VALMARK SECURITIES, INC.

August 27, 2010

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

Re: Request for Comment to Inform Study Regarding Obligations of Brokers, Dealers, and Investment Advisers (Release No. 34-62577; IA-3058; File No. 4-606)

Dear Ms. Murphy:

I am writing in response to the Securities and Exchange Commission ("Commission's") request for public comment to inform its study of the obligations and standard of care of brokers, dealers, and investment advisors when providing personalized investment advice about securities to retail customers.

Our firm owns and has operated both an SEC-registered investment advisor, ValMark Advisers, and a FINRA member broker-dealer, ValMark Securities, for almost the last 15 years. These businesses emerged from a successful state-licensed insurance brokerage, Executive Insurance Agency, founded in 1963. We work through approximately 400 independent registered representatives who offer a combination of general account life products, separate account life products, general securities and advisory services through these three entities. Through these professionals we have placed approximately 40 billion dollars of insurance protection and serve several thousand clients through both the RIA and the broker-dealer with a very favorable rate of customer satisfaction measured by a low number of complaints and arbitrations. Through our own RIA and those owned by our registered representatives, we offer investment advisory services for more than 10 billion dollars in assets.

I am President and CEO of the broker-dealer and the RIA and hold Series 7 and 24 licenses. In addition, I am a non-active member of the Ohio Bar Association and a CFP® Licensee. I was also a member of the CFP® Board of Examiners and a past board member for the Association for Advanced Life Underwriting (AALU). For most of my career, I personally have been an advocate for the benefits of offering consumers the choice of having equities as the underlying asset class for insurance products and the added protection of separate accounts. I have also advocated for the benefits of consistent and reasonable FINRA regulations in addition to reform for life settlements[1].

[1] See *Testimony on Ohio HB 404*, Ohio Senate Insurance Subcommittee. (April 2, 2008); *Testimony on Ohio House Bill 404*, Ohio House of Representatives Subcommittee. (December 18, 2007); Rybka, Lawrence J., Callahan, Caleb J. and Leimberg, Stephan R. (2008). Securities Regulation of the Settlement Industry, *Tools and Techniques: Life Settlement Planning*; Rybka, Lawrence J. and Holler, Jeffrey M. (February-March 2006). Disclosure in a Post-Spitzer World; A Case for Variable Life, *Journal of the American Society of CLU & ChFC*.

In support of our independent Registered Representatives, through the three businesses, we directly employ 110 employees in our Akron and St. Paul office, including six full time compliance staff. In addition, we require all front-line marketing people who advise our registered representatives to obtain both the Series 7 and 24 licenses. In the past 15 years, we have been through approximately one audit of the RIA and eight audits of the broker-dealer, as well as numerous SEC and FINRA sweeps, informal inquires and separate audits of our OSJ and Branch offices. We literally spend hundreds of thousands of dollars ensuring compliance, including individual product reviews, monitoring correspondence and email, in addition to visiting our offices and conducting ongoing training to ensure compliance with existing FINRA rules.

Our firm is very familiar first hand with how standard investment services can be offered in fiduciary capacity, through a registered investment advisor. Directly through our own SEC-registered investment advisor, ValMark Advisers, we provide investment services to thousands of clients. Additionally, some of our registered representatives own their own investment advisory firms. All of these accounts are managed under the standards of the Investment Advisers Act of 1940 ("1940 Act"), or their state law equivalents. When serving the clients under this regulatory model, our advisors use the steps required of a fiduciary under the Uniform Prudent Investor Act. These steps include: providing the client a written investment advisory agreement, taking client data to create an appropriate investment policy statement, and then purchasing and monitoring those securities that match the requirement through an independent custodian. In this regulatory model, the client pays a fully disclosed fee on a quarterly basis for this service. Under this business model, we are buying mainly low-cost, fully transparent exchange traded funds and mutual funds as the underlying investment. In exchange for this fee, we provide the services of reporting on, monitoring and rebalancing these funds in the program and meeting with the client on a periodic basis.

On the broker-dealer side, the same registered persons who offer advisory services also offer commission-based products under the 1933 and 1934 Acts. Many of our registered representatives offer specialized services around estate planning; therefore, our two most popular product sets in the broker-dealer are variable life and variable annuities. Like most fully disclosed independent broker-dealers, we also offer a broader array of products including mutual funds, group annuities and have a fully disclosed trade desk where we offer stock and bond execution. With the variable life and variable annuities, we are paid from the issuer via a commission that is built into the product and taken from sales charges that are disclosed in the prospectus to the client. Statements of Additional Information provide even more detailed information.

<u>The sale of separate account products through the broker-dealer (variable life and variable annuities) is inconsistent with the fee-based advisory model or the proposed fiduciary standard:</u>

In comparing our experience in offering both advisory products and those governed by a suitability standard through the broker dealer, it is our experience over thousands of transactions that bundled products like variable annuities and variable life products do not lend themselves to the fee-based advisory process being advocated by proponents of a harmonized fiduciary standard for several reasons:

1. <u>The unitized nature of variable products is largely incompatible with an advisory model</u>. Complex bundled products like variable annuities and variable life issued by a single financial intermediary do not fit the same model of managing simple products like individual stocks, ETFs, mutual funds and bonds that can be separately assembled in managed portfolios under an advisory model. The variable life and annuities come "pre-assembled" by the issuer with several investment choices and separate contractual guarantees from the issuer such as guaranteed death benefits and lifetime income guarantees. The riders or features that offer clients guarantees of income or death benefits often require selection of a specific investment option that allows the carrier to provide these guarantees.

   I also offer as evidence the relative absence of variable products that are fee-based, and the failed attempt by issuers that have attempted to create them. Thus, many advisors who solely offer investment advice do not present these products as an option to their clients. It is likely that if the proposed fiduciary standard is adopted, it would lead to a substantial decrease in offerings of products that provide clients with these innovative products because the product offered will have to be the "best", a complicated concept that is further described in Sections 3 and 4 below. This new regulation could have a chilling effect on the development and offering of an array of valuable products to meet investors' needs, and make financial professionals hesitant to offer their eminently suitable products because they might not be deemed by regulators to be the absolute "best," however that term is chosen to be defined in a given instance.

2. <u>It is in most client's best interests to have the charges for advice paid via a sales load on variable products because of how they are taxed</u>. Unlike separately managed accounts, where a management fee is deducted periodically from a client account, it is very difficult to charge an ongoing fee for the management of a variable life or annuity product and have those fees deducted from the product. One of the features that is attractive to clients of variable life and variable annuity is the deferral of income tax. If a client authorized payment of fees from variable products, in most circumstances this payment would trigger additional income taxes for their client. In fact, if the client is under the age of 59 it would, in most circumstances, also trigger a penalty tax as well. The current system of paying registered representatives through embedded sales charges disclosed in the prospectus, does not trigger a taxable gain since these are built into the internal product costs. It has been my observation that fee-based advisors (those not registered through a FINRA firm) have a strong bias against these products because of this practical difficulty in charging fees and the adverse tax consequences to the client.

3. <u>The complex nature of the variable products makes determination of what is in the client's best interest on a prospective basis almost impossible</u>. Variable life insurance and annuity products represent a highly flexible and adjustable product that must be customized for each client. By their very nature they require customized financial analysis, as to which sub-accounts and features match the client's goals.

   This complexity makes it very difficult to determine which product is "best" and almost certainly would lead to increased litigation. Our industry has a long history of being able to establish and supervise sales under the objective standard of suitability, but determining what is "best" would be highly subjective and invite second guessing after the fact. For example, determining the best annuity product would depend on what happened after the sale. In a rising equity market, the best product would be the one most aggressively allocated to equities, with the lowest charges. The "best" product for the client that dies three years into the contract would be the one with the highest death benefit. In a prolonged depressed or flat equity market, the product with the best income guarantee would clearly be most favorable to the client. Good advisors can also argue the merits of a product with fewer investment choices and lower cost vs. one with higher charges but a wide range of investment choices. Under the current suitability standard, all of these recommendations, if properly matched to client investment goals, income and net worth would be suitable. Under the proposed best interest standard, there would be considerable uncertainty and argument about which was best prospectively.

4. <u>Underwriting of variable products</u>. One of the unique services involved with the recommendation of a variable life product is the whole process of underwriting a client's unique medical history. Good insurance professionals not only look at life insurance products in terms of their features and internal costs, but also negotiate for the most favorable risk classification (sometimes with multiple carriers). This has the impact of lowering the costs of insurance for their clients specifically. The recommendation to proceed with a purchase of variable life is often predicated on obtaining this favorable risk classification. This process may take anywhere from 30 to 180 days, depending on the size of the policy and the level of medical information that needs to be gathered. This extended process impacts the determination of the proposed standard in two significant ways:

   - There is an extended time for the client (and often a separate trustee or other advisors) to continue to evaluate all aspects of the transaction. Thus, these sales are never rushed or impulsive sales and have been conducted with considerable dialogue and information.

   - Secondly, any determination of what is "best" would need to take into account differing mortality factors that result from this process and then involve the client's heath information. There is no corresponding complexity in the advisory model for managing mutual funds or ETFs. I remember distinctly a FINRA audit that our firm went through a couple of years ago looking at large variable insurance transactions, where we were asked to produce a list of transactions we approved for clients over a certain age. Our Staff provided the information requested, but I asked the auditors if they wanted to also take into consideration those transactions not recommended because we were unable to get a favorable enough risk classification in the underwriting process? This whole concept of factoring underwriting into the determination of an appropriate recommendation was completely foreign to them, but is essential to what good insurance professionals do. How would it be measured under a fiduciary standard and how would broker-dealers monitor this?

5. <u>Increased regulation under a fiduciary standard will likely lead to a default recommendation of general account products by many insurance licensed professionals</u>. One of the ironies of the financial reform bill was the last minute approval of the Harkin amendment. This amendment essentially removed general account equity index annuity and equity index life products from SEC jurisdiction. My extensive study of these products (that are funded with derivatives) has brought me to the conclusion that these products are actually much more complex, often allow the companies to change benefits to policyholders at their discretion and can be subject to far greater abusive sales tactics

than any variable products regulated by FINRA. Evidence of the potential for abuse with these products is supported by numerous actions by state attorneys general, state securities administrators and the SEC's own proposals to regulate them under Rule 151(a). It is very likely that the adoption of a strict fiduciary standard will have the unintended consequence of some registered representatives dropping registration with FINRA and many insurance-licensed professionals following a path of least regulatory resistance and only offering these products instead of variable products. Thus, in a quest to "protect consumers" many clients may only be shown less transparent equity index products, which will lack any status as a security; will not be subject to full, fair and adequate disclosure; will lack the sales review examination done by the SEC or FINRA; and will lack the need to comply with the FINRA suitability standard. Those sales will not have the review of any proposed enhanced fiduciary standard. Rather than leveling the playing field, it will make it more uneven.

Gaps, Shortcomings or Overlap in Existing Law and Regulation

In comparing the investment adviser and broker-dealer regulatory regimes, the broker-dealer regulatory regime provides better guidance to registered representatives and their supervisors and therefore better protection to their customers, because the rules are clearer and more specific, and the conduct of registered representatives is capable of being monitored and audited. The written supervisory procedures we are required to create, implement and monitor are far more rigorous than anything on the advisor side of the business. By contrast, the principles-based nature of the investment advisor regulatory regime may work in managing what is essentially a fee-based service for managing securities assets, but it would be very problematic for much more complex and expanded product sets offered through the broker-dealer.

One of the most significant gaps in regulation is the lack of inspections and examinations of investment advisors. The fiduciary duty of investment advisors gives scant protection to investors in light of the infrequency of SEC or state examinations. Most small advisors have no federal regulation and oversight whatsoever. In our own experience with our RIA and broker-dealer, we allocate six times the resources to FINRA compliance and over 20 times the legal costs for the same dollar of gross revenue. These gaps and shortcomings in oversight of advisors is an area of investor protection that the Commission should address first, before changing any standards of care for brokers. In other words, the need (if any) to adopt a "uniform" standard of care for broker-dealers and investment advisors pales in comparison to the need to adopt uniform standards for examination and inspections of securities professionals and implement them to be the same level of recurring events.

On three separate occasions we considered registration with our broker-dealer of prospective advisors who wanted to affiliate and who were already operating as SEC-registered investment advisors. In a careful review of their business activities before we would agree to register them, and if we registered them with our broker-dealer then we would be required to monitor and supervise under our existing obligations under FINRA, we concluded that these advisors were inadvertently participating in the direct offering of securities inconsistent with the fee-based offerings that they should have been providing under the 1940 Act. Two of the three involved private placement of offerings that should have been offered through a broker-dealer, and the third involved the offering of a very complex hedge fund with no independent monitoring or verification of actual client positions. We declined the decision to register these people, but it was evidence to me that there are gaping holes in the current regulatory structure for advisors and no comparable checks on outside business activities or private securities transactions regulated by NASD Rule 3040. If there are gaps in current regulation, the largest ones are for investment advisors, not broker-dealers.

For example, one of the investment advisory firms was the general partner of a fund that is a private placement, offering limited partnership interests in a hedge fund pursuant to the exemption from registration under the 1933 Act provided by Regulation D. According to their SEC registration and the regulations they needed to follow as a result, their conduct was permissible. However, SEC rules were not the only regulations they (and we, as their prospective broker-dealer) should have been concerning themselves with. According to FINRA (then NASD) guidance, the broker-dealer must, upon notice and approval of a registered representative's/investment advisor's ("RR/IA") participation in such a private securities transaction for compensation, record the transaction on broker-dealers' books and records and supervise such transactions. All the RIA was concerned with was meeting its regulatory obligations under the SEC's rules, which they believed they did. However, in the current regulatory environment, that is not enough. There were many things the RIA wasn't doing simply because they were not concerned with anything other than SEC regulations. There were a litany of checks and balances that needed to be in place to comply with FINRA regulations – regulation standards that, in my opinion, are more comprehensive and do much more to protect investors.

Under current law the same professional can offer different products and services under a broker-dealer, RIA or through state regulated insurance offerings. If the issue of investor confusion over the legal obligations of the investor's particular financial service provider is a point of concern — as has previously been suggested in published research reports — there are many ways to address this issue short of requiring that all business be conducted under an untried standard. These could include clarification of roles, designations and better disclosure of potential conflicts of interests. One of the other studies being conducted under the Financial Services Reform bill is the whole issues of designations, which address separately this very issue. Having earned a degree in finance, a Juris Doctorate degree and as a CFP® who has invested considerable time in professional education and credentials, I do believe that there is room to set higher standards for education and disclosure to consumers. I am a firm believer that it is choice that fuels the innovation of our system and that investors, if presented with appropriate information, can make a choice that is right for them. Disclosure is a far better alternative than eliminating investor choices by attempting to make all financial professionals the same and harming small investors who will end up without professional advice.

We have endeavored to offer a wide range of quality products through the independent financial professionals we serve. I truly believe that our registered representatives aspire to do what is best for their client, be it in the offering of incidental investment services, broker-dealer products or general account life insurance. I agree with Chairman Schapiro that similar products should be regulated in a similar manner. However, from a practical perspective I believe that the broker-dealer already bears a disproportionate regulatory burden over either general account life insurance (equity index life and annuity products in particular) and advisory services under the 1940 Act. Adoption of a strict Fiduciary Standard will increase that imbalance. The unintended result will be less choice and less protection for clients and average Americans who will not be served. I am grateful that the commission has the opportunity to consider the practical implications of this action landscape for investors.

I strongly encourage the Commission to consider the specific issues as they relate to variable life products and the unique role of insurance professional in the marketplace. Again, I thank the Commission for the opportunity to comment and welcome future opportunities to provide input.

Sincerely,

Lawrence J. Rybka, JD, CFP®
President & CEO

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