



Consumer Federation of America

June 14, 2010

The Honorable Christopher Dodd
Chairman, Committee on Banking,
Housing and Urban Development
U.S. Senate
Washington, D.C. 20510

The Honorable Richard Shelby
Ranking Member, Committee on Banking,
Housing and Urban Development
U.S. Senate
Washington, D.C. 20510

The Honorable Barney Frank
Chairman, Financial Services
Committee
U.S. House of Representatives
Washington, D.C. 20515

The Honorable Spencer Bachus
Ranking Member, Financial Services
Committee
U.S. House of Representatives
Washington, D.C. 20515

Re: CFA Outlines Investor Protection Title Priorities

Dear Chairman Dodd, Ranking Member Shelby, Chairman Frank, and Ranking Member Bachus:

We understand that the Conference Committee is scheduled to begin deliberations Wednesday on the Investor Protection title of H.R. 4173, the “Restoring American Financial Stability Act.” While other provisions of the legislation have garnered more headlines, these provisions are badly needed to restore fairness to our markets and effectiveness to our regulatory system. In order to bolster badly shaken investor confidence in the integrity of our nation’s capital markets, we urge you to adopt the strongest provisions from each bill.

The good news is that both the House and Senate have passed bills that include a strong package of investor protection reforms. Each bill has its own strengths and weaknesses. The following are our highest priorities in areas where there are significant differences between the two bills on issues that are of vital importance to average Main Street investors.

1) Require broker-dealers to act in the best interests of their customers when they provide investment advice. (House language)

Average investors are heavily dependent on financial professionals to help them navigate the complexities and risks of the investment markets. Under current laws, however, some financial advisers must act in their customers’ best interests, while others are free to recommend products that line their own pockets rather than those that are the best fit for the customer. The House bill would address that problem by requiring the SEC to adopt rules holding all financial advisers to the same fiduciary duty to act in the best interests of their customers when they give

personalized advice about securities to retail investors. The Senate bill would delay indefinitely a solution to that problem by requiring the SEC to conduct a further study the much-studied issue and denying it the authority it would need to act on the findings of that study. The House language carefully balances investor protection with measures to ensure that the broker-dealer business model is preserved. It should be included in the conference report.

2) Preserve protections against accounting fraud at small public companies. (Senate bill)

Companies under \$75 million in market capitalization make up roughly half of all public companies. History shows that they are both more prone to accounting fraud and errors than larger companies and less likely to have adequate accounting controls in place. And, when accounting fraud occurs at these companies, it almost always involves the complicity of the CEO or CFA, making an independent audit of fraud controls an essential ingredient in efforts to prevent fraud at these companies. Based on nothing more substantial than anti-regulatory rhetoric, and ignoring extensive evidence that costs of compliance are both reasonable and dropping, the House would permanently exempt small companies from the Sarbanes-Oxley Act requirement that a company's independent auditor include an evaluation of fraud controls as part of its annual financial statement audit. The Senate bill is silent on this topic. If investors are to believe in Congress's commitment to reform, it must not dismantle investor protections adopted in the wake of the last financial crisis as part of its legislation to respond to the current financial crisis. Toward that end, the House bill's permanent small company exemption from appropriate fraud controls must not be included in the conference report.

3) Strengthen SEC tools to combat fraud and protect investors. (House and Senate bill)

The House bill includes a more expansive package of reforms than the Senate bill to strengthen the enforcement powers and improve the effectiveness of the SEC. For example, the House includes provisions to enable the SEC to bring aiding and betting causes under all of the securities laws; to authorize nationwide service of subpoenas; to clarify the agency's authority to impose sanctions on individuals who committed violations while associated with a regulated entity but who are no longer associated with that entity; to improve the agency's ability to share information with and obtain information from other regulatory authorities; and, perhaps most importantly in this age of global markets, to enable the agency to go after wrongdoers who harm U.S. investors no matter where the fraud is based or who commit significant acts in furtherance of a fraud within the United States, even if the victims are located elsewhere. The Senate bill, on the other hand, includes stronger provisions to improve pre-sale disclosures to investors and to promote investor literacy and some useful reporting requirements, including for example with regard to agency supervisory controls and its oversight of National Securities Associations. The conference report should combine these measures from the two bills.

4) Create an Office of Investor Advocate within the SEC (Senate bill)

Too often, investors find it difficult to make their voices heard in SEC policy debates or to get their concerns addressed in their dealings with the agency. The Senate bill would address that problem by creating a powerful new Office of Investor Advocate within the SEC. A related

provision in the House bill would create an ombudsman. Because the ombudsman would help to resolve industry as well as investor issues, and because it would do so confidentially, this could serve as just another backdoor way for industry to influence the agency to the detriment of investors. The Senate provision, with its focus on investor protection, should be included in the conference report.

5) Preserve the SEC's ability to protect investors against abusive equity-indexed annuities sales practices.

Although it is not contained in either the House or the Senate bill, insurers reportedly continue to press for language to be included in the conference report preempting the ability of the SEC to regulate equity-indexed annuities. This highly controversial measure is clearly not within the scope of the conference, and its adoption would be a gross violation of the integrity of the legislative process. Equity-indexed annuities are hybrid products that include elements of both insurance and securities, but they are sold primarily as investments. A U.S. Court of Appeals has upheld the reasonableness of the SEC interpretation that they should be regulated as securities (while remanding the rule on procedural grounds). Preventing the SEC from adopting appropriate regulations to supplement state insurance department oversight would deny investors needed protections from one of the most abusively sold products on the market today. We urge you to reject this special interest amendment on both procedural and substantive grounds.

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Investors have suffered devastating losses as a result of a crisis they did nothing to cause. At the same time, glaring weaknesses in SEC oversight have been revealed. By combining the best aspects of the House and Senate bills, Congress could strengthen investor protections and enhance the effectiveness of the agency. We urge you to do so.

Respectfully submitted,

Barbara Roper
Director of Investor Protection

cc: Conferees
Senate Majority Leader Harry Reid
Senate Minority Leader Mitch McConnell
Speaker of the House Nancy Pelosi
House Minority Leader John Boehner