National Association of Insurance and Financial Advisors

2901Telestar Court • Falls Church, VA 22042-1205 • (703) 770-8188 • www.naifa.org

July 2, 2013

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

Re: Duties of Brokers, Dealers, and Investment Advisers; Request for data and other information
Release No. 34—69013
File No. 4—606

Dear Ms. Murphy:

This letter presents 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") request for data and other information relating to the benefits and costs that could result from various alternative approaches regarding the standards of conduct and other obligations of broker-dealers and investment advisers.

Founded in 1890 as The National Association of Life Underwriters (NALU), NAIFA is one of the nation's oldest and largest associations 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, multiline insurance products, 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.

Approximately two-thirds of all NAIFA members are licensed as registered representatives of broker-dealers who market and service mutual funds, variable annuities and other securities, while over one quarter of our members are dually licensed as registered representatives and either registered investment advisers or investment adviser representatives.

Our members and our organization are very interested in the SEC's consideration of the issue of what standard or standards of conduct should apply to broker-dealers and investment advisers when providing personalized investment advice to retail customers. We have conducted internal studies and surveys of our members and their customers during the past three years to get a better sense of how any changes to the current regulatory regime will affect Middle America's ability to receive sound, individualized financial advice and services. The following comments will provide the Commission with a better understanding of how the regulatory changes being contemplated would affect our members and – more importantly – their clients.

NAIFA's comments will respond to (i) the SEC's specific requests for data and other information regarding the current market for personalized investment advice and changes to the marketplace which might result from adoption of a uniform fiduciary standard; (ii) the SEC's request for comment on the possible uniform fiduciary standard as set forth in the release; (iii) the SEC's request for comment on the alternative approaches to the uniform fiduciary standard discussed in the release; and (iv) the Commission's request for data and comment on whether it should consider harmonizing other regulatory obligations of broker-dealers and investment advisers.

I. Overview of NAIFA Members, their Regulatory Regime and their Clients

A. 2010 LIMRA Survey and 2013 NAIFA/American College Survey

In October 2010, NAIFA commissioned the Life Insurance Marketing and Research Association ("LIMRA") to conduct a survey of NAIFA members to gain a better understanding of the specific business activities in which members engage on behalf of their clients. The survey also examined the views of consumers on various aspects of their financial services experience. The primary objectives of the survey were to ascertain quantitative and other data regarding NAIFA members' views on the fiduciary and suitability standards of care, to document members' involvement in securities, to gauge members' views on existing regulations and whether and how a uniform fiduciary standard of conduct would impact members and their clients, and to gather data on the dollar amount that NAIFA members' customers have to invest. The survey also included a consumer poll, conducted by the Opinion Research Corporation, which asked consumers how much they are willing to pay to receive investment advice, and how they wish to pay for that advice.

More recently, in an effort to better respond to the SEC's current request for information and comment, in May 2013, NAIFA collaborated with The American College of Financial Services – a nonprofit private educational institution located in Bryn Mawr, Pennsylvania, that provides financial education for securities, banking, and insurance professionals – in conducting a survey of both NAIFA's membership and American College alumni regarding, among other things, how the imposition of a uniform fiduciary standard would affect our members' ability to serve their clients. This latest survey also sought to update relevant data and findings from the 2010 LIMRA survey.[1]

[1] A report on the 2010 LIMRA Survey is online at www.naifa.org/ServingMainStreetInvestors/documents/LIMRASurveyResults.pdf. In these comments, this report is cited to as the "LIMRA Survey". Results of the 2013 NAIFA-The American College Survey are online at www.naifa.org/ServingMainStreetInvestors/documents/NAIFA-TACSurveyResults.pdf. In these comments, these results are cited to as the "NAIFA-TAC Survey".

Much of the content of our responses to the SEC's specific requests come from these surveys. The results indicate that the imposition of a fiduciary standard on registered representatives would likely result in a shift from middle to higher-income clients, increased costs, and limitations on the product options offered. These outcomes could serve to limit a registered representative's ability to provide service and advice to middle-market clients and to offer a broad variety of low-cost financial products to their clients.

B. Overview of NAIFA Members and their Clients

NAIFA members are "Main Street" small business owners who provide affordable insurance and financial services, primarily to middle-market customers and investors. As small business owners, NAIFA members are Middle America and serve Middle America by recommending financial products that are appropriate for their clients' specific goals and circumstances. NAIFA members are from communities, small and large, across the country, and they see their clients every day – at places of worship, schools, grocery stores, and as neighbors. The 2010 LIMRA survey indicated that 58 percent of NAIFA members' clients have annual household incomes of less than $100,000, while only 11 percent of NAIFA members' clients have household incomes of more than $250,000 (LIMRA Survey, page 14). All NAIFA members hold insurance producer licenses in one or more states; in addition, two-thirds of NAIFA members also hold securities licenses to serve as a registered representative in order to sell and market securities products, and 26 percent of our members are also dually registered as both registered representatives and investment advisers or investment adviser representatives.

A NAIFA member's association with his or her clients is based on long-term relationships, not individual transactions. We cannot emphasize enough the importance of the development and maintenance of a long-term relationship of trust between NAIFA members and their clients. Unless there is a relationship of trust along with ethical behavior on the part of the NAIFA member, the livelihood of NAIFA members would be threatened and their businesses would not survive. More than 80 percent of the respondents in the NAIFA-American College survey said their experience and reputation are important factors cited by retail clients who choose to work with them (NAIFA-TAC Survey, page 7). 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.

C. NAIFA Members Are Subject to a Comprehensive Regulatory Regime

1. Background

As both licensed insurance producers and broker-dealer registered representatives, NAIFA members are currently subject to a comprehensive regulatory regime consisting of state insurance laws, state and federal securities laws, self-regulatory organization rules and the compliance policies and procedures of their broker-dealers. Every NAIFA member holds an insurance producer license in one or more states and a majority of them hold one or more securities licenses, including the Series 6, 7, 63, 65, and 66. As such, NAIFA members devote a significant amount of time, attention, and resources to complying with myriad state and federal laws and regulations that – quite appropriately – seek to ensure that such persons are properly licensed and trained in the products they sell, and that they only recommend courses of action that are appropriate for their clients' individual needs and objectives.

In addition to current SEC regulatory requirements, the current compliance requirements applicable to registered representatives provide an abundance of upfront investor protections through adherence to various rules promulgated by the Financial Industry Regulatory Authority ("FINRA"). Additionally, because our members are also licensed as insurance producers, they are regulated by the various states in which they are licensed and must adhere to a broad range of state rules and regulations. As a result of these multiple regulatory layers, NAIFA members are among the most comprehensively regulated individuals in the financial services industry.

2. The FINRA Suitability Standard

Under current law, NAIFA members who are registered representatives have an obligation to recommend only those approved investments or investment strategies that are suitable for their clients. FINRA's strict "suitability" standard – which was recently amended and updated – requires a registered representative to make only appropriate recommendations based on the client's particular financial situation and financial objectives. For the reasons discussed below, NAIFA members believe the current suitability standard that registered representatives must meet is a strong standard that acts to sufficiently guide and ensure ethical behavior among broker-dealers and their registered representatives.

The suitability standard of care appears in specific self-regulatory organization rules, including FINRA Rules 2111 and 2330, and has been interpreted to be an obligation under the antifraud provisions of the federal securities laws. Registered representatives are required to deal fairly with their clients. More specifically, the suitability standard requires a registered representative to "have a reasonable basis to believe that a recommended transaction or investment strategy involving a security or securities is suitable for the customer, based on the information obtained through the reasonable diligence of the member or associated person to ascertain the customer's investment profile."[2] In order to further ensure the protection of consumers, separate FINRA rules provide specific, detailed requirements in connection with certain transactions which the regulators have determined contain additional complexities. For example, FINRA Rule 2330(b) imposes specific requirements with regard to recommendations concerning deferred variable annuities.

Registered representatives have an additional obligation to "know [their] customer," which obligates them to "use reasonable diligence, in regard to the opening and maintenance of every account, to know (and retain) the essential facts concerning every customer"[3] to ensure that any and all products recommended are appropriate for the client's particular needs and

[2] FINRA Rule 2111(a) (stating further that a customer's "investment profile" includes the customer's age, other investments, financial situation and needs, tax status, investment objectives, investment experience, investment time horizon, liquidity needs, risk tolerance, and any other information the customer may disclose).
[3] FINRA Rule 2090.

financial circumstances. Broker-dealers and their registered representatives also have general obligations to evidence or document their compliance with applicable FINRA rules.[4]

Accordingly, NAIFA members are currently under detailed obligations to determine customer-specific suitability for every client's financial situation. Those obligations require our members to obtain comprehensive information about factors such as the client's risk tolerance and liquidity needs so that the registered representative can make recommendations that meet the client's investment objectives. In practice, these obligations, along with other regulatory requirements (dealing with topics such as disclosures to investors, fairness of compensation and supervision by the broker-dealer), as well as the aforementioned long-term relationship-based business model, require NAIFA members to spend a great deal of time getting to know their clients, which helps to ensure compliance and – more importantly – helps to ensure that NAIFA members act to satisfy the needs of their clients.

Beyond the requirements these laws and regulations impose, the broker-dealers with whom NAIFA members work generally require registered representatives to provide additional assurances that the advice provided to clients is, in fact, suitable to the clients' needs, goals, and circumstances. These "best practice" policies require registered representatives to justify to the broker-dealer the course of action recommended. Detailed records are maintained that evidence "best practice" compliance, and all broker-dealers have compliance officers to ensure the sufficiency of a registered representative's particular recommendation. These practices are further detailed in the SEC Commissioned RAND Study, *Investor and Industry Perspectives on Investment Advisers and Broker-Dealers* (2008). Brokerage firms interviewed by RAND described how they have in place extensive training and compliance requirements, in addition to sophisticated software programs and protocols all designed to ensure trades are aligned with the clients' stated goals (RAND Study, page 75).

Compliance-related activities take up a significant amount of NAIFA members' time and resources. NAIFA members who sell securities spend an average of 526 hours each year, including staff time, on compliance matters. This includes 12 hours each year devoted to compliance examinations. In addition, they spend an average of $8,878 per year on exam expenses, compliance-related fees, and staff expenses devoted to compliance (LIMRA Survey, page 25).

The requirements and obligations described above detail only some of the compliance requirements and safeguards already in place for registered representatives. Regulatory requirements aside, given that NAIFA members' businesses and livelihood are dependent upon meeting and exceeding the needs of their clients, members have a fundamental incentive to provide honest and ethical services to their clients in order to ensure referrals and repeat business from satisfied clients.

[4] *See* FINRA Regulatory Notice 11-25 (July 9, 2012), available at http://www.finra.org/web/groups/industry/@ip/@reg/@notice/documents/notices/p123701.pdf.

II. Responses to the Commission's Requests for Data and Other Information

In response to the Commission's specific requests for data and other information, we urge you to consider the following comments based on the quantitative and qualitative data taken from the 2010 LIMRA survey and the 2013 NAIFA-American College survey.

A. Data and Other Information, Including Surveys of Customers, Describing the Characteristics of Customers who Invest through a Broker-Dealer as Compared to those who Invest on the Basis of Advice from an Investment Adviser, as well as Customer Perceptions of the Cost/Benefit Tradeoffs of each Regulatory Regime. (Item II (1) in the Release)

Most NAIFA members are community-based small business owners who provide affordable insurance and financial services to middle-market households.[5] NAIFA members frequently provide anecdotal stories of their clients who started with little money to invest, but, after working with the NAIFA member for 10, 20, 30 years or more, have been able to successfully grow their assets by significant amounts.

The registered representatives surveyed by NAIFA and the American College often serve investors with smaller portfolios. Nearly 83 percent said the majority of their clients have investment portfolios worth less than $250,000, while more than half said they primarily serve clients with investments of less than $100,000, and 27 percent said most of their clients have $50,000 or less invested. For dually registered advisors in the survey, those who said the majority of their clients have investments worth less than $250,000 drops to 63 percent (NAIFA-TAC Survey, page 5). The survey's results for investment advisers who are not also registered representatives are limited (due to the fact that not many NAIFA members or American College alumni are in this category), but for those who were surveyed, nearly 70 percent said the majority of their clients have portfolios of more than $250,000. This finding – that investment advisers typically work with clients with significantly larger investment portfolios – is supported by other sources, including the RAND Study (RAND Study, page 73).

The LIMRA Survey also found that many customers are in a position to invest only limited amounts: Half of all consumers who have less than $50,000 invested said that they could invest less than $1,200 per year (LIMRA Survey, page 6). Therefore, it is critical to have a variety of different business models offering financial services available in order to allow middle and lower income market individuals to have access to a broad range of products and professional investment advice.

The imposition of a uniform fiduciary standard could result in registered representatives having to significantly increase the time and resources they devote to regulatory compliance, which would, in turn, lead to increased costs for the registered representatives and increased prices for their clients. The likely result would be a decrease in services and advice for less well-off clients, who are less able to afford higher prices for service and assistance.

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[5] Fifty-eight percent of NAIFA members' clients earn less than $100,000 in household income, 31% have household incomes ranging from $100,000 to $250,000 per year, and 11% of NAIFA members' clients have annual household incomes above $250,000 (LIMRA Survey, page 14).

According to the NAIFA-American College Survey, 89.5 percent of registered representatives believed their cost of doing business would increase under a uniform fiduciary standard of conduct. Three-quarters of the survey respondents said that if their expenses go up they would be forced to pass at least some of the cost on to consumers (NAIFA-TAC Survey, page 1). Findings from the 2010 LIMRA Survey were similar: If compliance costs were to increase 15 percent, 65 percent of NAIFA members said that they would have to reduce their services offered to less-wealthy customers, increase their fees, or stop offering securities altogether (LIMRA Survey, page 30). NAIFA members also reported that, if compliance costs were to increase by 15 percent, access to financial advice for approximately half of their clients would be limited (LIMRA Survey, page 7).

Likewise, the LIMRA Survey showed that consumers express some opposition to a mandatory fiduciary standard if such a standard would increase costs. Data from the LIMRA Survey suggests that consumers generally prefer paying commissions, rather than a direct fee or a percentage of assets invested (LIMRA Survey, page 39). As a result, such increased costs would be likely to make the services registered representatives offer too expensive for many of the clients they now serve, and these clients' access to products and advice could be greatly reduced.

B. Data and Other Information Describing the Types and Availability of Services (Including Advice) Broker-Dealers or Investment Advisers Offer to Customers, as well as any Observed Recent Changes in the Types of Services Offered. (Item II (2) in the Release)

NAIFA members who offer securities to their clients offer not only variable life insurance and annuities, but also mutual funds, 529 plans, and individual stocks and bonds (LIMRA Survey, page 15). Registered representatives who responded to the NAIFA-American College Survey tend to sell a fairly narrow range of types of securities. The vast majority sell mutual funds (89 percent) and variable annuities (83 percent). Other leading products include variable life insurance (sold by 62 percent of registered representatives) and college 529 plans (62 percent). Only 9 percent regularly sell individual stocks and bonds, and even fewer (7.5 percent) sell real estate investment trusts (NAIFA-TAC Survey, page 3).

Because investment advisers generally serve higher-income clients, many existing customers of broker-dealers either cannot afford – or would prefer not to pay – the management fees that investment advisers typically charge. According to the NAIFA-American College Survey, for a client with a $100,000 portfolio, 77 percent of registered representatives would expect to receive commissions of less than $2,000 in a year. More than half (55 percent) say they would expect less than $1,000 in commissions, and 36 percent say they would expect less than $500 (NAIFA-TAC Survey, page 4). Annual fees charged by investment advisers based on assets under management generally fall in the range of .75 to 2.5 percent, with smaller clients paying towards the higher end of the range.

Moreover, the RAND Study indicated that approximately half of the 25 broker-dealers represented in the study indicated they "had no specific account minimums and were willing to work with investors with small sums," while the other half of broker-dealers surveyed targeted individuals with $100,000 or more in assets (RAND Study, page 69). Of the 38 investment advisers surveyed by RAND, about half "reported account minimums of at least $1 million, while most of the others had account minimum requirements of $100,000 to $500,000. Only one firm did not have an account minimum." (RAND Study, page 73). Thus, many investment advisers have account minimum requirements that would exclude them from working with a client with a portfolio of less than $100,000. A commission-based model, rather than a fee-based model, provides middle and lower income market customers with a low-cost way to receive access to needed products and services (NAIFA-TAC Survey, page 4).

C. Data and Other Information Describing the Extent to which Different Rules Apply to Similar Activities of Broker-Dealers and Investment Advisers, and Whether this Difference is Beneficial, Harmful, or Neutral from the Perspectives of Retail Customers and Firms. (Item II (3) in Release)

Imposing a fiduciary standard on registered representatives would not provide additional protections to the customers they serve and, indeed, could harm customers by resulting in less access to financial products and services. As discussed above, NAIFA members currently devote a considerable amount of time and resources to complying with existing laws and regulations – approximately 500 hours and $9,000 per year on compliance requirements and securities examinations alone (LIMRA Survey, page 25). Because of their business model and the need to forge long-term relationships of trust with their clients, NAIFA members "on the ground" already base their actions on looking out for the interests of their clients, and very few NAIFA members believe their clients would see improved protections or customer service under a fiduciary standard.

Our members who are involved in securities generally believe the imposition of a uniform fiduciary standard would result in increased compliance costs from a regulatory and legal standpoint and, in many cases, cause a shift in charges from per transaction commissions to management fees, which would harm their clients. Indeed, if members had to charge management fees instead of commissions, they believe that approximately half of their clients would no longer do business with them (LIMRA Survey, page 31).

D. Data and Other Information Describing the Types of Securities Broker-Dealers or Investment Advisers Offer or Recommend to Retail Customers. (Item II (4) in Release)

As indicated in II.B above, NAIFA members who offer securities to their clients offer a variety of products, including variable life insurance and annuities, mutual funds, 529 plans, and individual stocks and bonds.

E. Data and Other Information Describing the Cost to Broker-Dealers and Investment Advisers of Providing Personalized Investment Advice about Securities to Customers, as well as the Cost to Customers Themselves of Receiving Personalized Investment Advice About Securities. (Item II (5) in Release)

As previously discussed, middle-income individuals with smaller investment portfolios are generally less attractive as clients to investment advisers, who are typically compensated by set fees or fees based on a percentage of the assets under management (RAND Study, page 73). Middle-income customers prefer to work with registered representatives, who are compensated through product commissions (LIMRA Survey, page 40). Some 90 percent of registered representatives and 81 percent of dually-registered advisers believe that a move to a uniform fiduciary standard would increase their compliance costs (NAIFA-TAC Survey, page 1). Given the level of existing compliance costs discussed above, it is not surprising that such a move would have a significant monetary impact on members and, in turn, their customers. Imposing a fiduciary standard on registered representatives would mean that many middle-income clients could lose access to important financial services. Should costs increase by 15 percent, 48 percent of those surveyed by NAIFA and the American College said they would limit their practices to higher-income clients, 44 percent said they would implement or increase fees, and 10 percent said they would stop selling securities (NAIFA-TAC Survey, page 2).

F. Data and Other Information Describing and Analyzing Customer Returns (Net and Gross of Fees, Commissions, or Other Charges Paid to a Broker-Dealer or Investment Adviser) Generated Under the Two Existing Regulatory Regimes. (Item II (8) in the Release)

NAIFA does not have access to data or information regarding the investment returns earned by customers under either the broker-dealer or investment adviser business models/regulatory regimes. However, it is important that, in considering this issue and the information provided in response to this request, the Commission recognize that investment returns are not the only – or the best – measure of the quality of service provided or, indeed, the "success" of an investment strategy or plan, as this request for information suggests.

The issue for registered representatives is whether the product is suitable for the customer in light of the customer's unique situation and circumstances, and the focus should not and cannot solely be on investment returns. The advice provided by NAIFA members to their clients, and the actions taken to implement their advice and recommendations, are often focused on providing appropriate risk management and financial security for their clients rather than wealth accumulation or seeking the maximum rate of return. An investor's long-term goals and objectives, such as safety of principal, must be an important factor in any discussion of the significance of the rate of return generated under the different regulatory regimes for broker-dealers and investment advisers.

G. Data and Other Information Describing the Extent to which Customers are Confused about the Regulatory Status of the Person from whom they Receive Financial Services (*i.e.*, Whether the Party is a Broker-Dealer or an Investment Adviser). (Item II (14) in the Release)

Consumers have limited knowledge about the financial services industry, with 86 percent saying their level of financial knowledge is only "fair" or less than fair (LIMRA Survey, page 34). Over half of NAIFA members believed that "very few" or "none" of their clients understand the legal difference between the fiduciary and suitability standards. And while customers are reportedly confused about the standard of care applicable to their adviser, they are generally happy with their financial advisers (RAND Study, page 98). Accordingly, our surveys indicated that the imposition of a uniform fiduciary standard of conduct would not improve customer confusion about the regulatory status of the person from whom they receive financial service, and we do not believe it would improve the investor's understanding of the key aspects of either the fiduciary or suitability standards. If resolving customer confusion is one of the goals behind the SEC's efforts, providing the consumer with thorough, easy-to-read information describing the two standards would seem to be the best approach, rather than imposing an entirely new standard of conduct that consumers still may not understand and that could have the end result of reducing their access to affordable advice.

III. <u>Comparing the Business Models of Broker-Dealers and Investment Advisers</u>

Registered investment advisers and broker-dealers provide different types of financial services and operate under different business models. Whereas registered representatives of broker-dealers primarily sell individual investment products and may provide some incidental advice in connection with such sales, the entire business of investment advisers involves the sale of advice in the form of managing client assets and drafting financial plans. Additionally, investment advisers typically work with clients in the higher income and asset brackets and are generally compensated by fees paid to manage assets and/or develop financial plans; registered representatives, on the other hand, serve all investor classes through a commission-based compensation model that allows investors to purchase particular products, receive incidental advice and recommendations, and avoid paying asset management fees for the financial products and advice they need.

Because of the nature of the business and the compensation models, imposing an overly restrictive fiduciary standard could prove detrimental and difficult to apply in the broker-dealer context for several reasons:

- It could result in recommendations involving individual financial product sales being second-guessed at any time, including at the moment the financial product declines in value despite the registered representative's best efforts and compliance with all applicable laws and rules at the time of purchase;
- It could result in registered representatives having to increase significantly the time and resources they allocate to regulatory compliance with no commensurate improvement in investor protection. This could, in turn, lead to increased costs for registered representatives and increased prices for their customers;

- Registered representatives would be forced to protect themselves against an increase in potentially frivolous litigation, which would also lead to increased costs; and
- Ultimately, it could serve to limit investor choice and access to affordable financial products and services.

IV. <u>Response to Hypothetical Uniform Fiduciary Standard</u>

NAIFA believes the current comprehensive regulatory requirements, oversight, and enforcement of rules governing registered representatives' conduct work well to protect investors and help to ensure that all investors – not only the wealthy – have access to products and professional service. We do not agree with the views of some commentators that the current suitability standard is a "weaker" or "lesser" standard, and we feel strongly that this standard provides ample consumer protection.

Studies by the RAND Corporation (and affirmed by the SEC Staff Study on Investment Advisers and Broker-Dealers)[6] as well as others show general consumer satisfaction with financial services providers, which indicates that investors are satisfied with the services rendered under the separate business models for broker-dealers and investment advisers, under separate regulatory regimes (RAND Study, page 98). This system has proven to be an effective way to provide professional financial services to a wide range of consumer income and asset levels; and, absent a clear demonstration of harm to consumers from the current system, the SEC should take great care before taking action that might adversely impact investors who may not have many choices as to how they receive financial advice and service. Consumer confusion is not the same thing as consumer harm, and providing the consumer with easy to understand information describing the two different standards, through the use of appropriate disclosures, would effectively address any concerns regarding consumer confusion about the standard of care under which their registered representative is operating.

We respectfully recommend, therefore, that the SEC not take any action that would amount to an attempt to cure a problem that has not been demonstrated to exist, and which could have the unintended effect of reducing the access of middle and lower income market investors to needed financial products, services, and advice. Nonetheless, we recognize the complexities of the financial services marketplace, and the legal and regulatory standards applicable to investment advisers and broker-dealers, which many investors find difficult to understand. For that very reason, one goal of any new regulatory requirements should be to redress customer confusion – and be careful not to increase it.

Although we believe the SEC needs to carefully examine the harm or problem it is trying to remedy before proceeding with a "solution" that may end up adversely impacting some investors, we have reviewed the Commission's hypothetical proposal, and we are concerned that certain aspects of the proposal would exacerbate consumer confusion and negatively impact broker-dealers, their registered representatives, and the clients they serve.

[6] *See* Securities and Exchange Commission, *Study on Investment Advisers and Broker-Dealers* (January 2011), p. 98.

A. Assumptions

The following are several of the assumptions underlying the proposal that are of particular concern to NAIFA or are otherwise noteworthy:

1. Assumption 4: **The standard adopted would accommodate different business models and fee structures and permit broker-dealers to continue to receive commissions**

We believe strongly that any uniform fiduciary standard of conduct must, as the Commission proposes, be designed to accommodate different business models and fee structures of firms, permit broker-dealers to continue to receive commissions (as provided under section 913(g)(1) of the Dodd-Frank Act), and not require firms to change to asset-based fee business models. The commission-based payment structure generally allows middle-market investors to pay less for the services they receive from registered representatives than would be the case under an asset-based management fee model. Investment advisers, who typically serve higher-net-worth clients, are compensated on an assets-under-management or fee for service basis; middle-market investors are not interested in and often cannot afford to pay the higher management fees that investment advisers charge.

2. Assumption 5: **Any standard adopted would not require a continuing duty of care or loyalty to the retail customer**

If the Commission chooses to implement a uniform fiduciary standard, we agree strongly that such a standard should not require a broker-dealer or investment adviser to have a continuing duty of care or loyalty to a customer after providing him or her with personalized investment advice. This assumption is consistent with section 919(g)(1) of the Dodd Frank Act, which, in amending section 15 of the Securities Exchange Act of 1934, provides that "[n]othing in this section shall require a broker or dealer or registered representative to have a continuing duty of care or loyalty to the customer after providing personalized investment advice about securities." Indeed, absent contractual terms or other circumstances indicating such a continuing duty, imposing continuing duties of care or loyalty after personalized advice is given would lead to uncertainty and even legal disputes between broker-dealers and their customers over an investment's rate of return. Likewise, we agree that such a standard should not require a broker-dealer or investment adviser to provide services to a customer beyond those agreed to between the customer and the broker-dealer or investment adviser.

3. Assumption 6: **Offering or recommending only proprietary or a limited range of products would not be a violation of the standard**

If the Commission chooses to implement a uniform fiduciary standard, we agree with this Assumption, which parallels the requirement in section 913(g)(1) of the Dodd-Frank Act that offering or recommending proprietary or a limited range of products should not, in and of itself, be considered a violation of the standard of conduct that the Commission might establish.

B. Discussion of the Hypothetical Uniform Fiduciary Standard

1. Uniform Fiduciary Standard of Conduct – the Duty of Loyalty

As discussed in the release, the uniform fiduciary standard of conduct includes a duty of loyalty and a duty of care. We agree with the Commission's view that material conflicts of interest should be addressed either through elimination of the conflict of interest or by providing full and fair disclosure to retail customers about the conflict of interest.

The first assumption by the Commission in connection with the duty of loyalty is that a prospective rule would require the disclosure of all material conflicts of interest the adviser has with the retail customer as well as more general disclosures in the form of a general relationship guide similar to Form ADV Part 2A, which would discuss the firm's services, fees, and the scope of the services that will be provided to the investor.

NAIFA agrees with the general spirit of this assumption and has been a long-time supporter of clear and comprehensive disclosures to investors. However, NAIFA does caution the SEC to be mindful that a philosophy that "more is always better" as it relates to the issue of providing information to investors may not necessarily be in the best interests of investors or provide any additional protection to consumers. Inundating consumers with page after page of disclosures that they may not want or find helpful will be of little use to investors and may, in fact, serve only to increase confusion rather than provide clarity. Disclosures should be thorough and easy to understand, but they must focus on providing the individual investor with information that is relevant to that investor's decision making process.

One possible approach for providing consumers with the type and quantity of information they will find most useful would be to establish a two-tiered approach to disclosure. Under this approach, all investors would be provided with a summary disclosure document at the time of or prior to the establishment of the relationship with the registered representative or investment adviser. This document would provide information concerning: the duty of care that the firm owes to the investor; the types of services to be provided; a general discussion of any existing material conflicts of interest that may be significant to the investor's decision-making process; a brief description of the type(s) of compensation the registered representative or investment adviser will receive; and information on how the investor can access additional information. Any investor who wants to review more detailed information on the above issues would be provided, upon request and free of charge, with a more detailed, second-tier disclosure document.

NAIFA does have significant concerns regarding the third assumption, which would prohibit certain "sales contests." This assumption presumes that "the rule would prohibit the receipt or payment of non-cash compensation (*e.g.*, trips and prizes) in connection with the provision of personalized investment advice about the purchase of securities." FINRA Rule 2320 already restricts what might be viewed as the more improper aspects of non-cash compensation and limits its use to appropriate locations and situations where there is significant useful content, such as training and similar business purposes. NAIFA is concerned that further restricting – or prohibiting – non-cash compensation would hinder the professional development of registered representatives and, in turn, have a negative impact on their clients. Given this, if the Commission chooses to implement a new standard on registered representatives, we would recommend that the Commission consider adopting or referencing the text of the FINRA Rule itself.

The NAIFA-American College Survey indicates that while non-cash compensation is not a major element of a NAIFA member's overall compensation, it does provide registered representatives with valuable opportunities for professional training and motivation. According to the NAIFA-American College Survey, over half of the respondents did not receive any non-cash compensation, and less than 20 percent received more than $1,000 per year (NAIFA-TAC Survey, page 6). While non-cash compensation was not a significant element of NAIFA members' overall compensation, it is important to note that the survey did show that significant percentages of those who had received non-cash compensation strongly agreed that it provided important training opportunities, helped them better understand their company product offerings, and helped them better serve their clients (NAIFA-TAC Survey, page 6).

NAIFA members, as well as all financial advisers, have a difficult job. They work with clients to help them manage the financial risks of living too long, dying too soon, or becoming sick or disabled. Because it is a challenge to get clients to think about and take steps to address these difficult topics, our members receive significant emotional benefit from the opportunities that non-cash compensation provide for training, listening to motivational speakers, networking, and sharing of ideas with their fellow registered representatives. All of these benefits ultimately help our members to better serve their clients.

Finally, the proposed <u>elimination</u> of non-cash compensation is not consistent with the general approach followed in the relevant sections of the Dodd Frank Act (such as sections 913 and 919) or of this SEC release, which are generally focused on improved, effective disclosure rather than prohibition. We urge you to eliminate this assumption from any further consideration in connection with a possible standard of conduct rule.

2. Uniform Fiduciary Standard of Conduct – the Duty of Care

In addition to the proposed duty of loyalty, the SEC discusses a proposed duty of care as another critical component of the uniform fiduciary standard. As it did with the proposed duty of loyalty, the Commission identifies certain assumptions that a duty of care would impose, each of which is discussed below.

a. <u>Suitability obligations</u>

The first assumption provides that a duty of care would impose a suitability obligation in which there is a duty to have a reasonable basis to believe that securities and investment strategies recommended are suitable for at least some customers, as well as for the specific customer for whom the recommendation is made. NAIFA generally is supportive of this assumption, but questions why suitability needs to extend beyond the specific customer to whom a recommendation is made.

b. Product-specific requirements

The second assumption provides that a duty of care would impose specific disclosure, due diligence, or suitability requirements for certain securities products recommended (such as penny stocks, options, debt securities and bond funds, municipal securities, mutual fund share classes, interests in hedge funds, and structured products). Although we do not necessarily take issue with this assumption, it is unclear what this assumption actually would entail and thus request clarification on this issue. Furthermore, we note that registered representatives are already subject to numerous disclosure, due diligence, and suitability requirements, and we would therefore caution against imposing duplicative requirements that only add to the paperwork required and provide no benefits to consumers.

c. Duty of best execution

The third assumption provides that a duty of care would impose on broker-dealers and investment advisers a duty to seek to execute customer trades on the most favorable terms available under the circumstances. Again, while we do not necessarily take issue with this assumption, we note that this assumption is not sufficiently clear and that registered representatives are already subject to a similar duty of best execution.

d. Fair and reasonable compensation

The fourth assumption provides that a duty of care would impose a requirement that broker-dealers and investment advisers receive compensation for services that is fair and reasonable, taking into consideration all relevant circumstances. While we do not take issue with this assumption, we again note that it is not sufficiently clear and that registered representatives are already required to deal fairly with their customers.[7] Additionally, FINRA Rules 5110(a)(9) and 5110(c), as well as NASD rule 2440, generally require that registered representatives' prices for securities and compensation for services must be "fair and reasonable" under the circumstances.

3. Uniform Fiduciary Standard of Conduct – Application of Prior Guidance and Precedent Regarding Investment Adviser Fiduciary Duty

The Commission proposes that the uniform fiduciary standard would not presume continued applicability of existing guidance and principles regarding fiduciary standards currently applicable to investment advisers. To the extent that the proposal would not impose on registered representatives existing guidance and precedent under sections 206(1) and 206(2) of the Advisers Act regarding the fiduciary standard for investment advisers, we believe that this is a useful and appropriate assumption.

As discussed above, investment advisers and broker-dealers operate under separate and distinct business models, with each providing appropriate, needed, and helpful services to various market segments of the investor community. Because of the differences in the structure and operation of these different models, it would not be practical to apply existing Advisers Act

[7] *See, e.g.*, FINRA Rules 2010, 2090, 2111, & 2330; NASD Interpretive Material 2310-2.

guidance and principles to the broker-dealer business model, and doing so could significantly and adversely impact the ability of broker-dealers to serve their customers.

V. Response to Alternative Approaches to the Uniform Fiduciary Standard

As previously discussed, NAIFA does not believe the Commission should take any action that could have the unintended effect of reducing the access of middle and lower income market investors to needed financial products, services, and advice. The Commission identified in its release alternative approaches to the hypothetical uniform fiduciary standard discussed above, and, in the comments that follow, we offer brief comments on each of these proposed alternatives.

A. Alternative 1

In its first alternative approach, the Commission said that it could apply a uniform requirement for broker-dealers and investment advisers to provide disclosure about (1) key facets of the services they offer and the types of products or services they offer or have available to recommend, and (2) material conflicts they may have with customers, without imposing a uniform fiduciary standard of conduct.

NAIFA could be supportive of this approach. By focusing its efforts on disclosure of material conflicts and details concerning the types of services and products to be provided, the Commission would address the issue of consumer confusion which has been noted in the RAND Study and has been discussed elsewhere in these comments. We believe this approach would also address NAIFA's concerns that a uniform fiduciary standard could increase costs for registered representatives, increase prices for their clients, and limit investor choice and overall access to affordable financial services.

B. Alternative 2

In the second alternative, the Commission said that it could apply the hypothetical uniform fiduciary standard on broker-dealers and investment advisers, without extending to broker-dealers the existing guidance and precedent under the Advisers Act regarding the existing investment adviser fiduciary duty.

While we would again caution the Commission not to take any action that could adversely impact investors, this generally appears to be a favorable alternative to the hypothetical uniform fiduciary standard discussed in the release because it would seem to alleviate some of the concerns surrounding the imposition of a uniform standard, which revolve around the fact that a single standard of conduct relying on existing Adviser Act guidance and precedent may not allow for the operation of different business models in such a way as to not harm the very people it was designed to protect. The Commission, however, is not entirely clear what guidance would be applied to registered representatives under this approach and whether the current suitability standard would remain intact. In addition, as discussed in item (C) below, we would generally caution the SEC to not take any action that would attempt to cure a problem that has not been demonstrated to exist and to not attempt to resolve issues of consumer confusion by measures that could instead cause harm to middle and lower income market investors.

C. Alternative 3

In this alternative, the SEC said that, without modifying the regulation of investment advisers, the Commission could apply the above-discussed uniform fiduciary standard, "or parts thereof," to broker-dealers. We again caution the SEC to not take any action that would attempt to cure a harm to investors that has not been demonstrated to exist. Nor would implementing such a rule resolve the problem of consumer confusion, and could instead harm middle and lower income market investors by reducing or eliminating their access to needed financial products, services, and advice. The "or parts thereof" language gives the SEC broad discretion to act in whatever manner it chooses without providing any real guidance with regard to broker-dealer fiduciary obligations. We also note that the end result under this approach could be two different standards of care applicable to broker-dealers and investment advisers, which would seem to leave broker-dealer registered representatives, investment advisers, and investors in the same position as before.

D. Alternative 4

In its fourth alternative, the SEC said that, without modifying the regulation of broker-dealers, the Commission could specify for broker-dealers certain minimum professional obligations under an investment adviser's duty of care. This too is vague, and it is unclear whether or how it would permit the continued operation of the different broker-dealer and investment adviser business models we have previously discussed.

E. Alternative 5

In the fifth alternative, the Commission offers for consideration models set by regulators in other countries. For instance, the SEC notes, the United Kingdom's Financial Services Authority requires persons providing personalized investment advice to act in the client's best interests and has set limits on how investment advisers charge for their services; the Treasury of Australia imposes a best interest obligation on persons providing personal advice that would require the provider to place a client's interests before its own and prohibit the receipt of conflicted remuneration such as commission payments; and the European Securities and Markets Authority published guidelines to clarify the application of certain aspects of its current suitability requirements.

We respectfully recommend that the Commission need not, and should not, look abroad in comparing alternative approaches to the proposed uniform fiduciary standard. The United States is uniquely positioned in the financial services industry, and, if the Commission ultimately chooses to promulgate new regulations or standards, careful consideration need only be given to the impact such requirements would have on American businesses and the investors they serve.

F. Preserving Current Standards of Conduct Obligations

The Commission notes that it could also decide to take no further action at this time with respect to the standards of conduct applicable to broker-dealers and investment advisers. For the reasons stated herein, we respectfully recommend that following this approach – of allowing existing regulatory requirements to continue – would be consistent with our recommendation that the Commission not take any action that could have the unintended effect of reducing the access of middle and lower income market investors to needed financial products, services, and advice.

VI. Harmonization

The Commission's release asks for comment on the extent to which it should consider the harmonization of other regulatory obligations of broker-dealers and investment advisers. While there may be some areas in which a general harmonization of regulatory obligations would provide additional consumer protections while not adversely impacting investors and the registered representatives who serve them, NAIFA, as a general proposition, urges the SEC to exercise extreme caution in this area, because investment advisers and broker-dealers provide different types of financial services and operate under fundamentally different business models. In the same manner that we urge caution because applying a uniform fiduciary standard could prove detrimental and difficult to apply as it could result in middle and lower income market investors having less access to products and services, given the inherent differences between broker-dealers and investment advisers, harmonizing their additional regulatory obligations would likely not create a cohesive regulatory regime that better protects consumers.

Because registered representatives are currently subject to comprehensive regulatory oversight providing sufficient investor safeguards, subjecting them to other various requirements of the Advisers Act – such as the harmonization of provisions involving registration, advertising, and disclosures – would not be a useful endeavor. We respectfully recommend that the Committee need not, and should not, take further action at this time with respect to regulatory harmonization.

VII. Conclusion

NAIFA, on behalf of its members, urges the Commission to opt against taking any action that could result in a different manner of investor confusion and cause harm by reducing or eliminating the access of middle and lower income market investors to needed financial products, services, and advice. The existing regulatory requirements, oversight, and enforcement of rules governing registered representatives' conduct work well to protect investors, and have proven to be an efficient and effective way for middle and lower income market investors to retain access to financial products and services. To the extent the Commission desires to address the issue of consumer confusion about what standard of care under which their registered representative operates, we would suggest that the most effective way in which to do so would be to provide the consumer with easy-to-read information describing the two standards. The other path – imposing an entirely new standard of conduct that consumers still may not understand – could result in reducing customer access to financial products and services.

NAIFA greatly appreciates your consideration of this letter. We hope that this letter is useful not only in responding to the questions on which the Commission seeks input, but also by providing a better understanding of how regulatory changes would affect our members and their clients.

Please do not hesitate to contact us at your convenience if you have questions or if any additional information would be helpful.

Sincerely,

Susan B. Waters

Susan B. Waters
Chief Executive Officer