STATEMENT OF

THE FINANCIAL PLANNING COALITION

BEFORE THE

UNITED STATES HOUSE OF REPRESENTATIVES

COMMITTEE ON FINANCIAL SERVICES

CAPITAL MARKETS AND GOVERNMENT SPONSORED ENTERPRISES SUBCOMMITTEE

ON

ENSURING APPROPRIATE REGULATORY OVERSIGHT OF BROKER-DEALERS AND LEGISLATIVE PROPOSALS TO IMPROVE INVESTMENT ADVISER OVERSIGHT

September 13, 2011

Mr. Chairman, Ranking Member Waters, and Members of the Subcommittee, thank you for the opportunity to submit this statement as part of the record for the Capital Markets and Government Sponsored Enterprises Subcommittee hearing on September 13, 2011, titled "Ensuring Appropriate Regulatory Oversight of Broker-Dealers and Legislative Proposals to Improve Investment Adviser Oversight." We appreciate the opportunity to share our views on the most-pressing issues regarding the regulation of broker-dealers and investment advisers.

The Financial Planning Coalition (the Coalition),[1] which is comprised of Certified Financial Planner Board of Standards, Inc. (CFP Board), the Financial Planning Association (FPA), and the National Association of Personal Financial Advisors (NAPFA), represents over 75,000 financial planning professionals in the United States. The Coalition provides the financial planning profession with a strong, unified voice in advancing the recognition and regulation of the financial planning profession, and advocating for enhanced consumer financial protection.

We strongly supported section 913 of the Dodd-Frank Act, which authorized the Securities and Exchange Commission (SEC) to create a uniform fiduciary standard of care for broker-dealers and investment advisers when providing personalized investment advice about securities to retail customers. We also supported section 919C, which required the Government Accountability Office (GAO) to study the oversight of financial planners and the use of designations by financial planners.

We continue to believe these important investor protection provisions of the Dodd-Frank Act deserve broad bipartisan support. We urge the Subcommittee members to support the SEC as it moves forward to establish a strong and uniform fiduciary standard of conduct for broker-dealers and investment advisers. Additionally, we believe it is vitally important to provide the SEC with the resources necessary to fulfill its regulatory mandate, including enhancing examinations of investment advisers. Finally, we look forward to working with the Subcommittee members to address the issues identified in the GAO's study on financial planning.

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[1] CFP Board is a non-profit organization that acts in the public interest by fostering professional standards in personal financial planning through setting and enforcing education, examination, experience, and ethics standards for financial planner professionals who hold the CFP® certification. CFP Board's mission is to benefit the public by granting the CFP® certification and upholding it as the recognized standard of excellence for personal financial planning. CFP Board currently oversees more than 63,000 CFP® professionals who agree, on a voluntary basis, to comply with our competency and ethical standards and subject themselves to the disciplinary oversight of CFP Board under a fiduciary standard of care. For more information on CFP Board, visit www.cfp.net.
FPA® is the leadership and advocacy organization connecting those who provide, support, and benefit from professional financial planning. FPA demonstrates and supports a professional commitment to education and a client-centered financial planning process. Based in Denver, Colo., FPA has close to 100 chapters throughout the country representing more than 24,000 members involved in all facets of providing financial planning services. Working in alliance with academic leaders, legislative and regulatory bodies, financial services firms, and consumer interest organizations, FPA is the community that fosters the value of financial planning and advances the financial planning profession. For more information on FPA®, visit www.fpanet.org.
Since 1983, NAPFA has provided fee-only financial planners across the country with some of the strictest guidelines possible for professional competency, comprehensive financial planning, and fee-only compensation. With more than 2,400 members across the country, NAPFA has become the leading professional association in the United States dedicated to the advancement of fee-only comprehensive financial planning. For more information on NAPFA, visit www.napfa.org.

I. Broker-Dealers and Investment Advisers Should Be Held to a Strong and Uniform Fiduciary Standard of Conduct

The Coalition believes that establishing a strong and uniform fiduciary standard of care, that is at least as stringent as the standard currently applied to investment advisers under the Investment Advisers Act of 1940 (Advisers Act), for all financial professionals who provide personalized investment advice to retail customers is among the most important investor protection initiatives the SEC can undertake. The suitability standard that currently applies to broker-dealers is ineffective in protecting investors receiving personalized investment advice. Moreover, investors do not understand the regulatory differences between broker-dealers and investment advisers or the standards of care that apply to each, and even more importantly, they expect to receive advice that is in their best interests.

The fiduciary standard that has been applied to investment advisers for decades is a well-established and workable standard of conduct that has served investors well. We strongly support the SEC in its efforts to establish a uniform fiduciary standard of conduct that is no less stringent than the standard currently applied to investment advisers. We believe the SEC, which has extensive experience and knowledge of broker-dealer and investment adviser business models, will establish a fiduciary standard of conduct that enhances investor protection while maintaining access to current products and services that are consistent with investors' best interests.

A. Suitability Standard Is Ineffective in Protecting Retail Customers

Under current law, investment advisers are held to a fiduciary standard of care, which requires that advice be provided in the client's best interest and that any conflicts of interest be fully disclosed and consented to by the client, while broker-dealers are held to a lower suitability standard, which requires that any recommendations be suitable for the client on the basis of the facts, if any, disclosed by the client concerning his or her other security holdings and as to his or her financial situation and needs.[2] Absent unusual facts, such as the existence of a fully discretionary account or a special relationship of trust and confidence between the client and the broker-dealer, the large majority of courts have held that a broker-dealer is not a fiduciary to its client.[3] Moreover, a number of cases have held that although a fiduciary would have been liable on the facts at issue, a broker-dealer was not liable because it was not acting as a fiduciary.[4]

This difference in the standards of care that apply to broker-dealers and investment advisers has real, practical effects on the advice retail customers receive. In a given situation, a broker might identify several different securities as being suitable for a retail customer, and would be free (without disclosure of this fact) to recommend the one that provides the highest compensation to the broker, even if the broker believes that other choices in fact would better meet the retail customer's financial situation and needs. The resulting higher costs and lower payouts from these types of suitable recommendations that are not in the retail customer's best interest and that do not involve full and fair disclosure of conflicts of interest can amount to lower returns (often amounting to tens of thousands of dollars or more) that middle Americans cannot afford.

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[2] *See* NASD Rule 2310.

[3] *See, e.g.,* Lieb v. Merrill Lynch, 461 F. Supp. 951 (E.D. Mich. 1978), *aff'd*, 647 F.2d 165 (6th Cir. 1981); Fesseha v. TD Waterhouse Investor Servs., 305 A.D.2d 268, 268-69 (N.Y. App. Ct. 2003).

[4] *See* De Kwiatkowski v. Bear Stearns & Co., 306 F.3d 1293 (2d Cir. 2002) (collecting cases).

The elderly are particularly vulnerable when dealing with an investment professional who is not legally required to put their interests first. In a survey conducted by CFP Board in 2009 and 2010, nearly 60% of the 4,000 CFP® professionals who responded to the survey reported that they had a client or prospective client who had not received proper financial advice from another investment professional. Over 40% of those who responded indicated problems with individuals between 61 and 75 years old. Many examples involved the sales of annuity products to elderly clients that provided significant commissions to the investment professionals but were not in the best interests of the clients.

In comparison, an investment adviser cannot recommend an investment that he believes is inferior to other alternatives available for a retail customer. Additionally, to the extent the recommended product would provide higher compensation to the investment adviser, he would be required to disclose that conflict of interest fully and fairly to the customer. We believe it is critical that the retail customers of broker-dealers receive the same protections as those of investment advisers when broker-dealers are providing personalized investment advice. While suitability may be an effective standard in a sales environment, it falls short in an advice context where investors have a reasonable expectation that their investment professional is acting in their best interests.

B. Retail Customers Expect to Receive Advice in Their Best Interests

It is clear that retail customers do not understand and are confused by the current differences in standards applicable to broker-dealers and investment advisers when providing personalized investment advice. Moreover, retail customers reasonably expect that they will receive advice that is in their best interests. In September 2010, the Coalition, along with AARP, the Consumer Federation of America, the Investment Adviser Association, and the North American Securities Administrators Association, conducted a survey of 1,319 investors.[5] This survey confirmed that investors remain confused about the advice they receive.

- Retail investors do not understand the regulatory differences between broker-dealers and investment advisers, or the standards of care that apply to each.
- Most American investors mistakenly believe stockbrokers and insurance agents are required to act in the best interests of their clients.

We believe this confusion is understandable and a critical reason for the SEC to establish a strong and uniform fiduciary standard of care. Quite frankly, most retail customers do not have the sophistication, information, or access necessary to manage their own finances and instead rely on financial professionals to assist them in making these important financial decisions.

The survey also showed that retail investors overwhelmingly believe that all financial professionals who give personalized investment advice should be required to act in the best interests of their clients and disclose conflicts of interest. An almost unanimous 97% of investors agreed that a financial professional who provides investment advice should put the investor's interests ahead of the financial professional's

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[5] Letter from Barbara Roper, Director of Investor Protection, Consumer Federation of America, Denise Voigt Crawford, President, North American Securities Administrators Association, David G. Tittsworth, Executive Director, Investment Adviser Association, Kevin R. Keller, CEO, CFP Board, Marvin W. Tuttle, Jr., Executive Director/CEO, FPA, Ellen Turf, CEO, NAPFA, and David P. Sloane, Senior Vice President, Government Relations and Advocacy, AARP, to the Honorable Mary L. Schapiro, Chairman, SEC (Sept. 15, 2010), *available at* http://sec.gov/comments/4-606/4606-2748.pdf.

interests. A strong and uniform fiduciary standard of care for the delivery of personalized investment advice by broker-dealers and investment advisers will resolve ongoing investor confusion and meet investor expectations of fiduciary accountability.

C. The Clarifications in the Dodd-Frank Act Can and Should Be Interpreted Consistently with a Strong and Uniform Fiduciary Standard

We strongly support the recommendation in the SEC staff study that

> the standard of conduct for all brokers, dealers, and investment advisers, when providing personalized investment advice about securities to retail customers (and such other customers as the Commission may by rule provide), shall be to act in the best interest of the customer without regard to the financial or other interest of the broker, dealer, or investment adviser providing the advice.[6]

This description of the fiduciary standard broker-dealers and investment advisers, however, is only the beginning of the analysis. Specifically, section 913(g) of the Dodd-Frank Act requires that the fiduciary standard "be no less stringent than the standard applicable to investment advisers under section 206(1) and (2) of" the Advisers Act.[7] We encourage the SEC to look to precedent under the Advisers Act for guidance as it develops a fiduciary standard applicable to broker-dealers. This is especially important to ensure any new, federal fiduciary standard is no less stringent than the Advisers Act standard. All of those provisions are consistent with the adoption of a strong and uniform fiduciary standard of care for retail customers.

- The uniform standard of care will only apply in connection with personalized investment advice.

  The principal limits on what constitutes personalized investment advice is that the information must include an opinion or analysis rather than simply relaying facts, and the advice must concern securities (e.g., as opposed to commodities or real estate). Advice is personalized if it reflects the personal circumstances of the customer. Under a fiduciary standard, consistent with the Dodd-Frank Act and the SEC staff study, broker-dealers and investment advisers will be able to prepare generalized research reports, target asset allocations, or electronic investment analysis tools without fear that those activities will give rise to fiduciary liability to everyone who reads those reports or uses those tools. Similarly, if a retail customer chooses to conduct only unsolicited trading at a firm, then the firm would not assume a fiduciary duty to advise the customer concerning that trading.

- Charging a retail customer on a commission basis, in and of itself, is not inconsistent with a strong and uniform fiduciary standard of care.

  The Dodd-Frank Act and the SEC staff study make it clear that a commission-based pricing model can be consistent with a fiduciary standard. However, to the extent a firm or investment professional chooses to use a commission-based pricing model, it must recognize that it creates

[6] STAFF OF THE SECURITIES AND EXCHANGE COMMISSION, STUDY ON INVESTMENT ADVISERS AND BROKER-DEALERS 110 (2011) [hereinafter 913 STUDY].
[7] Investment Advisers Act of 1940 § 211(g)(1), 15 U.S.C. 80b-11(g)(1).

inherent conflicts of interest that are not present in an asset-based pricing model. The firm or investment professional must disclose that potential conflict of interest to the customer before the beginning of the relationship and at regular intervals thereafter, and obtain fully informed consent to that model from the client. Moreover, the burden must remain on the firm and the investment professional, not the customer, to justify each and every transaction (and the sum total of the transactions) as consistent with the client's best interest. And, if the firm offers both commission-based and asset-based pricing models, the firm and the investment professional have the obligation to recommend to the retail customer the pricing model that is in the customer's best interest, and to monitor regularly to assure that the customer remains in the account structure that is in the customer's best interest.

- The provision of individualized investment advice does not necessarily create an ongoing duty of care to the retail customer.

  A customer may obtain one-time, "snap-shot" financial advice, without necessarily creating an obligation on the part of the investment professional to monitor the ongoing activity of the customer. However, if the customer and the investment professional agree to create an ongoing relationship involving investment advice, then the fiduciary standard must continue throughout the course of that relationship. As the SEC has long held, an investment adviser cannot provide personalized advice to a customer, and then take off the investment adviser "hat" and act as merely a broker when executing transactions for that client.[8] If an investment professional promises to provide ongoing services to a customer, then the investment professional must live up to that ongoing obligation, and all of those services must be subject to the strong and uniform fiduciary standard of care.

- The provision of a limited range of products, or of proprietary products, is not, in and of itself, necessarily inconsistent with a fiduciary standard of care.

  A fiduciary duty does not create an obligation to create "open architecture"; indeed, a thorough and prudent due diligence process before offering each new product necessarily means that a firm likely will choose not to offer some products or services. However, the decision to offer only a limited range of products, and particularly the decision to offer a proprietary product, does create a potential conflict of interest with the customer. As a result, the firm and the investment professional must make full and fair disclosure of this conflict of interest to the customer, and obtain the customer's fully informed consent, before offering the product in these circumstances.

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There are many potential conflicts of interest that are not per se breaches of a fiduciary standard on their face. However, in each instance, the burden must be on the investment professional to demonstrate that he has fully satisfied his fiduciary duty, for example, by making full and fair disclosure even where that full and fair disclosure is not in the interest of the investment professional. None of these potential conflicts of interest excuses an investment professional from the basic obligation to act in the best

[8] *See* Marc N. Geman, Inv. Adv. Act Rel. No. 1924 (Feb. 14, 2001) (rejecting argument that investment adviser can use "dual hat" approach and act simply as a broker-dealer when executing client's transactions), *aff'd sub nom.* Geman v. SEC, 334 F.3d 1183 (10th Cir. 2003).

interests of his clients at all times. The fact that some potential conflicts of interest, in some circumstances, may be permissible, should not become a set of loopholes that undercuts the fundamental protections of a strong and uniform fiduciary standard.

D. Fiduciary Standard Requires More than Just Disclosure and Consent

We were pleased to see the SEC staff's statement that "[t]he fiduciary standard, because it would be 'no less stringent than' Advisers Action Sections 206(1) and 206(2), would ensure that the basic protections regarding conflicts of interest currently available under the Advisers Act would be preserved and would not be watered down."[9] It has been argued by some that compliance with a fiduciary standard is solely a matter of disclosure and consent concerning a firm's potential conflicts of interest. The Coalition disagrees, and fortunately, the SEC staff has previously rejected a disclosure only standard:

> We do not agree that "an investment adviser may have interests in a transaction and that his fiduciary obligation toward his client is discharged so long as the adviser makes complete disclosure of the nature and extent of his interest." While section 206(3) of the Investment Advisers Act of 1940 ("Act") requires disclosure of such interest and the client's consent to enter into the transaction with knowledge of such interest, the adviser's fiduciary duties are not discharged merely by such disclosure and consent. The adviser must have a reasonable belief that the entry of the client into the transaction is in the client's interest. The facts concerning the adviser's interest, including its level, may bear upon the reasonableness of any belief that he may have that a transaction is in a client's interest or his capacity to make such a judgment.[10]

Consent is only informed if the client has the ability fully to understand and evaluate the information. Many complex products may be appropriate only for sophisticated and experienced investors. It is not sufficient for a firm or an investment professional to make full disclosure of potential conflicts of interest with respect to such products. Rather, as the SEC staff study indicates, "it is the firm's responsibility—not the customers'—to reasonably ensure that any material conflicts are fully, fairly, and clearly disclosed so that investors may fully understand them."[11]

The fiduciary standard is not just a "disclosure and consent" process standard—it is a substantive standard that requires an investment professional to act consistently with the long-standing and well-established duty to act as a "prudent investor." It is well-established that an element of fiduciary duty under the Advisers Act is (as part of the duty of due care) a duty of due diligence to assure that the investment professional fully understands and has fairly evaluated an investment recommendation. Even with full and fair disclosure and consent, if an investment professional gives investment advice that is inconsistent with what a prudent investor would do in similar circumstances, then the investment professional has violated the fiduciary duty to the client to engage in fair dealing and provide disinterested advice. It is vitally important that the SEC include these substantive elements of the Advisers Act fiduciary standard as part of the fiduciary standard applied to broker-dealers who provide personalized investment advice.

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[9] 913 STUDY, *supra* note 6, at 117,

[10] Rocky Mountain Financial Planning, Inc. (pub. avail. Feb. 28, 1983).

[11] 913 STUDY, *supra* note 6, at 117.

E. Investors Would Maintain Access to Advice and Services Under a Strong and Uniform Fiduciary Standard

Some industry organizations have argued that requiring broker-dealers to operate as fiduciaries will raise costs and limit investors' access to products and services. For example, in October 2010, the Securities Industry and Financial Markets Association (SIFMA) conducted a study of its members "to assess the impact of significant changes to the existing standard of care for broker-dealers and investment advisors" (the Oliver Wyman Study).[12] The Oliver Wyman Study finds that "[w]holesale adoption of the Investment Advisers Act of 1940 for all brokerage activity" would restrict choice, reduce access to products, and increase the costs of advisory services.

While we agree that, because the differences between a fiduciary standard and a suitability standard are real and substantial, if broker-dealers do not adapt their business models, they will incur additional liabilities under a fiduciary standard, we do not believe that it therefore follows that a fiduciary standard will deprive retail customers of access to financial products or services. As we understand the Oliver Wyman Study, the principal findings are based on a scenario that would eliminate the broker-dealer exclusion from the Advisers Act and thereby make broker-dealers subject to the provisions of the Advisers Act. The SEC staff study does not recommend eliminating the broker-dealer exclusion; rather it recommends adoption of a uniform fiduciary standard of conduct. Because the Oliver Wyman Study is based on assumptions that are not recommended by the SEC, its findings do not constitute reliable evidence regarding the impact of requiring broker-dealers to operate at a fiduciary standard that is consistent with Dodd-Frank and the SEC staff study.

Application of a fiduciary standard will not restrict an investor's access to commission-based services. Nothing in the Advisers Act or the Dodd-Frank Act prevents investment advisers from charging commissions. In fact, as discussed below, a large number of financial planners currently receive commissions while providing fiduciary advice.

Nor will application of a fiduciary standard restrict retail customers' access to products or offerings that are made available on a principal basis or as proprietary products, such as corporate or municipal bonds or participation in public offerings. The Dodd-Frank Act makes clear that the provision of a limited range of products or of proprietary products is not, in and of itself, necessarily inconsistent with the fiduciary standard of care. The primary limitations should be that the sale of such products be in the customer's best interest, and appropriate disclosure be made to, and consent received from, the client.

Finally, we do not believe that application of a strong and uniform fiduciary standard would necessarily result in a substantial increase in costs to clients. Contrary to the assertions in the Oliver Wyman Study, neither the Dodd-Frank Act nor the SEC staff study would require a shift from commission-based to fee-based accounts. While there may be some modest increases in compliance costs, we believe that the benefits to clients will far outweigh any potential increased costs. Clients may receive cost savings from the enhanced duties required by the Advisers Act fiduciary standard. Additionally, clients will have greater clarity regarding the duties and obligations of financial professionals, will be better able to compare financial professionals, and will likely select a financial professional with fewer potential conflicts of interest. We believe that an appropriate analysis of the costs and benefits is necessary to

[12] SECURITIES INDUSTRY AND FINANCIAL MARKETS ASSOCIATION/OLIVER WYMAN, STANDARD OF CARE HARMONIZATION: IMPACT ASSESSMENT FOR SEC 3 (Oct. 2010).

determine the true impact on cost to the investor, and we support the SEC in its efforts to conduct a careful and thorough cost benefit analysis in support of its rulemaking under section 913.

F. Financial Planners Have Successfully Operated Under a Fiduciary Standard While Providing Brokerage Services

Some commentators have argued that the standard of care for firms providing personalized investment advice to retail customers should be modified to accommodate different business models. The SEC has been given latitude to adopt a standard as long as it is no less stringent than that of the Advisers Act. This is inviolable. Accommodation must not mean a weakened standard. As discussed above, the fiduciary standard already provides flexibility.

CFP Board and FPA are business model neutral. CERTIFIED FINANCIAL PLANNER™ professionals and FPA members operate in a variety of different business models, including brokerage, insurance, and advisory models, with a variety of fee structures, including commission-based, fee-only, and assets under management fee structures. [13] At the same time, CERTIFIED FINANCIAL PLANNER™ professionals and FPA members voluntarily embrace, by virtue of their CFP® certification or membership in FPA, a commitment to provide financial planning services (which include investment advice) at a fiduciary standard of care.

That commission-based financial professionals can operate successfully under a fiduciary standard is nothing new. Our tens of thousands of fiduciary financial professionals provide strong evidence that the fiduciary standard is a practical, flexible, and workable standard no matter if the financial professional providing investment advice is a broker, insurance agent, investment adviser, or financial planner. Contrary to some who suggest that requiring the fiduciary standard will hurt investors by increasing costs and reducing services, our experience is just the opposite: providing services with fiduciary accountability is good for investors and good for business. Moreover, permitting a modified or watered down version of the "fiduciary" standard to accommodate different business models would completely frustrate the interests of eliminating client confusion, closing regulatory gaps, and developing a strong and uniform fiduciary standard of care for the delivery of personalized investment advice—regardless of the legal registration of the investment professional.

In fact, earlier this year more than 5,400 financial planning professionals signed a petition urging the SEC to apply a fiduciary standard to anyone providing personalized investment advice to retail customers. The Coalition and thousands of financial planners across the nation believe that those who provide personalized investment advice to retail customers should be held to a strong and uniform fiduciary standard. Requiring financial professionals to act in their clients' best interests should help restore the confidence of millions of American investors in the securities markets and facilitate the needed return to the markets as the economy continues to recover.

[13] In contrast, NAPFA members operate only under a fee-only compensation model. The organization has required its members to sign the NAPFA Fiduciary Oath since the 1980s.

II. Authorization of a Self-Regulatory Organization Is Not the Solution to Increase Investment Adviser Examinations

Congress, in section 914 of the Dodd-Frank Act, recognized that the frequency with which investment advisers are examined is inadequate and required the SEC to conduct a study on enhancing investment adviser examinations. This study included a review and analysis of the need for enhanced examination and enforcement resources for investment advisers, including consideration of the frequency of examinations of investment advisers over the preceding five years, the extent to which authorizing a self-regulatory organization (SRO) would improve the frequency of examinations, and other approaches to examining investment advisers that are dually-registered as, or affiliated with, a broker-dealer.

We agree that the current frequency in which SEC-registered investment advisers are examined is inadequate and that a solution will be necessary in the coming years as the number of investment advisers registered with the SEC grows. However, authorizing the SEC to recognize an SRO for investment advisers, as proposed in the Discussion Draft of the Investment Adviser Oversight Act of 2011 (Discussion Draft), is not the solution to increase investment adviser examinations.

While properly governed SROs have a place in the U.S. securities regulatory scheme,[14] we do not believe an SRO is the solution to increase investment adviser examinations. Unlike broker-dealers, which have been regulated by SROs since the 1790s, the investment adviser industry has been directly regulated by the SEC for more than seventy years. When the SEC recommended to Congress that it adopt what became the Advisers Act, it made a conscious and informed decision that an SRO model—which the SEC and Congress had relied on only the year before for over-the-counter broker-dealers—would not be as effective for investment advisers.

We strongly believe the SEC (and the states), which has overseen investment advisers for over seventy years, is the appropriate regulator of investment advisers. The SEC has a substantial, professional, and experienced staff of investment adviser examiners. Additionally, the SEC staff is already fully conversant with the legal and regulatory issues pertaining to investment advisers. Leveraging these resources is the quickest and most effective way to enhance examinations of investment advisers. As the existing SEC oversight of investment advisers generally has been effective, we strongly urge Congress to provide the SEC with the resources necessary to enhance examinations of SEC-registered investment advisers rather than shift oversight to an SRO.

A. The Proposed SRO Does Not Address Inherent Problems Identified by the SEC in an SRO Model

While SROs can be effective, the inherent conflicts of interest present in a self-regulatory membership model have resulted in uneven effectiveness over the years. These are exemplified in a series of failures in SRO oversight, which include the conviction of NYSE President Richard Whitney for embezzlement

[14] The Coalition does not oppose SROs as a general matter. During the legislative process on the Dodd-Frank bill, the Coalition advocated that Congress establish federal regulation of financial planners by allowing the SEC to recognize a financial planner oversight board that would set professional standards for, and oversee the activities of, individual financial planners. This oversight board is distinctly different from an SRO and more-closely aligned with a PCAOB model. Additionally, the proposal is designed to fill a gap and regulate an unregulated profession.

in the 1930s;[15] the collapse of regulation at the American Stock Exchange detailed in the SEC's 1963 Special Study of the Securities Markets;[16] the SROs' failure to prevent the paperwork crisis of the late 1960s; Nasdaq's failure to prevent price-fixing among market-makers[17] and the collusion among the options exchanges to prevent multiple listing in the 1990s; the failure of the NYSE and regional exchanges to prevent off-floor trading by floor brokers[18] and trading ahead by specialists[19] early in this decade; and the failure by the NASD and Nasdaq to detect wash sales that benefitted those SROs in terms of market data revenues.[20]

These repeated problems, together with the conversion of many SROs to for-profit, shareholder-owned status, led the SEC to issue a Concept Release on SRO governance in 2004.[21] As the SEC recognized at that time, while SROs can be effective, they have inherent conflicts of interest that need to be addressed by carefully designed governance mechanisms. However, the SEC has not yet acted on the issues in that Concept Release by adopting rules to address proper SRO governance and oversight. As discussed below, the Discussion Draft does nothing to address the issues identified in the SEC's Concept Release.

B. The Proposed Investment Adviser SRO in the Discussion Draft Goes Far Beyond the Targeted Approach Needed to Increase Investment Adviser Examinations

Congress and the SEC have recognized a narrow problem facing oversight of investment advisers: namely, that the current frequency of examinations of SEC-registered investment advisers is inadequate and that a solution will be necessary in the coming years as the number of investment advisers registered with the SEC grows. The SEC staff study, which addresses a number of issues related to examinations of SEC-registered investment advisers, does not mention any problems related to the rules under or enforcement of the Advisers Act.[22] Additionally, the SEC staff study does not mention issues related to the examination resources of the states.[23] Yet, the proposed SRO would have jurisdiction over state-registered investment advisers; have broad rulemaking and enforcement authority; and implement an

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[15] *See* JOEL SELIGMAN, THE TRANSFORMATION OF WALL STREET: A HISTORY OF THE SECURITIES AND EXCHANGE COMMISSION AND MODERN CORPORATE FINANCE 156–79 (Aspen Pub. 3rd ed. 2003).
[16] *See id.* at 281–86.
[17] *See* In the Matter of National Association of Securities Dealers, Inc.; Exchange Act Release No. 37,538, August 8, 1996; Administrative Proceeding File No. 3-9056 ("21(a) Administrative Order"); Report and Appendix to Report Pursuant to Section 21(a) of the Securities Exchange Act of 1934 Regarding the NASD and The Nasdaq Stock Market (August 8, 1996) and Exchange Act Release No. 37,538 (August 8, 1996) ("21(a) Report").
[18] New York Stock Exchange, Inc., Exchange Act Release No. 41,574 (June 29, 1999).
[19] New York Stock Exchange, Inc., Exchange Act Release No. 51,524 (Apr. 12, 2005).
[20] *See* Report of Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934 ("Exchange Act") Regarding The Nasdaq Stock Market, Inc. ("Nasdaq"), as Overseen By Its Parent, The National Association of Securities Dealers, Inc. ("NASD"), Exchange Act Release No. 51,163 (Feb. 9, 2003).
[21] *See* Exchange Act Release No. 50,700 (Nov. 18, 2004).
[22] In a separate study required under section 913 of the Dodd-Frank Act, the SEC staff recognized a number of differences in the rules that apply to broker-dealers and investment advisers when providing personalized investment advice about securities to retail customers. The staff recommended that the regulatory protections that apply to broker-dealers and investment advisers should be the same or substantially similar when performing the same or substantially similar functions. "[H]armonization should be considered to the extent that such harmonization appears likely to add meaningful investor protection." 913 STUDY, *supra* note 6, at 129.
[23] In fact, Congress determined in the Dodd-Frank Act that transferring oversight of mid-size investment advisers to the states was an appropriate and effective way of enhancing oversight of those investment advisers. Dodd-Frank Wall Street Reform and Consumer Protection Act § 410, Pub. L. No. 111-203, 124 Stat. 1376 (2010).

additional layer of regulation and costs for investment advisers, which could particularly burden small businesses, without the benefit of a thorough cost-benefit analysis.

The proposed legislation to create an SRO for investment advisers directly impacts financial planners, most of whom provide investment advice to retail clients as SEC- or state-registered investment advisers. We do not believe this approach, which creates additional costs and an added layer of regulation, can be justified without conducting an appropriate and thorough analysis of the costs and benefits, which, at a minimum, should demonstrate that the proposed approach is the most efficient, cost-effective way to enhance protection of investment advisory clients. We urge the Committee to give particular consideration to the views of those, like us, who are most directly affected by this proposal.

Based on an initial review of the Discussion Draft, we have a number of initial concerns regarding the potential for an SRO for investment advisers, including but not limited to:

- The SRO would have jurisdiction over state-registered investment advisers. This would create an anomalous situation in which the SEC, which does not regulate state-registered advisers, would have oversight authority over an SRO that oversees state-registered advisers. This would impose an additional layer of regulation on state-registered advisers, with potentially conflicting rules and enforcement mechanisms between federal and state regulators.
- The SRO would have broad rulemaking and enforcement authority, yet neither Congress nor the SEC has recognized problems related to the SEC's ability to establish and enforce rules under the Advisers Act.
- The proposed rules of the SRO would not be subject to cost-benefit analysis or requirements under the Administrative Procedures Act.
- The SRO would not be required to be a transparent body, and would not be subject to the Freedom of Information Act (FOIA), the Sunshine Act, or other open government laws.
- The SRO is not required to provide its members with basic constitutional protections, such as due process rights.
- While the SEC has approval authority over the SRO's fees, there are no clear limits or restrictions on the structure or amount of fees, potentially creating an unlimited tax on investment advisers.

Creating a new layer of bureaucracy and cost in order to improve the frequency of investment adviser examinations is not the best use of limited regulatory resources. First, it does not necessarily reduce the SEC's need for additional resources. Under this proposal, the SEC would be required to oversee the newly created SRO, while retaining responsibility for most of the advisers with the highest risk profile. In addition, it would include additional infrastructure costs involved with creating an SRO oversight structure for investment advisers. Outsourcing oversight could result in inconsistent or redundant regulation and enforcement (as the SRO, the SEC, and the states interpret and enforce the relevant rules). Further, an SRO model would dilute accountability. Currently, depending on the size of the investment advisory firm, either state securities regulators or the SEC have the undivided responsibility for rulemaking, oversight, and enforcement for investment advisers. For the larger advisers, that means the SEC has exclusive jurisdiction and is accountable directly to the Congress (and thus to the general public). In contrast, an SRO is, to a significant extent, accountable to its members as well as the SEC.

Efforts to insulate SROs from inappropriate influence from their members cannot fully counteract the fundamental conflict of interest in a membership organization.[24]

Moreover, this approach may not solve the problem it seeks to address. Some have suggested that an SRO is necessary to prevent future Madoff Ponzi schemes. But the proposed investment adviser SRO will not necessarily prevent future fraud. Madoff conducted his scheme for over twenty years while operating a registered broker-dealer, subject to SRO oversight.[25] Congress and the SEC have already taken targeted steps to reduce the likelihood of future Madoff Ponzi schemes by amending the custody rules for broker-dealers and investment advisers and allowing the Public Company Accounting Oversight Board (PCAOB) to implement oversight of independent public accountants of broker-dealers. These approaches are designed to leverage third parties to audit the activities of broker-dealers and investment advisers without creating an additional layer of regulation.

It is not clear that an SRO will substantially enhance these protections, at least not to a degree that warrants changing 70 years of adviser oversight at a significant cost. We believe further Congressional and regulatory review can identify a targeted approach to address the narrow issue of inadequate examinations of SEC-registered investment advisers.

C. Supporting Enhanced SEC Oversight is the Most Appropriate Solution

We strongly believe the SEC (and the states) is the appropriate regulator of investment advisers. SEC regulation of investment advisers has generally been effective at protecting investors over the past seventy years. Compared to the broker-dealer community, the investment adviser area has had comparatively fewer problems.[26] We do not believe there is sufficient reason for a change in the policy of direct federal regulation that has largely been effective for such an extended period of time in favor of a costly outsourcing of investment adviser oversight.

Because the SEC has been the sole federal regulator of investment advisers, it has a substantial, professional, and experienced staff of investment adviser examiners already in place. These examiners are located in every one of the SEC's regional offices as well as its headquarters. This examination staff already works closely with the SEC's Division of Investment Management, which has primary responsibility for issuing regulations concerning investment advisers, and the SEC's Division of Enforcement, which has a dedicated asset management unit that focuses on investigations of investment advisers. The fact that all three groups are located within the SEC makes each of them more effective than if the examination function were moved to a separate organization.

We believe it would be much quicker and more efficient to leverage the SEC's existing investment adviser examination staff, which is already fully conversant with all of the legal and regulatory issues that pertain to investment advisers, than to create an entirely new SRO from scratch to oversee investment advisers. The SEC can provide for increased examinations by hiring new examiners in the

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[24] In contrast, the Coalition's proposed financial planner oversight board would not be a membership organization, which would limit potential conflicts of interest. *See supra* note 14.
[25] Bernard L. Madoff Investment Securities LLC did not register with the SEC as an investment adviser until 2006.
[26] There have been a number of repeated industry-wide scandals that have plagued the broker-dealer industry for at least the past twenty years (e.g., insider trading, penny stocks, limited partnerships, market-maker price-fixing, unsuitable mutual fund share classes, research conflicts of interest, auction rate securities, CDOs).

investment adviser area, which can be trained by existing experts on the SEC staff. The expansion of the SEC's existing investment adviser examination staff could start immediately. By contrast, an SRO would have to obtain funding; lease offices; build information technology systems; appoint officers and senior staff; propose and adopt rules (which would be subject to SEC approval); create internal policies and procedures; and then hire an entire line-level staff.

The Coalition strongly urges Congress to provide the SEC with the resources needed to enhance its current direct oversight of SEC-registered investment advisers and create a robust and effective examination and enforcement program for those investment advisers. Given that the SEC is funded through fees assessed on the industry, not through tax revenues, an increase in SEC funding would have no impact on taxpayers and no impact on the federal deficit. Nor would it hinder the formation of capital. Rather, it would enhance the SEC's ability to adequately police the securities markets, thereby increasing investors' confidence that they will be adequately protected.

D. Supporting Enhanced SEC Oversight Avoids Significant Concerns with FINRA Oversight

FINRA has suggested that it is capable of stepping in and taking responsibility for investment adviser oversight, and has discussed specific governance and advisory structures that it would put in place to oversee advisers. While we appreciate FINRA's recognition of some of the many issues that would need to be addressed to achieve appropriate self-regulatory oversight of investment advisers, we have serious concerns with the possibility of FINRA being designated as the SRO for advisers. FINRA is at its core a membership organization for broker-dealers, not investment advisers. We question whether a governance structure that is affiliated with FINRA would allow for the type of truly independent governance that will be critical to ensuring oversight that is not subject to conflicts of interest. Moreover, FINRA's experience is primarily with a rules-based approach designed for the oversight of salespeople, sales practices, products, and financial/operational concerns, as well as market integrity. It does not have any experience examining or enforcing the Advisers Act and, more generally, lacks experience interpreting and applying concepts of fiduciary duty and enforcing a principles-based fiduciary standard of care. This knowledge and experience is essential for the effective oversight of investment advisers.

III. The Gap in Financial Planner Regulation Should Be Considered and Addressed Going Forward

Another issue of importance to the regulation of broker-dealers and investment advisers is the oversight of financial planners. Section 919C of the Dodd-Frank Act required the GAO to study whether there are any gaps in the regulation of financial planners and make recommendations to fill any recognized gaps. The GAO submitted its report, titled "Regulatory Coverage Exists for Financial Planners, but Consumer Protection Issues Remain," on January 18, 2011.

The Coalition appreciates the time and effort GAO staff spent in developing its report, and recognizes the short time frame under which they were required to operate. The GAO report recognizes many of the same regulatory gaps and consumer protection issues that have long concerned financial planners. While the GAO's judgment was that given the data available, another layer of regulation is not necessary at this time, we continue to believe regulation of financial planning is necessary to address the regulatory gaps and consumer protection issues that remain. We are committed to continuing to build

the case for regulatory recognition of this emerging profession while at the same time working with Congress, regulatory agencies, and industry to address these issues.