**Statement Regarding Regulatory Oversight of
Broker-Dealers and Investment Advisers**

**Subcommittee on Capital Markets and Government Sponsored Enterprises
House Financial Services Committee**

September 13, 2011

The American College appreciates the opportunity to submit this written statement regarding the oversight of broker-dealers and investment advisers. We thank Representative Garrett, Representative Waters, and the other members of the Subcommittee for conducting this hearing and allowing us to share a few thoughts with you on this important subject.

The American College, a non-profit academic institution with an 84-year heritage and the highest level of accreditation, has a unique, educator's view of the financial services landscape. We work with banks, insurance companies, broker-dealers, financial planning firms, and independent advisers to raise the professionalism of our students and, by extension, the financial services industry as a whole. We are keenly aware of how the education we provide ultimately impacts the financial security of individuals, families, and businesses throughout the country.

Since our founding in 1927 by Dr. Solomon S. Huebner of the Wharton School, more than 160,000 professionals have earned graduate degrees or financial services designations from The American College. Along with other top credentials and two accredited master's degrees, we confer the prestigious CLU® for insurance professionals, have educated more advisors for CFP® certification than any other institution, and offer the ChFC® for advanced financial planners.

We are concerned that proposals from the SEC to extend a fiduciary standard of care to broker-dealers will backfire, hitting lower- and middle-income investors the hardest. The work has not been done to quantify the ultimate cost of expanding the fiduciary standard to broker-dealers as the SEC intends. The SEC staff study was not able to determine how this approach will impact investors in terms of higher expenses and reduced access to valuable products and services. Many families and individuals do not have the assets necessary to move to a fee-for-service model and cannot afford to pay $2,500 for a stand-alone financial plan before any investments or insurance products are purchased. While regulators are not proposing that a fee-based model be mandated for broker-dealers – and Dodd-Frank specifically states that such a change is not required in the context of a broader fiduciary standard – it may be the practical, unintended result of the SEC's new regulations. In fact, senior executives at brokerage firms have already observed an increasing number of broker-dealers moving to a fee-

based model to get ahead of any changes the SEC may propose. The same risks to smaller investors hold true for the DOL's recent initiative to rewrite 36-year-old rules defining fiduciary status under ERISA for retirement plans: the middle-income IRA investor could be the one who's most damaged by their well-intentioned, if misguided, changes in regulations.

The SEC and the DOL must have persuasive answers to two key questions before they act: (1) what consumer harm is being done under the current standards of care that will be ameliorated by broader application of a fiduciary duty; and (2) what will the ultimate cost be to consumers in terms of expense, product limitations, or reduced access to advice? There is no clear evidence of what problem the SEC is attempting to solve with their proposed change. While there may be some level of consumer confusion about various business models, that issue could be addressed in a much simpler fashion. Our fear is that the SEC's suggested standard-of-care adjustments and the related compliance complexity and costs will drive broker-dealers to target higher-income markets, focusing on clients who are the most economically viable under the new model to the exclusion of lower- and middle-income investors. The SEC should be responsible for demonstrating convincingly why this will not be the case prior to taking any action to broaden applicability of the fiduciary standard.

The "best interest" fiduciary standard the SEC is considering for broker-dealers would be very difficult to enforce. The vast majority of successful financial professionals work with transparency and diligence to serve the best interest of their clients. Any other approach would make it impossible to recruit and retain clients and gain referrals to grow a long-term, successful practice. While serving a client's best interest may be a simple concept philosophically, it can actually be quite complex to regulate. How would the concept work, for example, with variable insurance products? Suppose the market proves to be exceptionally turbulent and declines significantly. In hindsight, would a policy sold in a client's "best interest" have been one with the most guarantees and minimal market exposure? What if the reverse happens and we see a vigorous bull market. Wouldn't a client have been better off with broader exposure to equities? Who will determine "best interest," and over what timeframe: Two quarters? Two years? Ten years? Variable products, with their insurance and investment components, are already more highly regulated than many other offerings regulators oversee, and yet the burdensome impact to these very products are often not considered when the SEC pursues rulemaking activity. Clearly any adverse effect to these products must be included in the SEC's comprehensive cost-benefit analysis prior to taking any action on a broader fiduciary standard.

Suitability, the strict rules-based standard broker-dealers must adhere to now, may actually protect consumers more effectively than a vague, principles-based standard. Experts do not all agree that a principles-based, fiduciary approach will protect consumers more effectively than the current rules-based, "suitability" standard broker-dealers must use. Rules-based enforcement focuses on controls "before the fact." Allowable behaviors are clear before a recommendation is made to a retail investor. Principles-based enforcement – the fiduciary approach – focuses on controls "after the fact." Essentially, it's up to regulators to know a violation after they've seen it, and sometimes quite long after the consumer harm has occurred. While broker-dealers are currently subject to inspection every two years for their compliance with specific rules, investment advisers, on the other hand, are inspected on average every decade,

allowing a Bernie Madoff to escape detection for years. One third of investment advisers, according to the SEC, have never been inspected. Discussion of any change in the standard of care for broker-dealers must be linked to the issue of inadequate enforcement under the current adviser model.

Your committee has the right focus in addressing the disparity in enforcement between broker-dealers and investment advisers. In fact, a FINRA enforcement model applicable to investment advisers may do more than a standard-of-care change for broker-dealers to protect consumers. There must be rules, standards of practice, and metrics in place for effective, efficient enforcement. FINRA has the scale and scope to raise the bar for investment adviser inspections quickly, following a similar approach to what that organization has done for broker-dealers and creating the best of both worlds for consumers. Properly enforcing both standards, while protecting consumer choice, will be an ideal outcome.

The SEC must do its homework prior to taking an action that could harm lower- and middle-income investors. While some investors may have the assets to benefit from a fee-based arrangement, it is vital to protect business model choices for the rest of the investing public. Unless and until the SEC can clearly demonstrate what harm is being done under the current broker-dealer approach and fully articulate the costs of abandoning an option consumers clearly value, there should be no contemplation of expanding the fiduciary standard. Instead, moving investment adviser examinations and enforcement closer to the rigor and frequency applied to broker-dealers could be a productive area of meaningful, consumer-oriented reform.

Thank you for the opportunity to comment on these issues impacting the investing public. The professors, staff, and management of The American College are available to help you in any way that we can in your important work.

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