August 5, 2009

We are writing to you to comment on some of the key provisions of the legislative proposals encapsulated in Financial Regulatory Reform: A New Foundation. As financial advisors, we have more than the usual amount of understanding of these proposals and how they would affect the financial services world – and financial consumers generally. Until recently, we were concerned that significant issues were not being addressed. Now, with this package of legislative recommendations, we think there may be a real chance to protect our financial markets and the financial consumers who live within your constituency.

We generally support the key provisions in the proposal as you will see in the following paragraphs, but we want to start by expressing a great concern we have regarding the proposed Custody Rule change which would require every advisor the SEC considers to have custody of client assets to engage an independent public accounting firm to conduct an annual "surprise" audit of the advisor to verify client funds and securities. Under the SEC's broad definition of "custody" this would include advisors who's only "custody" is to deduct advisory fees from client accounts and/or facilitate transactions into or out of client accounts on the clients' behalf (such as instructing disbursements, etc.). If the first these advisors use to custody client assets (like Schwab Institutional, SEI, etc.) are providing account statements direct to the advisor's clients, the clients can clearly see their assets and transactions without any ability by the advisor to manipulate the data. This unnecessary financial burden such an audit would place on small advisors (for which the vast amount of RIA's are), would not provide any increased consumer protection.

As Registered Investment Advisors with the Securities and Exchange Commission, we've watched the brokerage firms and investment banks wreak financial havoc on financial consumers, retirees – and many of your constituents. Now, those same companies, and their trade organizations, are spending millions of our taxpayer dollars, out of the TARP fund, to try to lobby against more effective regulation – just as they have been – for years – successfully lobbying against being held to a fiduciary standard of care whenever they give investment advice. We ask you to resist their self-serving pleas and stand up for consumers.

Page 71 of the Blueprint points out, correctly, that "Retail investors are often confused about the differences between investment advisers and broker-dealers," and that "retail investors rely on a trusted relationship that is often not matched by the legal responsibility of the securities broker." The report says that investment advisors, and not brokers, are legally required to act as fiduciaries, and calls for all broker-dealers who provide investment advice about securities to retail investors to be "raised to the fiduciary standard to align the legal framework with investment advisers."

This provision, by itself, would go a long way toward strengthening consumer protection in the investment markets. It would require brokers to recommend not just suitable products, but investments that would benefit their customer's financial situation. It

would cause brokerage firms to think twice about encouraging their representatives to recommend highly-profitable toxic or misleading derivatives products, and it would finally bring to light the under-the-table payments to brokerage firms for product recommendations and sales.
The current SEC Chairperson, a former CEO of the FINRA (brokerage industry) regulatory organization, has been strongly focused on lowering standards for advice to a compliance or suitability standard, which any securities attorney will tell you is far inferior to the consumer protections afforded by a fiduciary standard. You will no doubt hear her, and the brokerage firms whose executives make up the FINRA board and served as her employer, argue vigorously against holding brokers to a fiduciary standard, or transferring regulatory authority for registered investment advisors from the SEC to FINRA. They may even say that it is impossible for them to function under such restrictions. Please remember that more than 50,000 investment professionals already operate under a fiduciary standard as registered investment advisors. They may argue that fiduciary standards are not a panacea, and we would agree. But they represent a big step up from current regulatory obligations.

On pages 55-70 of the proposal, under the headline "Protect Consumers and Investors from Financial Abuse," the report talks about creating a new Consumer Financial Protection Agency which would regulate investment products before they ever reach the shelves of brokerage sales offices, before they could be recommended to financial consumers. It is clear that the financial world is rife with products which benefit the sales organization much more than consumers. This includes equity-index annuities and variable annuities with surrender charges that last 15 years or more, complex derivatives and packages of loans whose credit quality is never examined, cash value life insurance policies with hidden fees and commissions – and, of course, tricky mortgages that are sold without full disclosure.

We support this provision because it attacks the problem of unsafe financial products directly, rather than how FINRA has always tried to control them, by determining whether the product was "suitable" to the financial consumer's circumstances. Thus, if a consumer needs life insurance protection, it becomes "suitable" to sell a fully-loaded variable life insurance policy, even though a no-load policy or a term insurance contract might have been a far better recommendation.

In addition, the Reform proposal would empower the CFPA to require plain-English-disclosures of sales commissions, expenses and risks. It's a breath of fresh air to see that somebody in Washington finally realized that 47 pages of dense legalese is not effected disclosure of these issues.

The bottom line here, in my opinion, is that the Financial Regulatory Reform blueprint offers a surprisingly good, potentially effective set of proposals for addressing the real underlying risks and conflicts in our financial markets. It represents a better way to protect consumers than the systems we have today, and would, if implemented in whole or in part, make it far less likely that we would experience the kind of financial trauma that swept through the markets last Fall and Winter.

We have no doubt that it will require political courage for you and your peers in Congress to support these initiatives in the face of vigorous lobbying by the powerful Wall Street firms and their trade organizations. Our guess is that you will hear that these proposals are “unrealistic,” or that they fly in the face of capitalism. Please understand that we and tens of thousands of other financial advisors voluntarily live under these standards every day. Your constituents and American investors deserve the chance to receive clear, unconflicted, professional advise, disclosures in plain English, and a promise that they won’t see their tax dollars shunted to large “too big to fail” firms that lost risky bets with no accountability.

We also want to recommend that you give credence to the views of the National Association of Personal Financial Advisors, the Financial Planning Association, the Consumer Federation of America and the CFP Board of Standards, who are attempting to speak on behalf of investors and those advisors who put investors’ interests first.

Thank you for your attention, and in advance for your help in creating better regulation, protection and standards.

Debra A. Hanley, CFP®
Business Manager

Omega
WEALTH MANAGEMENT, LLC
Integrating Your Values, Vision and Wealth

(Formerly Kirchenbauer Financial)