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Subject: **AALU Submits Comments to SEC on Its Study Of Broker-Dealer And Investment Adviser Standard Of Care Regulatory Obligations**

- Major References: 1. [*AALU's August 30, 2010 Comment Letter \(with Attachment\) Delivered to the SEC On Its Study;*](#)
2. [*The August 30, 2010 Joint Trades Comment Letter to the SEC signed by AALU, ACLI, the Financial Services Institute, the Insured Retirement Institute, NAIFA and the Securities Industry and Financial Markets Association;*](#)
3. [*Request for Comment to Inform Study Regarding Obligations of Brokers, Dealers, and Investment Advisers \(Release No. 34062577; IA - 3058; File No. 4-606\); Section 913 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 \(2010\).*](#)

Prior AALU Washington Reports: 10-79

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The U.S. Securities and Exchange Commission (the "SEC" or "Commission") has begun conducting a Congressionally-mandated study (the "Study" which was required by section 913(b) of the Dodd-Frank Act, i.e., Dodd-Frank Wall Street Reform

and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010)) primarily on (i) the effectiveness, understanding, and authorities pertaining to the current standards of care for brokers, dealers, investment advisers, and their associated persons when providing personalized investment advice and recommendations about securities to retail customers and (ii) the potential impact of changes related to the standards. The Study is to be followed by a report to Congress on the SEC's findings in which the Commission may recommend rulemaking should it identify a need. Under the Dodd-Frank Act, the Commission has the authority, at its discretion, to write rules following the study to impose a fiduciary best interest standard on brokers, including those who sell variable life insurance products. The Study's first phase was just completed with the August 30 conclusion of a 30-day public comment period offered by the SEC to inform its study. (See the Request for Comment to Inform Study Regarding Obligations of Brokers, Dealers, and Investment Advisers (Release No. 34062577; IA - 3058; File No. 4-606); Section 913 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010)).

AALU has addressed and delivered to the Commission its own August 30, 2010, 33-page letter of comments ("AALU's Comment Letter"), along with attached reference material, stressing a number of concerns and views of AALU members. It also has signed onto a unified industry letter with several life insurance and securities associated entities underscoring the broad scope of those concerns. (The August 30, 2010 "Joint Trades Comment Letter" signed by ACLI, AALU, the Financial Services Institute, the Insured Retirement Institute, NAIFA and the Securities Industry and Financial Markets Association.) A sizeable number of respondents from the over 2,000 comment letters submitted aligned themselves with AALU's position, i.e., that a broad, one-size-fits-all uniform fiduciary standard could cause significant damage to the availability of variable life and annuity products, and that the Commission should utilize its study to gain an objective understanding, in particular, of the rigorous nature of oversight and retail customer protections currently governing life insurance producers and product sales before proceeding with any new rules.

The key concerns stressed by AALU are discussed below.

A. Background: Dodd-Frank Act

Section 913 requires the SEC to conduct a six-month study of the effectiveness of existing legal and regulatory standard of care obligations for brokers, dealers, and investment advisers. The study is to determine whether there are gaps, shortcomings, or overlaps in legal or regulatory authority for brokers, dealers, and investment advisers and any affiliated persons when providing personalized investment advice about securities to retail customers.

The statutory requirements for the study and report include thirteen considerations, some with multiple subparts, which the SEC must incorporate into its findings and conclusions.

The study and accompanying report to the House Financial Services and Senate Banking Committees is required to be completed and delivered by January 21, 2011.

It should be understood that the required SEC study report to Congress is a major improvement (generated in substantial part by the efforts of AALU and its industry partners) from the mandatory "fiduciary" standard of conduct set forth in the bill originally adopted by the House of Representatives. (See our Bulletin No. 10-79.)

Consistent with the discretion under the Dodd-Frank Act and existing authority, the SEC has a variety of options after completion of its standard of care study. One option is propose rules to adopt the “best interest” standard of care. Another option is to take no action imposing such a standard. A third option is to propose other rules to address the standards of care. A fourth option is to promulgate rules of conduct for brokers, dealers, and investment advisers pursuant to other provisions of the federal securities laws, as it has done in the past. A fifth option is for the SEC to utilize FINRA to rulemaking, subject to SEC approval to address any gaps, shortcomings, or overlap found in the study or otherwise determined to exist.

B. *AALU Stresses the Need for an Objective and Comprehensive Study as Mandated by Congress*

On August 30, 2010, we delivered to the Commission AALU's Comment Letter. In our letter, we are encouraging the Commission not to adopt a broad “best interest” standard on life insurance producers, but instead to conduct an objective and comprehensive study that carefully examines the full picture of investor protection and promotes access to an important array of services for retail customers (including through the expertise of life insurance agents and affordable life insurance products). AALU encourages the Commission to conduct its study with the following important considerations in mind:

- ***The Commission should acknowledge and provide respect to the existing level of overlapping and robust regulation specific to insurance producers who sell SEC-regulated products.***

There already exists multiple layers of relevant regulation and oversight -- by the Commission, the Financial Industry Regulatory Authority (FINRA), state securities regulators, and state insurance regulators. In particular, insurance producers who sell variable products operate in a highly-regulated field. In fact, variable life insurance and annuities are among the most highly-regulated financial products sold to retail customers.

Further regulation or a change in the standards of care could have the unfortunate consequence of causing insurance producers to move from variable to fixed life insurance products, thus inadvertently and inadvisably limiting consumer choice. Increased regulation means increased cost and time at the expense of retail customers.

- ***The Commission should protect investors through appropriate rules of conduct and effective regulatory oversight.***

The proposed potential standard of conduct, i.e., the “best interest” standard, or any other broad amorphous standard protects investors far less than existing standards, and does not address more important gaps in regulatory oversight and inspections of investment advisers.

Broker-dealers are subject to far more regulation and inspection than are investment advisers. Broker-dealers are subject to repetitive regulation, oversight, and inspection by the Commission, FINRA and state securities regulators. In addition, they are subject to the oversight of state insurance regulators (in the case of sales of securities-related products by insurance producers), whereas investment advisers are subject to regulation by the Commission or state regulators (but not both) and are inspected, on the average, only once every 11 years.

A new standard of conduct is meaningless without a mechanism to monitor and enforce its application. The limited Commission resources should not be offered for use in connection with such a mechanism without first addressing the gap in oversight, inspection and supervision between broker-dealers and investment advisers.

- ***The SEC should preserve retail customer choice and access to services.***

The SEC should preserve retail customer choice and access to services by considering the diversity that now exists among financial professionals and range of activities and relationships between financial professionals and their customers. AALU, in referencing a 2008 report by the RAND Institute for Civil Justice (“RAND Report”), emphasized that investors report high levels of satisfaction with their own financial professionals. A key point of the RAND Report is that the surveyed investors viewed themselves as having a broad range of choice. The investors could choose to work with registered investment advisers who receive fees for providing financial planning, with other professionals who manage accounts for asset-based fees, or with regulated broker-dealers who are in the business of selling products based on commissions and who provide investment advice incidental to that business. More relevant to AALU members, retail customers may purchase life insurance of the variable or fixed kind from insurance producers who hold licenses as registered representatives.

A one-size-fits-all standard will leave some individuals out -- most likely smaller to mid-sized investors. Further, the increase in compliance costs and expanded liability will likely result in the withdrawal of some professionals from the sale of SEC-regulated products, leaving the investor with less choice. The SEC should instead protect investors through the diverse sets of rules that allow the investor a choice of financial professionals and products.

C. *Joint Trades Comment Letter*

AALU also joined with others in or associated with the life insurance or securities communities to submit a comment letter (the “Joint Trades Comment Letter”) conveying a set of key points of consensus existing among the letter's signatories. The Joint Trades Comment Letter expresses a view that the Commission:

- (i) approach these important issues in a comprehensive manner, working with all interested parties to provide a lasting framework that protects investors and instills confidence in U.S. capital markets,
- (ii) perform a rigorous analysis of the existing rules and regulations to identify areas that work well and to fully evaluate the consequences to investors and the industry from any potential changes, including increased costs to retail customers
- (iii) preserve retail customer choice and access, and
- (iv) recognize the benefits to investors from diversity in approaches to the provision of products and services to retail customers.

Any AALU member who wishes to obtain a copy of the three documents designated as Major References here may do so through the following means: (1) use hyperlink above next to “Major References,” (2) log onto the AALU website at www.aalu.org and enter the Member Portal with your last name and birth date and select Current Washington Report for linkage to source material or (3) email Anthony Raglani at raglani@aalu.org and include a reference to this Washington Report. In order to comply with requirements imposed by the IRS which may apply to the *Washington Report* as distributed or as re-circulated by our members, please be advised of the following:

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The mission of AALU is to promote, preserve and protect advanced life insurance planning for the benefit of our members, their clients, the industry and the general public.

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