Consumer Federation of America
Investment Adviser Association
Shareowners.org
National Association of Personal Financial Advisors
Certified Financial Planner Board of Standards, Inc.
Financial Planning Association

November 2, 2009

The Honorable Barney Frank Chairman Financial Services Committee	The Honorable Spencer Bachus Ranking Member Financial Services Committee
The Honorable Paul E. Kanjorski Chairman Capital Markets, Insurance and Government Sponsored Enterprises Subcommittee	The Honorable Scott Garrett Ranking Member Capital Markets, Insurance and Government Sponsored Enterprises Subcommittee
U.S. House of Representatives Washington, D.C. 20515	U.S. House of Representatives Washington, D.C. 20515

Re: Investor Protection Act (to be reported as H.R. 3817)

Dear Chairmen Frank and Kanjorski, Ranking Members Bachus and Garrett, and Members of the Committee:

We are writing as representatives of organizations that support a strong, universal fiduciary duty for investment advice to express our grave concerns over the degree to which that goal is threatened by changes made to date during consideration of the Investor Protection Act. Unless these short-comings are fixed before final approval, the legislation could set a standard for advice by brokers that falls well short of the full fiduciary duty under the Investment Advisers Act.

We have written previously to express the following concerns: that, in describing standards of conduct, the phrase “when providing personalized investment advice” might be used to argue that “hat switching” by brokers is allowed; that the language requiring rulemaking by the Securities and Exchange Commission (“SEC”), which references personalized advice to retail clients, could be seen to narrow the existing fiduciary duty under the Investment Advisers Act, which does not vary depending on type of client served; and that the language which states that the standards adopted under the legislation should be “at least as high” as those currently applied under the Advisers Act is only included in that portion of the legislation that amends the

Advisers Act, which could lead some to conclude that the rules for brokers could meet a lower threshold.

Fiduciary Duty Weakened in Manager's Amendment

None of these concerns was addressed in the manager's amendment. Instead, changes to the manager's amendment prior to the mark-up actually reinforced these concerns. There are now so many conditions and specific, potentially limiting, provisos in the amended language that it is unclear whether brokers that provide investment advice are truly fiduciaries subject to the full panoply of accompanying duties. Because we believe you intended to hold brokers that provide investment advice to the same overarching fiduciary principles applicable to investment advisers, we urge you to clearly confirm that this is the case in any Committee report language accompanying the legislation.

One particularly troubling example of last-minute limiting changes to the legislation is the new section, added to the manager's amendment just before mark-up, which states that brokers who sell only proprietary products or an otherwise limited range of products can satisfy their fiduciary obligations by providing notice and obtaining "consent or acknowledgement" from the customer. While the sale of proprietary products and of a limited range of products has long been permitted under the fiduciary duty, this provision could, under some circumstances, permit such practices regardless of whether they are in customers' best interests and may be read to limit the regulations the SEC would be permitted to adopt to address these significant conflicts of interest. Moreover, it appears to us to be in direct conflict with, and to greatly limit the benefits of, that section of the legislation that directs the agency to study conflicts of interest and adopt rules to address or prohibit such conflicts.

Pending Matter Could Further Eviscerate the Standard

These problems could be made far worse depending on how the bill's authors respond to an amendment by Congressman Hensarling that was offered and withdrawn, but with a commitment to continue to examine the issues raised as the bill heads to the floor. The problem the amendment purports to address – that discount brokers who offer limited, transaction-based advice not be held to a fiduciary duty to provide on-going monitoring of the account – is a non-issue. As we have noted before, the fiduciary duty is a facts-and-circumstances-based standard. The obligation to provide on-going account monitoring is specific to those circumstances where a promise of on-going account management or on-going advice is made or implied. As long as clear disclosures were provided, no such obligation would be triggered in the circumstances described by discount brokers.

If the amendment were as narrow as the author claims, it would likely be of little concern, since it would not change the existing standard. In fact, however, the amendment is far broader and would throw open the door to rules that allow "hat switching." By "hat switching" we are referring to the common practice where the same financial intermediary provides investment advice under a fiduciary duty and then executes the recommended transactions under a lower suitability obligation. Such an approach, clearly permitted under the Hensarling amendment, would leave brokers free to implement their advice by selling products with higher costs, poorer performance, and other characteristics that make them poorly suited to the client's interests but financially beneficial for the broker.

It is therefore absolutely essential that the legislation not be amended to restrict the fiduciary duty in this fashion. If it were, the bill would not only perpetuate existing abusive practices, it could make them much worse by promoting a false sense of security among investors who believe they are protected by a fiduciary duty when they are not.

Delegation of Authority to FINRA Undermines Protections

Perhaps the most serious threat to the fiduciary duty came on a seemingly unrelated amendment. That amendment by Ranking Member Bachus, which was adopted on a voice vote, would permit the SEC to delegate responsibility to the broker-dealer self-regulatory organization, FINRA, for enforcing compliance with the Investment Advisers Act for its members and persons associated with its members. Based on an analysis of IARD data, the authority to oversee "persons associated with members" could extend FINRA's jurisdiction to between 25 percent and 30 percent of all federally registered investment advisory firms. In aggregate, these firms manage almost 80 percent of advisory firms' total assets under management. In addition, according to the North American Securities Administrators Association, roughly 88 percent of all investment adviser representatives are dually registered as representatives of broker-dealer firms. As a result, the amendment would appear to permit the SEC to designate FINRA as the de facto SRO for the majority of investment adviser representatives, including financial planners who combine advice and implementation services. The SEC could delegate this authority to FINRA with no further involvement of Congress and no prior analysis of the risks and benefits of that approach.

Moreover, the amendment gives FINRA not only inspection and enforcement authority, but also rule-making authority under the Investment Advisers Act. Both are problematic.

In the first instance, this amendment appears to reward FINRA for its failures in the Madoff and Stanford cases, and its misleading statements about the causes of those failures, with a broad expansion of authority. While FINRA has brazenly claimed that a gap in its authority prevented it from examining Madoff's advisory operations, in fact Madoff was solely a broker-dealer during virtually the entire duration of the scheme, and FINRA had full jurisdiction over its conduct. Moreover, although FINRA supporters claim this broadened authority is needed to supplement inadequate SEC oversight, separate provisions of the bill already address that resource problem by reducing the number of advisers that are subject to SEC oversight, by authorizing substantially increased SEC's funding, and by providing for user fees to support enhancement of the SEC's inspection program. Despite the SEC's failings, we believe that this approach is preferable to delegating broad investment adviser oversight responsibility to an organization with a broker-dealer mindset.

Even more disturbing than its expansion of inspection authority is the amendment's broad grant of rulemaking authority to FINRA. For years, FINRA and its predecessor organization, NASD Regulation, have sided with brokers in opposing efforts to hold brokers to a fiduciary standard when they provide investment advice. With the rulemaking and enforcement authority this amendment would provide, FINRA could become the main arbiter of how the fiduciary duty is applied to conduct by brokers, SEC-registered advisers with broker-dealer affiliates, and most financial planners. All of the concerns outlined above regarding weaknesses in the underlying legislation would be magnified if FINRA were given this rulemaking role and continued to adopt its industry-centric approach to the issue.

Conclusion

Unless these problems are fixed, we fear this legislation would give investors a false sense of security that they are receiving enhanced protections while in fact doing little to raise the standards that apply when brokers give investment advice. As the legislation moves to the floor of the House, we urge you to fix these severe shortcomings in the legislation so that it can fulfill the Administration's intent to apply the Investment Advisers Act fiduciary duty to all investment advice. We look forward to working with you to achieve that goal.

Respectfully submitted,

Barbara Roper
Director of Investor Protection
Consumer Federation of America

David Tittsworth
Executive Director
Investment Adviser Association

Richard Ferlauto
Chairman
Shareowners.org

Ellen Turf
Chief Executive Officer
National Association of Personal Financial Advisors

Kevin Keller
Chief Executive Officer
Certified Financial Planner Board of Standards, Inc.

Marvin W. Tuttle, Jr., CAE
Executive Director/CEO
Financial Planning Association