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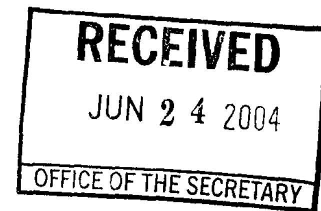

The Honorable Laura S. Unger
Acting Chairman
Securities and Exchange Commission
450 5th Street, N.W.
Washington, D.C. 20548

Re: Exemption for Thrift Institutions Under the Investment Advisers Act of 1940

Dear Chairman Unger:

The Financial Planning Association ("FPA")[1] wishes to express its concern with an exemption that the Securities and Exchange Commission (the "Commission" or "SEC") is considering for thrift institutions under the Investment Advisers Act of 1940 ("Advisers Act").[2]

The rationale for the exemption, as we understand it, is that when the federal securities laws were amended in the Gramm-Leach-Bliley Act ("GLB Act"),[3] the term "bank" was expanded to include a "depository institution,"[4] a term that in federal banking law

[1] The Financial Planning Association is the largest organization in the United States representing financial planners and affiliated firms, with more than 29,000 members. Most are affiliated with investment adviser firms registered with either the SEC or state securities administrators, or both. FPA maintains administrative offices in Atlanta and Denver, and a government relations office in Washington, D.C.

[2] *See* keynote address by Paul F. Roye, Director, Division of Investment Management, at the Glass LegalWorks Fifth Annual Investment Advisors Compliance Conference, New York, New York, May 4, 2001. Mr. Roye stated that with respect to changes to the investment management business brought by enactment of the Gramm-Leach-Bliley Act, "it seems appropriate to use our rulemaking authority to exempt thrifts from the Advisers Act, to the extent that they engage in bond fide fiduciary activity. Consequently, we have been working on an exemptive rule for thrifts in this area." *See also*, "Managing the Revolution," keynote address by Paul F. Roye at the Third Annual Compliance Summit, Washington, D.C., March 26, 2001.

[3] P.L. No. 106-102.

[4] 15 U.S.C. § 80a-2(a)(5)(A).

includes both banks and thrifts.[5] As a result, the Commission began to promulgate rule changes consistent with this requirement, most recently issuing interim final rules that provide exemptions from broker-dealer registration for banks, savings associations and savings banks on the same terms and conditions that banks are excepted or exempted. We are concerned that the SEC will seek to rely on its discretionary authority under Section 203A of the Advisers Act to exempt thrifts and thereby thrift advisory clients from the protections of such Act.

FPA finds the position contemplated by the Commission to be flawed when viewed in the absence of any express intent by Congress to amend the definition of "Bank" in the Advisers Act to include thrift institutions, and for other critical public policy reasons. In summary, by providing a new exemption to the thrift industry, we respectfully submit that the SEC would:

- act in a capacity inconsistent with its own public policy arguments strongly supporting functional regulation of the financial services industry under the various securities acts;
- act outside of its rulemaking authority by providing exemptive relief to a specific industry group in contravention of clear congressional intent when the GLB Act was signed into law in 1999;
- reduce investor protection by eliminating the disclosure of conflicts of interest, qualifications, and other critical information that clients of investment advisers – but not of banks or thrifts -- must receive; and
- continue to erode the level playing field for investment advisers and financial planners -- as well as the integrity of the Advisers Act -- by adding to the list of exempted industries that wish to provide identical or similar advisory services.[6]

1. ***The contemplated exemption is inconsistent with the Commission's own public policy declarations arguing for functional regulation of securities activities.***

As the financial services industry accelerates its consolidation with repeal of the Glass-Steagall Act, many of the firms that are eager to expand their menu of new financial products and services are also resistant to accepting the obligations of functional regulation. By functional regulation, we mean agency jurisdiction over a defined advisory or sales activity. In the 1999 congressional debate over Glass-Steagall reform, the SEC was emphatic in its support of functional regulation of the financial services industry with respect to securities regulation. In testimony before the House Committee on Commerce concerning H.R. 10 (to evolve later into the GLB Act), then SEC Chairman Arthur Levitt stated:

[5] *See* 12 U.S.C. S 1813(c) for definition of depository institution.

[6] *See* SEC Release Nos. 34-42088; IA-1845; File No. S7-25-88, "Certain Broker-Dealers Deemed Not To Be Investment Advisers" ("BD Exception").

> H.R. 10 now creates too many loopholes in securities regulation – too many products are carved out, and too many activities are exempted. These loopholes would prevent the Commission from effectively monitoring and protecting U.S. markets and investors. Moreover, the scope of those loopholes, which are ambiguously drafted, may create even greater problems and uncertainties in the future. The Commission cannot ensure the integrity of U.S. markets if it is only able to supervise a portion of the participants in those markets. *Neither can it ensure fair and orderly markets if market participants operate by different sets of rules and investors receive different levels of protection....*[7] [Emphasis added.]

More recently, the SEC continued to express support for functional regulation, but only in the context of clarifying its authority over a bank's brokerage activities. The GLB Act, according to a May 11, 2001, Commission interim rule

> codified the concept of functional regulation...by the same expert regulator, *regardless of the type of entity engaging in those activities* [emphasis added]. Congress believed that, given the expansion of the activities and affiliations in the financial marketplace, functional regulation was important to building a coherent financial regulatory scheme.[8]

Later in the Release, however, the SEC indirectly concedes its role of functional regulator to bank regulators with respect to investment advisory services offered by banks. "Because Congress believes that the 'examinations of bank trust departments are today rigorous in nature,' these examinations would provide customers with 'some basic protections' to mitigate the lack of federal securities law protections," the Release stated.[9]

2. ***The contemplated exemption for thrifts is inconsistent with the provisions of the GLB Act and exceeds the Commission's rulemaking authority.***

When Congress passed the GLB Act in 1999, federal securities and other financial services laws were substantively amended, with the exception of the Advisers Act. One of the few substantive changes to the Advisers Act was narrowing the exemption for banks if the bank or bank holding company "serves or acts as an investment adviser to a registered investment company."[10] Nonetheless, as noted recently by the Commission, the GLB Act was landmark legislation ending more than three decades of

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[7] Testimony of SEC Chairman Arthur Levitt before the U.S. House Committee on Commerce Concerning H.R. 10, "The Financial Services Act of 1888"" May 5, 1999.

[8] *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 1834," at 8, May 11, 2001.

[9] *Ibid.*, at 22.

[10] Section 217 of the GLB Act.

careful deliberation.[11] In revising numerous provisions of the securities laws, Congress had more than sufficient opportunity to consider a specific industry exemption for thrifts similar to that enacted for banks under the Advisers Act. Yet the final legislation was silent with respect to thrifts. The Commission should be wary of devising by rule what Congress did not address in legislation. If Congress had intended to grant similar treatment of thrifts as with banks, it could have done so.

This is not the first time that the Commission has reviewed the exemption question for thrifts in the context of a banking exemption under the Advisers Act. In a 1983 release,[12] the SEC asked for public comment on whether it should propose rules or recommend legislation to treat thrifts like banks under the federal securities laws. In that release, the Commission recognized that the "historical differences" between thrifts and banks had diminished through legislative action. However, the SEC stated that it was reluctant to take any action to treat thrifts like banks under securities laws without providing the public with the opportunity to comment. That proposal apparently died with no further action taken. As a result, the Commission and thrift industry had ample opportunity during the Glass-Steagall debate to clarify the treatment of thrifts under the Advisers Act. The Commission should be extremely cautious in imposing its judgment on policy issues that were the subject of extensive congressional debate. In effect, the Commission would be legislating on issues deemed to be legitimately within the scope of congressional review.

3. ***The contemplated exemption would reduce investor protection by eliminating the disclosure of conflicts of interest, qualifications, and other critical information that clients of thrift institutions would receive under the Advisers Act.***

When a person becomes a client of a registered investment adviser, the adviser is required to provide detailed information about the firm, conflicts of interest, the qualifications and background of the adviser, and any material information that could affect the delicate nature of a fiduciary relationship. Such information is typically contained in Form ADV. The adviser's brochure also serves as a core document during a routine SEC examination to determine whether the investment adviser has violated the anti-fraud and other provisions of the Advisers Act. Moreover, the Commission is preparing to upgrade Form ADV to include consumer-friendly, plain-English narrative disclosures that would make it easier for prospective clients to understand the adviser's business and individual qualifications.

Banks have never had the same level of transparency in their customer relationships as have investment advisers. As a result, thrifts would be added to the list of financial services industries offering comprehensive advisory and financial planning services without being subject to the same level of disclosure and oversight as registered

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[11] Publ. L. No. 106-102, 113 Stat. 1338 (1999).

[12] *See* Investment Company Release No. 13666, 48 Fed. Reg. 56,061 (Dec. 19, 1983).

investment advisers. During the Glass-Steagall debate, Chairman Levitt argued to make banks at least partly subject to the Advisers Act. Banks, he 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.[13]

The SEC's arguments were successful in convincing Congress that the Advisers Act should be amended to require registration of banks or bank subsidiaries that provide investment advice to fund companies. However, the debate failed to address the continued absence of Commission oversight of a bank's retail advisory customers. As such, customers of thrifts could also be subjected to the following problems without oversight by the appropriate functional regulator:

- Recommending sale of securities from the thrift's affiliated brokerage firm's inventory;[14]
- Absence of minimum competency standards, compared to current testing of investment adviser representatives by state securities administrators (including IA reps of a federal covered adviser with a place of business in a state); [15]
- No performance advertising restrictions of a thrift's 'model' portfolios;
- No general disclosure requirements to provide information of the thrift's investment practices and other general aspects of the firm (as required in Form ADV); and
- An inability by Commission examiners to conduct routine examinations of a thrift's advisory activities, including commingling of client funds; suitability of investment recommendations; disclosure to investors of the thrift employee's disciplinary

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[13] *See* Levitt Testimony, May 5, 1999.

[14] The Commission's May 11, 2001, Release makes the argument that bank advisory customers have adequate protection under banking laws. In addition to regular audits by bank examiners, and under federal and state trust law, the SEC asserts that banks owe a duty of loyalty, including an affirmative duty to make full and fair disclosure to the customer of all material facts relating to conflicts. However, not all client engagements may be conducted in a bank's trust department, as the Release notes at 22. Further, not all bank advisory activities may meet the SEC's standard of "a fee paid for investment advice" in the Release, which holds such advice to be "continuous and regular" investment advice (as opposed to episodic or periodic advice) in order to meet the exemption from the brokerage requirements. *See* discussion at 19-21. In the context of a limited client engagement, a thrift employee who is not a broker, or part of a trust department of the bank or thrift, would be able to provide investment recommendations without the cloak of fiduciary protection and full and fair disclosure as contemplated in the Release.

[15] *Ibid* at 10. The Release notes that all persons associated with a broker-dealer are required to pass a qualification test covering aspects of the securities industry. "By contrast, bank personnel generally are not subject to licensing or other regulations designed to test their knowledge of the securities business." However, the Commission was silent with respect to the lack of competency standards for bank customers who receive investment advisory services.

history, and the kinds of investigations with which bank regulators would be inexperienced.

As noted in Chairman Levitt's testimony, "Although some customer protections have been suggested by the banking regulators, they are less comprehensive than the federal securities laws and serve to perpetuate the disparities between the bank and securities regulatory schemes." Under the Commission's current contemplated exemption, such inequities would continue to exist for retail clients of a thrift institution.

4. ***Adding yet another exemption to the Advisers Act would exacerbate the unlevel playing field for financial planners and investment advisers.***

Financial planners are one of the most heavily regulated professions in the United States today. Yet, unlike broker-dealers, banks, and under a contemplated exemption for thrifts, they operate on an unlevel playing field compared to their new competitors, all of whom are permitted to selectively showcase paid, and unpaid, client testimonials.[16] In addition, compliance and professional development is costly. All federally registered, and most state, advisers are now required to pay from $100 to $800 annually in new administrative fees to register electronically with the Investment Adviser Registration Depository. They also are being required to expend hundreds of thousands of dollars cumulatively to completely revise their Form ADVs. Many planners also carry brokerage and insurance licenses, and pay for continuing education requirements and professional accreditation as part of a multidisciplinary practice. With respect to federally registered investment advisers, they must be prepared to undergo a routine audit of their complete business records by a Commission examiner at least once every five years. Advisers paying for solicitation activities also must comply with detailed disclosure requirements to prospective clients; thrifts, like banks, would not be subject to such disclosure of conflicts of interest for paid or shared referrals.[17] The costs of maintaining an adviser registration are burdensome for the small businessperson and become a competitive disadvantage compared to the market power of larger financial institutions.

Conclusion

A thrift industry exemption from the Advisers Act is more than just problematic. With respect to the Advisers Act, such an exemption would continue the misguided pattern

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[16] *Ibid.* The SEC Release acknowledges this discrepancy, but only in the context of broker-dealers having to meet certain conditions with respect to testimonials and performance advertising compared to banks. Advisers, in contrast, are generally prohibited from advertising client testimonials.

[17] To our knowledge, the SEC has not directly commented on 'finder' fees paid to bank employees for referrals to investment advisers. However, it has viewed with concern referral fees paid in the brokerage area. On May 23, 2001, the Commission held a public roundtable to discuss whether Internet portals receiving referral fees from broker-dealers linked to their web site should be subject to Commission oversight. The only reference made concerning banks and referral fees in its May 11, 2001, Release was how to create a *de minimis* exemption for bank employees who receive incentive compensation for brokerage referrals, at 11-12.

by the SEC to respond to changes in the marketplace without relying on current functional regulation as the foundation for making sound policy judgments.

FPA is an organization representing primarily small financial planners, most of whom are affiliated with registered investment advisers. FPA requires member adherence to the CFP Code of Ethics and Professional Conduct, which requires them to place the interest of the client first, and to embrace competency standards.[18] We believe that anyone providing comprehensive financial planning advice should be subject to similar standards. Maintaining the integrity of the Advisers Act by limiting industry exemptions that do not meet those tests is consistent with the SEC's mission to protect the public.

As a byproduct of Glass-Steagall repeal, and the Commission's apparent concession not to support full, functional regulation of investment advisory services, we have seen large broker-dealers visit the Commission seeking exemptive relief to provide advisory services for compensation directed related to those services.[19] We now see the savings and loan industry lobbying the SEC to include their firms under the Advisers Act exemption for banks. To provide a broader perspective, industry pressures are not absent in other sectors of the marketplace. The banking industry recently objected to federal credit unions wanting to expand their consulting services to include retirement planning and other financial services in an area where they already have an exemption.[20] And the real estate industry, in turn, has opposed bank expansion into real estate brokerage activities.[21] Of course, banks would not object to federal credit unions providing investment advice if credit unions weren't in direct competition; and thrifts would not seek an exemption from the Advisers Act if they were not expanding services in this functional area of federal securities laws. As former Chairman Levitt stressed in his May 5, 1999, testimony to Congress, "It is crucial that there be *consistent* regulation of securities activities engaged in *by all types of entities*" [emphasis added]. Now that public attention on Glass-Steagall reform has lapsed, we fear that the clarion call to functional regulation is being ignored and forgotten with respect to the Advisers Act, exacerbated by industry pressure on the Commission to eviscerate the Act's definition of "Investment adviser."

Recognizing the need for comprehensive oversight of investment adviser activities, particularly as more Americans seek professional investment advice, FPA urges the Commission to resist a piecemeal approach to requests by industry groups who seek to gut the Advisers Act for

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[18] *See* Rule 202 of the CFP Code of Ethics and Professional Responsibility, Rules that Relate to the Principle of Objectivity. "A financial planning practitioner shall act in the interest of the client."

[19] *See* BD Exception.

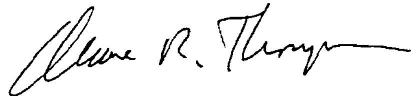
[20] *See* Federal Credit Union Incidental Powers Activities; 12 CFR Part 721. *See also* "Credit Unions Laud Proposed New Powers, Banking Groups Voice Continued Opposition," Bureau of National Affairs *Daily Report for Executives*, at A-2, March 5, 2001.

[21] *See* "Realtors Face Uphill Battle Against Banks' Acquiring Real Estate Powers," BNA *Daily Report for Executives*, at A-23, June 8, 2001.

competitive reasons. Instead, we call on the SEC to place a moratorium on any new exemptions from the Advisers Act until it undertakes a comprehensive analysis of investment adviser activities by other industries, and determines in a public forum what exemptions are necessary in light of changes in the marketplace since 1940. Any changes that the Commission believes are necessary and that go beyond its rulemaking authority should be made in legislative recommendations to Congress.

I would be happy to discuss any of the above comments in greater detail. Please do not hesitate to contact me at 202.626.8770.

Sincerely,



Duane R. Thompson
Director of Government Relations

Cc: The Honorable Isaac C. Hunt, Jr.
The Honorable Paul R. Carey
Paul F. Roye, Director, Division of Investment Management
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