FPA
THE FINANCIAL PLANNING ASSOCIATION

1615 L Street, N.W.
Suite 650
Washington, D.C. 20036
Voice: 202.626.8770
Fax: 202.626.8233
Web site: www.fpanet.org

10

S7-20-04

RECEIVED
JUN 2 4 2004
OFFICE OF THE SECRETARY

March 28, 2002

The Honorable Michael G. Oxley
Chairman
Committee on Financial Services
United States House of Representatives
Washington, D.C. 20515

The Honorable Spencer Bachus
Chairman
Subcommittee on Financial Institutions and Consumer Credit
United States House of Representatives
Washington, D.C. 20515

The Honorable John J. LaFalce
Ranking Member
Committee on Financial Services
United States House of Representatives
Washington, D.C. 20515

The Honorable Maxine Waters
Ranking Member
Subcommittee on Financial Institutions and Consumer Credit
United States House of Representatives
Washington, D.C. 20515

Re: H.R. 3951; Proposed Thrift Industry Exemption from Advisers Act

Dear Chairmen Oxley, Bachus and Ranking Members LaFalce and Waters:

The Financial Planning Association ("FPA")[1] wishes to express its strong opposition to a provision in H.R. 3951, a banking reform proposal pending in the Subcommittee on Financial Institutions and Consumer Credit ("Subcommittee"), that provides thrift institutions with an exemption from the Investment Advisers Act of 1940 ("Advisers Act").[2] FPA respectfully requests that you carefully review the issues set forth below that were not addressed in the March 14, 2002, hearing on the exemption. We urge you to revise section 201 of the bill so that the proposed exemption from the Advisers Act is no longer available to thrifts.

[1] The Financial Planning Association is the largest organization in the United States representing financial planners and affiliated firms, with more than 28,000 individual members. Most are affiliated with registered investment adviser firms ("RIAs") registered with the Securities and Exchange Commission ("SEC"), state securities administrators, or both. FPA maintains administrative offices in Atlanta and Denver, and a government relations office in Washington, D.C.

[2] 15 U.S.C. §§ 80b-1 to 80b-21 (2000); 54 Stat. 847 (1940) [hereinafter Advisers Act].

i. Background

The Office of Thrift Supervision ("OTS") on March 14, 2002, testified before the Subcommittee, essentially making two points supporting the exemption. [3] First, OTS offered comment on the disparity between the regulatory requirements of thrifts and those of banks even though both may offer the same advisory or brokerage services.[4] Second, OTS stated that regulatory changes as proposed in H.R. 3951 meshes with an important goal of the OTS to "[protect] consumers by fully utilizing the consumer laws we have jurisdiction to enforce."[5]

FPA takes issue with both points. The OTS testimony completely ignores the broad public policy goals of the Gramm-Leach-Bliley Act[6] ("GLBA") to permit functional regulation of the financial services industry. Further, it offers no comment in connection with the loss of the consumer protection provisions of the Advisers Act currently afforded to thrift customers. And finally, it provides only a cursory picture of the exemption's negative impact on registered investment advisers ("RIAs"). Without having the benefit of broader financial industry feedback during the preliminary drafting and hearing phase, we urge the Subcommittee to take into consideration the comments made hereunder to provide a more balanced view of this ill-advised proposal.

ii. Functional Regulation under Gramm-Leach-Bliley Act.

The core business of banks and thrifts for many years was making loans. Banks, however, were originally excluded from the 1940 Advisers Act[7] for the practical reason that some Depression-era banks provided trust and custodial services to wealthy clients involving investment advice. Banking regulation traditionally focused on the solvency of the banking system. During the debate on Glass-Steagall reform, then-Securities and Exchange Commission ("SEC") Chairman Arthur Levitt noted, "Banking regulation focuses on the safety and soundness of banking institutions and prevention of bank failures. In contrast, securities regulation focuses on disclosure, investor protection, and the maintenance of fair and orderly markets." [8]

Of course, the delivery of financial services and demographics of the marketplace have changed dramatically over the last six decades, accelerated in the past few

---

[3] Testimony of Carolyn J. Buck, Chief Counsel, OTS, before the Subcommittee on Financial Institutions and Consumer Credit, March 14, 2002 [hereinafter "OTS Testimony"].

[4] Id. at 1.

[5] Id. at 2.

[6] Pub. L. No. 106-102, 113 Stat. 1338 (1999).

[7] Section 202(a)(11) of the Advisers Act.

[8] Testimony of SEC Chairman Arthur Levitt before the U.S. House Committee on Commerce, concerning H.R. 10, "The Financial Services Competition Act of 1997," July 17, 1997. [Hereinafter, "Levitt Testimony."]

years by passage of GLBA. This law encourages the creation of financial "supermarkets" through cross-ownership of banks, insurance companies and securities firms. Cross-ownership was previously prohibited by Congress as a result of Depression-era laws passed in response to the 1929 stock market crash and subsequent bank failures.

GLBA also attempted to functionally regulate the financial services industry by clarifying the various agencies' regulatory authority. As a result, financial services activities were generally regulated by the appropriate regulatory authority, irrespective of the financial institution or affiliate providing the service or product. Consistent with the notion of functional regulation, the SEC argued successfully during the congressional debate to make banks at least partly subject to the Advisers Act. Banks, Chairman Levitt noted:

> currently enjoy an exemption from the registration and other requirements of the [Advisers Act]. As a result, bank investment advisers are not subject to the substantive requirements applicable to registered investment advisers, including: (i) regulation of advertising, solicitation, and receipt of performance fees; (ii) establishing procedures to prevent misuse of non-public information; (iii) books and records and employee supervision requirements; (iv) [and] the general anti-fraud provisions.[9]

Congress agreed. The full exemption for banks from the Advisers Act was narrowed under GLBA by requiring banks or their affiliates for the first time to register with the SEC when acting as investment advisers to mutual funds.

The Advisers Act and its rules have changed, too, since the Great Depression. The contemporary differences with banking regulation, as noted above in SEC testimony, also include minimum competency requirements for federal and state RIAs under state licensing requirements.[10] That GLBA failed to fully eliminate the banking exemption amendment so that banks' retail advisory services were covered by the Advisers Act means that an unwise loophole still exists in the functional regulatory scheme. This deviation from functional regulation would be exacerbated under H.R. 3951 by extending the banking exemption to the thrift industry.

iii. Thrift Exemption Would Reduce Investor Protection.

It is not surprising that the thrift industry is interested in reinventing its business model. By the end of 1996, individual investors for the first time had more

[9] Testimony of SEC Chairman Arthur Levitt before the U.S. House Committee on Commerce, concerning H.R. 10, "The Financial Services Act of 1999," May 5, 1999.

[10] Section 203A(b)(1)(A) of the Advisers Act permits states to "license, register, or otherwise qualify any investment adviser representative [of a federally registered advisory firm] who has a place of business located within that State..."

money invested in mutual funds than in bank savings accounts.[11] However, while GLBA has accelerated cross-marketing by all financial institutions, there remain functional gaps in Advisers Act regulation, the most apparent a full banking exemption from offering retail advisory services under the Advisers Act.

As mentioned previously, OTS testimony noted that relieving thrifts from regulatory burdens would help in its goal of "protecting consumers by fully utilizing the consumer laws we have jurisdiction to enforce."[12] What the testimony did not mention was the panoply of consumer protections provided by the Advisers Act to current thrift customers that would be removed through an exemption. Nor did the OTS elaborate on how consumers would benefit specifically from the regulatory relief contained in H.R. 3951, outside of appearing to suggest unspecified cost-savings from adviser compliance requirements that theoretically would be passed on to the consumer.

To provide a more detailed comparison of some of the consumer protection provisions of the Advisers Act not required under banking rules:

- RIAs on the federal and state levels are required to disclose to new clients, and offer to re-disclose annually to existing clients, current and material information on the adviser's conflicts of interest, qualifications, disciplinary histories, methods of compensation, and investment strategies using a uniform disclosure form. [13] Banking regulators have no equivalent uniform disclosure form or requirement.
- RIAs under state licensing requirements as investment adviser representatives - including those affiliated with SEC-registered firms -- are generally required to meet minimum competency standards with respect to their investment advice and knowledge of pension and securities laws. Under current law and the proposed exemption for thrifts, a bank teller could be a "qualified" investment adviser tomorrow[14] inasmuch as bank regulation provides for no mandatory, uniform competency standards or qualifications. The SEC noted in a May 11, 2001, Release on new rules for banks that persons associated with a broker-dealer are required to pass a qualification test covering aspects of the securities industry. "By contrast," the Release stated,

---

[11] Levitt 1997 testimony, at 4.

[12] OTS Testimony at 2.

[13] Such information is contained in Form ADV, which is a uniform disclosure and registration document required by the SEC and under all state investment adviser statutes. *See* section 206(3) of the Advisers Act.

[14] For example, pension reform legislation recently passed by the House Committee on Ways and Means, H.R. 3669, in section 104 would provide for non-taxable fringe benefits for "qualified retirement planning services" offered by an employer. The Committee Report clarifies that "qualified investment advisors also include investment advisors within a financial institution's trust or custody department chartered under the National Bank Act."

"bank personnel generally are not subject to licensing or other regulations designed to test their knowledge of the securities business."[15]

- RIAs have a blanket fiduciary requirement to their clients. Depending upon the facts and circumstances of the advisory service, banks may not have the same requirement as they are not subject to the antifraud provisions of the Advisers Act upon which the Supreme Court based its decision that RIAs are fiduciaries. [16]
- RIAs are prohibited from referring, directly or indirectly, to client testimonials, and are subject to strict standards in advertising portfolio performance.[17] Banks have no similar advertising restrictions.
- RIAs that pay for outside solicitors are required to comply with detailed disclosure requirements about the nature of the relationship, including delivery of a copy of the solicitor agreement to prospective clients.[18] Bank regulation has no similar requirement.
- The Advisers Act requires that an RIA engaging in a principal transaction provide written disclosure to the client of the fact that the RIA is acting as principal,[19] and obtain the client's consent to the transaction.[20] The purpose of this rule is to prohibit an adviser from "dumping" unwanted securities from the firm's brokerage account into the client's portfolio. Again, banks have no similar requirement.

The RIA's overall disclosure obligations, compared to the absence of similar requirements under banking rules, cannot be overemphasized. The SEC has stated that an RIA's fiduciary obligations include

> the duty to render disinterested and impartial advice; to make suitable recommendations to clients in light of their needs, financial circumstances and investment objectives; to exercise a high degree of care to insure that adequate and accurate representations and other

---

[15] *See* SEC Release No. 34-44281; File No. S7-12-01, "Definition of Terms in and Specific Exemptions for Banks, Savings Associations, and Savings Banks Under Sections 3(a)(4) and 3(a)(5) of the Securities Exchange Act of 1934," at10, May 11, 2001.

[16] *SEC v. Capital Gains Research Bureau, Inc.,* in which the U.S. Supreme Court held that the antifraud provisions and legislative history of the Advisers Act reflected "congressional recognition 'of the delicate fiduciary nature of an investment advisory relationship.'" 375 U.S. 180 (1963).

[17] Section 275.206(4)-1, Advisers Act rules.

[18] Section 275.206(4)-3, Advisers Act rules.

[19] This disclosure generally includes (a) the adviser's original purchase price for the security it proposes to sell to the client; (b) the price the advisers expects to receive on resale for securities it purchases from clients; (c) the price at which the security could be bought or sold elsewhere, in the event the client would have received a better price. *See* Advisers Act Release No. 40 (Jan. 5, 1945); Advisers Act Release No. 470 (Aug. 20, 1975).

[20] *See* Advisers Act section 206(3).

information about securities are presented to clients; and, to have an adequate basis in fact for its recommendations, representations and projections.[21]

We strongly encourage the Subcommittee to ask the bank regulators about the nature of the qualitative disclosure provided to bank customers who are their advisory clients.

1. To what extent do bank regulations contain the same comprehensive disclosure requirements of the Advisers Act?
2. What, if any, mandatory competency standards are in place for bank investment advisers under current regulation?
3. What changes does the OTS propose to make in connection with its new supervisory requirements if the exemption is enacted into law?
4. How will the expanded jurisdiction of the OTS for advisory activities affect its current examination cycle?

This final question is particularly germane to the argument supporting expanded OTS jurisdiction over advisory activities of thrifts, given the agency's recent announcement that it is laying off some 58 examiners and closing one regional office due to a new reorganization plan.[22] The number of investment advisers who would migrate to OTS oversight is difficult to estimate, although *Newsweek* recently claimed the overall number in the U.S. at 600,000.[23]

It is interesting to note, however, the response of the SEC when it was eventually swamped with new RIAs. Rapid growth of the advisory industry in the 1980s led the SEC at one point to endorse a self-regulatory organization for RIAs because of an inability to keep pace with agency audits.[24] By 1996, when the SEC's audit cycle of each RIA averaged once every 44 years, Congress resolved the SEC's resource problem by dividing authority over RIAs between the federal agency and the states.[25] Since then, the SEC has been able to resume a more frequent audit cycle of the 7,417 RIAs under its jurisdiction to once every 5.3 years.[26]

---

[21] SEC *Investment Adviser Examination Manual.*

[22] "OTS Says Approximately 58 Examiners To Be Cut in Upcoming Reorganization," BNA's *Daily Report for Executives,*" March 22, 2002, at A-43.

[23] "It's Time for a Checkup: There are more than 600,000 investment advisers in the United States. How do you pick the one who's right for you?" *Newsweek,* April 1, 2002, at 67.

[24] S. 1410 and H.R. 3054, 101st Cong. (1989), Investment Adviser Self-Regulation Act. *See* also "Self-Regulation for Investment Advisers is Urged," *Wall Street Journal,* June 12, 1989.

[25] Pub. L. No. 104-290, 110 Stat. 3416, H.R. 2005.

[26] SEC 2001 ANNUAL REPORT, at 68, *at* http://www.sec.gov/pdf/annrep01/ar01ocie.pdf.

Uniform, functional application of such standards and examinations is critical for all Americans seeking investment advice, irrespective of whether the advice takes place within the brick walls of a bank or the office of an advisory firm. In the absence of any required bank disclosure, or at least disclosure containing the same elements of Form ADV, investors shopping at the new financial supermarkets of the post-Glass-Steagall reform era will find widely varying levels of disclosure, qualifications and oversight of their trusted adviser.

iv. Thrift Exemption Would Place RIAs at a Competitive Disadvantage.

OTS testimony notes that "some have objected to this [exemption] based on concerns that it would give thrifts a competitive advantage over registered investment advisers.... These amendments will have a relatively minor impact on the investment adviser industry because banks are already exempt."[27]

FPA notes that the consolidation of services offered by the financial services industry as a result of the GLB Act has only begun. Many banking institutions are only now beginning to offer investment advisory services. The impact on RIAs and the financial planning profession will not be known for many years. Certainly adding new exemptions from a heavily regulated area of the financial marketplace will only exacerbate the competitive costs for RIAs, most of who are sole proprietors or principals in small, independent firms. The cost of functional regulation can be borne as well by the larger corporate firms with greater resources.

v. Summary.

The proposed thrift industry exemption should be dropped from H.R. 3951 for three reasons. First, it is inconsistent with the public policy goal of functional regulation under GLBA; second, the exemption will reduce investor protections for the investment advisory clients of thrift institutions; and finally, it will place RIAs at a competitive disadvantage.

Please do not hesitate to contact the undersigned at 202.626.8771 if you have any questions or comments.

Sincerely,

Duane R. Thompson
Director of Government Relations

cc: Members of the House Committee on Financial Services

[27] OTS Testimony at 7.