulators and the Commission. According to Commission statistics, the Commission will inspect approximately 9% of Registered Investment Advisers in 2010.[22] This relatively low percentage, which may be due to a lack of resources, may result in weaker investor protection under investment adviser regulation than is afforded under broker-dealer regulation, where FINRA will inspect 55% of all broker-dealers this year[23], and Registered Representatives are subject to annual office inspections and daily monitoring of their activities and obligations.

III. The Broker-Dealer Exclusion

Broker-dealers and their Registered Representatives do not owe a fiduciary duty under the Advisers Act as long as the relationship with their clients meets certain criteria. This exemption, particularly as it relates to many NAIFA members, reflects the different type of relationship that Registered Representatives have with their clients compared with those of registered investment advisers and their clients. Elimination of this "broker-dealer exclusion" would have negative consequences for both NAIFA members and, more importantly, their clients. In the context of a Registered Representative–client relationship, a vague and unclear standard of care would be difficult, if not impossible, to comply with. The ambiguity of the fiduciary standard would impose a state of regulatory uncertainty; the increased disclosure obligations could be counter-productive; and the heightened vulnerability to litigation, and the attendant increased costs of compliance and errors and omissions insurance, would increase expenses to the point that many of our members might be forced to cease operations.

When it enacted the Advisers Act, Congress specifically excluded broker-dealer advisory services from the Act's requirements as long as two conditions were met: first, the broker's advice must be "solely incidental" to brokerage services;[24] and second, the broker must receive "no special

[22] SEC, *FY 2011 Congressional Justification In Brief* 20 (Feb. 2010), *available at* http://www.sec.gov/about/secfy11congbudgjust.pdf..
[23] *Id.*
[24] 15 U.S.C. 80b-2(a)(11).

compensation" for the provision of advice.[25] Although exempt from the Advisers Act requirements (discussed above) NAIFA members who are Registered Representatives must nonetheless comply with FINRA's suitability standard and make recommendations that are appropriate for the client, based on the client's financial situation and financial objectives. Moreover, Registered Representatives are subject to all other Securities and Exchange Act and FINRA broker-dealer investor protection requirements and may be liable for fraud or negligence if they provide false or misleading information to customers.

The broker-dealer exclusion is justified because registered investment advisers and broker-dealers provide different types of financial services and operate under different business models. Registered Representatives sell investment products and may provide some incidental advice in connection with such a sale. This is completely different from Registered Investment Advisers, whose entire business is centered on selling advice in the form of managing client assets and drafting financial plans. The element of the financial product sale changes the character of the relationship between the financial professional and the client, and makes the fiduciary standard very difficult to apply in the broker-dealer context—and would effectively abridge the current legal relationship that exists between the Registered Representative and the broker-dealer.

As discussed above, even in the investment adviser context, the fiduciary standard is recognized to be relatively ambiguous. As Larry E. Ribstein, securities and business law professor at the University of Illinois states, "'Fiduciary Duty' is one of the most amorphous concepts in the law. The concept has been developed through centuries of case law. Part of the problem is that courts and commentators have used fiduciary language to describe duties in a bewildering variety of circumstances ranging from seemingly straightforward contractual relationships between franchisees and franchisors to professional relationships of dependence such as between patients and doctors and pharmacists and customers. J.C. Shepherd, a leading commentator, despairs of 'confusion and uncertainty in applying the fiduciary principle to disparate fact situations.'"[26] This "confusion and uncertainty" would be magnified in the

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[25] *Id.*
[26] *Wall Street and Fiduciary Duties: Can Jail Time Serve as an Adequate Deterrent for Willful Violations?: Hearing Before the S. Comm. on the Judiciary*, 111th Cong. 1-2 (statement of Larry E. Ribstein, Professor, Univ. of Ill. College of Law) (quoting J.C. Shepherd, *Law of Fiduciaries* 7 (1981)).

Registered Representative context, where a recommendation involving the sale of a financial product could be second-guessed at any time – including the instant the financial product goes down in value – despite the best efforts of the Registered Representative at the time the financial product was purchased.

Imposition of an ambiguous fiduciary obligation would likely require many NAIFA members to increase significantly the time and resources they devote to regulatory compliance. This would be an unnecessary duplication given the current comprehensive regulatory requirements, and the "best practices" undertaken to comply with those requirements, particularly in light of the relationship-based practice that drives NAIFA members to serve their clients ethically and to the best of their abilities – in many cases for decades and even generations. Moreover, layering on an additional standard of care on broker-dealers would do little to discourage improper conduct. Instead, its consequences would be largely concentrated on well-intentioned financial professionals, increasing their administrative costs and introducing an element of confusion and redundancy for both them and their clients.

Eliminating the broker-dealer exclusion would also force NAIFA members to protect themselves against what will undoubtedly be a substantial increase in frivolous litigation. Illustrative of the likely consequences is the history of Section 36(b) of the Investment Company Act, which imposes a fiduciary duty on mutual fund investment advisers. Forty years after the adoption of Section 36(b), hundreds of cases have been brought imposing billions of dollars in costs without a single plaintiff victory at trial.[27] A broker-dealer fiduciary duty may lead to costs that substantially exceed those of litigation under Section 36(b), particularly because the standard is not precisely defined. Such costs could be catastrophic for our members, and would likely force many of them to shut down their operations.

Subjecting Registered Representatives to the Advisers Act could have a serious negative impact on investor choice and markedly limit access to affordable financial services because of the business model used in the broker-dealer world. Registered Representatives currently serve all investor classes – generally through a commission-based compensation model that allows investors to avoid paying

[27] *See generally* M. Todd Henderson, *Justifying Jones* (U. Chi. L. & Econ. Olin Working Paper No. 491), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1499410 (forthcoming U. Chi. L. Rev.).

expensive up front and ongoing fees to receive recommendations regarding suitable financial products that will further their financial objectives. In contrast, registered investment advisers are paid fees to put together a generic financial plan or to place assets under management.[28] As a result, investment adviser services are financially outside of the reach of most middle income investors, who cannot afford the upfront and ongoing fees for service.

Elimination of the broker-dealer exclusion would have the added effect of subjecting Registered Representatives to all the other requirements of the Advisers Act, including registration, disclosures, and more. This is wholly unnecessary and duplicative because Registered Representatives are currently subject to comprehensive regulatory oversight that provides substantial investor safeguards. Imposing an entirely new regulatory regime on them is not likely to provide additional investor protections. The additional layer of regulation could, however, raise their costs, force them to change their business models, or, as many NAIFA members fear, force them to leave the business entirely. Such an outcome would be a disservice to honest, hardworking professionals and would result in real harm to middle-market investors.

IV. Conclusion

This study represents an opportunity for the Commission to undertake a rigorous and thorough examination of the requirements applicable to broker-dealers and their Registered Representatives and investment advisers and their representatives, and to fully understand how these requirements apply, how they are implemented and how they actually protect investors.

NAIFA believes the comprehensive regulatory requirements, oversight, and enforcement of rules governing Registered Representative conduct, combined with best practices and rigorous implementation of those requirements by broker-dealers, work well to protect investors. We recognize, however, that the complexity of the financial services marketplace and the varying services provided by

[28] NAIFA members who are investment advisers report that in their experience Registered Investment Advisers generally require clients to have at least $150,000 or more to invest or charge thousands of dollars for a written financial plan.

broker-dealers and investment advisers can be difficult for the average investor to understand.[29] The goal of any new regulatory requirements, therefore, should be to address the issue of consumer confusion while not imposing on Registered Representatives unnecessary additional obligations on top of current requirements. To that end, NAIFA recommends that any change in the regulatory requirements include clearly delineated standards and obligations that are not repetitious and that are designed to improve investor understanding. Moreover, any new rule should fully coordinate with existing rules and practices, in order to create a cohesive regulatory regime that protects consumers, addresses their confusion, fosters a marketplace where all consumers have choices and access to financial products and services, and enables broker-dealers and Registered Representatives, such as NAIFA members, to comply with the law and to continue providing quality services to the clients who rely on them.

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NAIFA is grateful for the opportunity to provide comments on the SEC's forthcoming study. We hope that the foregoing comments enable the Commission to have a better understanding of the role NAIFA members play in the financial industry. It is a complex and nuanced task the SEC faces, and at NAIFA we recognize, appreciate, and share the mutual concerns of both the Commission and the other members of the industry. We submit these comments with the hope that they are the beginning of an ongoing dialogue between NAIFA and the SEC, so that we might assist the Commission going forward, as the Commission has helped guide our industry for the past seventy-five years. Please feel free to reach out to us at any time.

Sincerely,

/s/ Susan B. Waters

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Susan B. Waters
Chief Executive Officer

Attachment (1)

[29] RAND Research Study on Investor and Industry Perspectives on Investment Advisers and Broker-Dealers

Attachment A

Overview of the Insurance Regulatory Framework Applicable to Insurance Producer Licensing, Examination, Market Conduct, and Other Requirements

Insurance producers (agents and brokers) are subject to cradle-to-grave regulatory oversight to ensure that they have the training and knowledge necessary to sell complicated insurance products.

Licensure

Insurance producers are required to hold licenses in every jurisdiction in which they operate – including a resident license in the producer's home state and non-resident licenses in every other jurisdiction in which the producer operates. Conceivably, then, a NAIFA member could hold 50+ licenses (including the District of Columbia and the territories). Moreover, most states require agencies to be licensed as well, so an agent could hold an individual license and a business entity license for every jurisdiction in which it does business.

Licenses are issued by "line of authority." Most, if not all, NAIFA members hold the life insurance line of authority. Those that sell variable products also must hold the variable life/variable annuity line of authority. If they sell other types of insurance – health or homeowners, for example – additional lines of authority would be required. Some states also require agencies to be licensed by lines of authority. As a result, a producer could hold 100 or more licenses and multiple lines of authority under each license.

Education

In most states, insurance producers seeking a resident license are required to undergo 20 hours of prelicensing education for each major line of authority (life, variable, etc.) for which they are seeking a license. After obtaining a license, they are required to have 24 hours of continuing education every two years, including 3 hours of ethics education. Some states require additional continuing education for agents selling long-term care or annuity policies.

Examinations

Every state requires an applicant for a resident license to pass an examination covering the relevant line(s) of authority that the applicant intends to sell.

Applications

In order to obtain a license, an individual or entity must submit an application that solicits a broad array of information from the applicant, including, perhaps most importantly, background information. The background information, in conjunction with the fingerprint check that many states perform, provides regulators with background and criminal history information to determine if the applicant is fit to hold a license in a profession in which consumer protection is paramount.

Market Conduct

In addition to continuing education requirements, insurance producers are subject to ongoing regulation, including license renewal procedures. Insurers are also subject to extensive market conduct exams by the states, and agent conduct and practices are examined as part of that process. Moreover, producers are subject to a plethora of state insurance consumer protection laws and rules, including unfair trade practices laws, disclosure requirements, anti-discrimination requirements, and more. Similar to the requirements for broker-dealer Registered Representatives and investment adviser representatives, initial enforcement for many of these requirements falls on the carriers whose products are offered by the producer.

Suitability

One consumer protection of particular relevance to the issues to be addressed in the Commission's study is the National Association of Insurance Commissioner's (NAIC) recently-adopted Suitability in Annuity Transactions Model Regulation. The NAIC model, which updates a previous NAIC model that is in effect in many states, was drafted to closely mirror the stringent suitability standards established by FINRA for the sale of variable annuities in its Rule 2330. Highlights of the new model include:

- establishing the duties of insurers and insurance producers with respect to compliance with the model;
- requiring an insurer or producer to make "reasonable efforts" to obtain the consumer's "suitability information" prior to recommending a particular annuity to a consumer;
- requiring the producer to have reasonable grounds to believe the recommendation being made to the consumer is suitable, based on the suitability information gathered in the transaction;
- prohibiting producers from dissuading or attempting to dissuade a consumer from responding truthfully to requests for, or confirmation of, suitability information or from filing a complaint with the insurer or appropriate regulatory authority;
- requiring a producer to record any recommendation made or obtain a customer signed statement documenting his or her refusal to provide suitability information; or a consumer signed statement acknowledging that an annuity transaction is not recommended and that it is not based on the producer's or insurer's recommendation; and
- requiring a producer to have adequate product specific training, including compliance with the insurer's standards for product training, prior to soliciting an annuity product. This includes a one time, minimum four credit hour general annuity training course offered by an insurance department-approved education provider and approved by an insurance department in accordance with applicable insurance education training laws or regulations.