Consumer Federation of America

Fund Democracy

February 2, 2010

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

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

Re: "Restoring American Financial Stability Act of 2009" Committee Print

Dear Chairman Dodd, Ranking Member Shelby and Members of the Committee:

We are writing to express our appreciation for the strong package of reforms included in the "Restoring American Financial Stability Act of 2009" to enhance protections against investment scams and abusive sales practices targeted at senior citizens. In particular, the crack-down on misleading titles designed to convey an expertise in advising seniors on financial matters in Section 989A and the elimination of the broker-dealer exclusion from the Investment Advisers Act in Section 913 provide much needed tools to combat some of the most pervasive abuses that victimize older investors.

An estimated five million senior citizens become victims of financial fraud and abuse each year.[1] In part, this reflects the fact that nearly one-third of all U.S. investors are between the ages of 50 and 64. Moreover, the transition from work to retirement is a particularly vulnerable time, as individuals must switch from a strategy based on accumulating assets for future retirement to one of investing for income during retirement. When these older investors are defrauded or otherwise taken advantage of, the results are particularly devastating, since these victims are generally beyond or near the end of their earning years and thus have little or no ability to rebuild their retirement funds.

Section 913 Regulation of Brokers, Dealers and Investment Advisers

Unfortunately, Section 913 appears to be under attack by members of the broker-dealer and insurance industries whose questionable sales practices would be more difficult to maintain under the fiduciary duty and disclosure obligations imposed under the Investment Advisers Act. We urge you to resist calls to eliminate the section entirely, as some in the insurance industry have suggested, or to water down its protections by replacing it with a new, lowest common denominator "fiduciary duty

[1] Securities and Exchange Commission, FINRA, and North American Securities Administrators Association, *Investor Alert, Investment Products and Sales Practices Commonly Used to Defraud Seniors: Stories from the Front Line*.

lite" as advocated by many in the brokerage industry.[2] Weakening the legislation in this way would harm all investors, but the vulnerable senior population would be hit the hardest.

The broker-dealer community's attack on Section 913 has been subtle. Claiming to embrace the fiduciary standard, they have sought changes that would significantly limit its scope and divorce it from the legal precedent that has evolved under state common law. The arguments in favor of this approach are based on gross misrepresentations. Contrary to brokerage industry claims, for example, there is no evidence of significant inconsistencies among states in the application of the fiduciary duty.[3] Moreover, far from being a one-size-fits-all standard, the Advisers Act fiduciary is precisely the sort of flexible, principles based regulation the securities industry claims to admire, imposing obligations based on the particular facts and circumstances of the relationship and the services offered. In contrast, the new standard they advocate – applying it to advice, but not the sales recommendations designed to implement that advice – would create the impression of new investor protections where none exist. This could leave investors more vulnerable than ever by creating a false sense of security.

The insurance industry attacks on Section 913 have been particularly virulent. Under the legislation, insurance agents who sell variable annuities and other variable products would be required, with regard to these products, to make recommendations in the best interests of their clients and to disclose all material information regarding those recommendations, including information about costs, risks, and conflicts of interest. While industry trade associations have argued that "there have been few concerns in the life insurance marketplace that would justify additional regulatory oversight," concerns over abusive practices involved in the marketing and sales of annuities and more particularly variable annuities have led NASAA to issue numerous warnings about the products to investors [4] and were similarly identified as a problem area in the joint SEC-FINRA-NASAA Investor Alert on schemes to defraud senior investors.[5]

Personal finance articles are rife with warnings regarding the high costs, low flexibility, and "horrendous" tax treatment often associated with variable annuities. InvestSense, LLC, for example, calls variable annuities "one of the most overhyped, most oversold, and least understood investment

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[2] See, for example, the November 19, 2009 letter from the National Association of Insurance and Financial Advisors and the National Association of Independent Life Brokerage Agencies to Chairman Christopher Dodd and Ranking Member Richard Shelby, Committee on Banking, Housing and Urban Development, U.S. Senate; the November 20, 2009 letter from the Association for Advanced Life Underwriting, the National Association of Insurance and Financial Advisors and the National Association of Independent Life Brokerage Agencies to Chairman Dodd and Ranking Member Shelby; and the October 29 letter from Kenneth E. Bentsen, Jr., Executive Vice President, Public Policy and Advocacy, Securities Industry Financial Markets Association to Chairman Frank and Ranking Member Bachus, Financial Services Committee, U.S. House of Representatives.

[3] The cases cited by SIFMA, for example, relate not to how the fiduciary duty applies to investment advice, but to whether the fiduciary duty applies to brokers in particular circumstances. By clarifying that all investment advice by brokers is subject to a fiduciary duty, the legislation would eliminate this ambiguity.

[4] See, for example, NASAA news release, "State Securities Regulators Release 'Unlucky 13' Investor Traps, February 16, 2006; NASAA news release, "State Securities Regulators Identify Top 10 Traps Facing Investors," May 15, 2007; NASAA news release, "State Securities Regulators Issue Senior Investor Alert," September 10, 2007; NASAA news release, "NASAA Identifies Traps Likely to Burn Investors This Summer," June 17, 2008.

[5] SEC, FINRA, NASAA, *Investment Products and Sales Practices Commonly Used to Defraud Seniors: Stories from the Front Line*.

products."[6] And personal finance writer Liz Pulliam Weston has labeled them the "worst retirement investment you can make."[7]

Moreover, as insurance industry trade associations themselves point out, these products are most often sold to "middle-market consumers who look to [life insurance agents] for insurance and retirement products."[8] But these middle-market consumers are precisely those who can least afford to squander limited retirement resources on the often astronomical fees associated with variable annuities and are least likely to have the financial sophistication needed to comprehend the many complex considerations that go into selecting an appropriate annuity product. One analyst estimates that variable annuities transfer approximately $25.6 billion a year "of spendable investment returns" from vulnerable investors to the insurance industry and its sales force.[9]

The SEC, NASAA, and FINRA have launched efforts to crack down on unsuitable sales of variable annuities. While progress has been made, problems persist.[10] Holding insurance agents and brokers to a fiduciary duty when they provide investment advice in association with the sale of variable annuities would provide additional investor protection tools. Most notably, it would no longer be sufficient to show that a variable annuity was generally suitable for the customer; they would have to determine that, among the investments they have available to sell, the variable annuity was the option *best* suited to the customer. This would discourage the practice of loading the variable annuities with extra features that are financially lucrative for the insurance agent and insurance company, but not for the investor making the purchase, or selling annuities within qualified retirement plans, a practice the SEC has said is rarely if ever in investors' best interests.[11] Moreover, the broker or insurance agent recommending the variable annuity would have to provide robust disclosures of key features of the investment, including costs, risks, and conflicts of interest associated with the purchase. If this information were provided in advance of the sale, investors would be better equipped to protect themselves.

Certain segments of the insurance lobby have also opposed the pro-investor provisions of Section 913 on the grounds that the legislation would require these firms to register and be regulated as investment advisers, a requirement they claim is unduly burdensome. In reality, however, the requirements are quite modest. Registration can be accomplished by filing a form electronically with either the SEC or appropriate state regulators.[12] Annual state registration fees average only $210 per firm and $60 per individual. In addition, those who provide the advice must pass a test to demonstrate their basic qualifications, at an added cost of $135. In short, for roughly the same price that an investor

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[6] InvestSense, LLC, *Common Sense InvestSense™ … Variable Annuities*, 2002.
[7] Liz Pulliam Weston, *The Basics: The worst retirement investment you can make,* updated January 2008.
[8] See, for example, AALU, NAIFA, NAILBA letter.
[9] Scott Burns, "Variable Annuity Watch, 2008," *AssetBuilder – Registered Investment Adviser*.
[10] As recently as June of this year the SEC charged Prime Capital Services, a registered broker-dealer, and members of its sales force and their supervisors with engaging in abusive sales practices in to the sale of variable annuities to seniors. The SEC's enforcement action alleged that the variable annuities generally paid commissions of 6 percent as opposed to other investments that pay less than 3 percent. According to the SEC's complaint, the defendants earned millions of dollars in commissions.
[11] Approximately 55 percent of variable annuity assets are held in either IRA rollover accounts or qualified retirement accounts, according to Levine, Alan, *Do IRA Rollovers Mix With Tax-Deferred Variable Annuities*, February 24, 2009 available at http://www.registeredrep.com/wealthmangement/insurance/ira_401k_variable_annuities_0224/index.html.
[12] States may require additional materials in order to satisfy their registration requirements but these are minimal and generally include a copy of a sample client contract or a financial statement.

pays in annual expenses on a typical $100,000 variable annuity, an insurance firm could register itself and ten agents for a year and cover the agents' testing costs. That hardly seems like an excessive burden to place on an industry that sold in excess of $154.8 billion in variable annuities in 2008.[13]

Section 989A. Senior Investor Protections

Section 989A offers additional resources to combat investment scams targeted at seniors. This provision would provide grants to states that adopt the NASAA *Model Rule on the Use of Senior-Specific Certifications and Professional Designations* designed to curb the misleading use of designations that create the false impression the salesperson or adviser has special expertise in advising seniors on financial matters. The grants could be used for a wide variety of senior investor protection efforts, including: hiring additional staff to investigate and prosecute cases; providing funding for new technology, equipment and training for regulators, prosecutors and law enforcement; and providing educational materials to increase awareness and understanding of designations.

Retirees and those approaching retirement have been particularly hard hit as the financial crisis has decimated their retirement savings at a point in their lives when they have little if any opportunity to recover those savings. The "Restoring America's Financial Stability Act" includes important provisions to ensure that older investors are not further victimized by investment frauds and abuses. We urge you to stand up for vulnerable seniors by standing up to industry groups seeking to weaken these vital investor protections.

Respectfully submitted,

Denise Voigt Crawford
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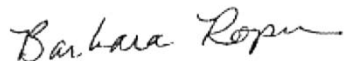
Mercer Bullard
Founder and CEO
Fund Democracy



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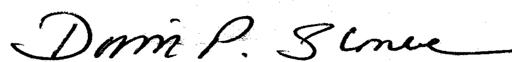

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[13] See, Variable Annuities-2008 Update available at http://www.irionline.org/pdfs/09AnnuityFactBook/chapter6.pdf.