Testimony of
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On

"Ensuring Appropriate Regulatory Oversight of Broker-Dealers and Legislative Proposals to Improve Investment Adviser Oversight"

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Introduction

Good morning, Mr. Chairman and members of the Subcommittee. I am Bill Dwyer, president of national sales and marketing for LPL Financial, and I am pleased to be here today on behalf of the Financial Services Institute (FSI).

We are here today because Congress has a unique opportunity to make sure that all Americans have access to trustworthy financial advisors who can help them save properly for retirement, their children's education and other common financial goals. Guaranteeing this access requires two key steps to shape the regulatory environment:

First, FSI urges Congress to engage in meaningful oversight of the SEC's efforts to formulate and adopt a new uniform fiduciary standard of care for broker-dealers.

Second, and equally important, FSI urges Congress to pass legislation authorizing the SEC to approve a self-regulatory organization (SRO) to oversee the activities of retail investment advisers.

Together, these changes to the current regulatory structure will ensure that all American investors receive the same protections, regardless of whether they do business with a broker-dealer or an investment adviser.

Americans need and want advice from trustworthy professionals. A recent ING Research study confirmed what we already knew to be true: investors who spend time with a financial professional save significantly more, perhaps two to three times more, than their counterparts without the benefit of this advice. The business relationship between investors and financial advisors is based on trust. Its success depends on investors' confidence in the advice these financial professionals offer.

If investors lose access to their trusted advisers, or lose confidence in them, the nation's entire economy will suffer. Nor should investors have to be regulatory experts in order to understand the legal duty owed to them or the extent of regulatory supervision dedicated to their activities. Instead, investors should feel confident that the legal and regulatory protections extended to them do not fluctuate with the registration status of their chosen financial adviser. Any proposal that fosters investor confusion about professional standards or creates the perception or reality of disparate, unevenly enforced rules and supervision will do serious harm not only to our industry, but to the whole economy.

The Dodd-Frank Act has given Congress a unique opportunity to enhance investor protection by exerting meaningful oversight over the SEC's proposals for a fiduciary or "best interest of the client" standard of care for broker-dealers. Clearly financial advisors who provide personalized investment advice should be held to the same standard of conduct no matter what their registration status. However, resolving the standard of care issue is only half of the job now before you. In order to ensure that the Dodd-Frank Act achieves its stated goal of protecting retail investors, we also urge Congress to act on additional legislation that ensures that all Americans have access to competent, affordable financial advice that is subject to uniform regulatory oversight and supervision.

The members of FSI have a unique perspective to offer the Subcommittee on Sections 913 and 914 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank Act), the subsequent studies published by the SEC, and efforts to implement the findings of those studies. FSI members work almost exclusively with retail investors, the individuals and families who use retail investment products to save for retirement, fund their children's educations, and manage their personal wealth. Our members are dual registrants, licensed as both broker-dealers (B/Ds) and registered investment advisers (RIAs), so we understand how the existing regulatory standards and examination structures differ for these service providers. Last, but perhaps most important, our members rely upon their personal reputations to win and retain business. Since we have this powerful incentive to put client interests first, higher standards and closer oversight will only enhance our clients' trust in us. Therefore, the concerns we detail below relate merely to the means of pursuing these goals.

Formulating and Implementing a New Uniform Fiduciary Standard of Care

Title IX, Section 913 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the Dodd-Frank Act) required the SEC to study the obligations and standards of care for broker-dealers and investment advisers who provide personalized investment advice to retail investors. That study concluded that it would be appropriate to establish a uniform fiduciary standard of care in the best interest of the client.

FSI agrees with this conclusion and supports the adoption of a new uniform fiduciary standard of care. Uniformity is an important goal, as it will ensure that investors receive the same protections no matter whom they choose as their financial advisor. For this reason, we strongly oppose the Department of Labor's attempts to impose an ERISA fiduciary standard of care on all broker-dealers and registered investment advisers who provide personalized investment advice and other services to IRAs, 401(k)s and other ERISA-covered plans. The creation of a second competing and distinctly different fiduciary duty for particular types of client accounts will serve only to exacerbate the existing lack of consistency and transparency in our regulatory system. In addition, the DOL's proposal would have enormous unintended consequences by restricting access to personalized investment advice to only those who choose to enter into a fee based investment advisory relationship. Clearly this is the wrong direction.

However, a uniform fiduciary standard alone is not enough. It is also essential that the new standard be carefully designed to preserve investor access to personalized investment advice from a broad range of service providers. Because broker-dealers and investment advisers serve different clientele, offer different services and have different cost structures, we join Ranking Member Barney Frank in opposing efforts to harmonize the regulatory requirements by simply applying the Investment Advisers Act of 1940's implied fiduciary duty to broker-dealers. The '40 Act's fiduciary duty standard has been developed through decades of investment adviser fact-specific case law. Thus, applying the '40 Act's standard of care to the unique clientele, services and cost structure of the independent broker-dealer industry would force these providers to guess as to their specific obligations. This would lead to an unacceptable level of regulatory uncertainty for these firms, significant additional costs, and a resulting loss of access to services and support for small investors.

Therefore, FSI supports the rulemaking framework proposed by the Securities Industry and Financial Markets Association (SIFMA), in which the SEC crafts a set of common core principles of fiduciary conduct that serve as the basis for developing RIA- and B/D-specific regulatory requirements.

The simple promulgation of a new uniform fiduciary standard of care is not enough to protect investors, as some have suggested. This view is dangerously naive, and may even pose a threat to investors, if they lose the ability to make meaningful choices among financial advisors. We need a uniform fiduciary standard of care that also allows for investor choice, especially for small and mid-sized investors who may not need nor want to pay an ongoing fee, but do need ongoing advice and service if they are to meet their financial goals.

We strongly believe that the new uniform fiduciary standard must be designed carefully so as not to disadvantage any segment of the investing public or a particular business model. Because our members' relationships with their clients are uniquely personal, it is essential that the new standard of care recognize the differences between our members' business model and those, for example, of large institutional investment advisory firms. Therefore, we have called on the SEC to ensure that the standard of care is tailored carefully to work for all business models and client relationships, to preserve investors' access to the broadest possible range of choices among financial service providers.

While we believe that sufficient empirical data exists to support a fiduciary standard rulemaking, we ask Congress to ensure that the SEC takes a comprehensive approach to these issues, and to ensure that the SEC works with all interested parties to provide an effective, efficient framework that is flexible enough to last in a changing marketplace, while protecting investors and helping to instill confidence in the nation's capital markets. This comprehensive approach should begin with a rigorous analysis of the current regulatory regime, in order to identify the elements that work well, and those that do not. The analysis should also carefully evaluate the likely consequences of regulatory changes to retail investors, other public investors, and the industry.

As directed by Congress, the SEC's goal should be to improve protection of retail investors, without unnecessary cost increases or reductions in the range of products and services now available. Access to personalized investment advice will only be preserved by controlling the incremental costs associated with the new regulatory standard. Broker-dealers, registered investment advisers and the financial advisors affiliated with them can manage these costs only if they are provided with clear regulatory guidelines that provide the clarity necessary to achieve compliance. Retail customers currently benefit from a diverse array of business models to choose from when seeking personalized investment advice, and any regulatory changes should recognize and preserve those benefits of investor choice.

Thus we believe the implementation of a new uniform standard of care will require three essential elements that will not only enhance investor protection, but also promote access to financial advice and preserve investor choice. These should apply equally to all financial advisors who offer personalized investment advice to retail customers.

First, **clearly articulated rules of conduct**. These will ensure that independent broker-dealers and independent financial advisors know their specific obligations to their retail customers. This, in turn, will allow our members to ensure compliance and preserve investor access to advice and service, while also enhancing predictability and controlling costs. With the new uniform standard of care in place, regulators should follow existing rulemaking procedures to formulate rules of conduct consistent with this standard of care, to be enforced prospectively. Uncertainty and fear of arbitrary or retrospective enforcement will inhibit our members' ability to serve their clients, expand access to advice and service, or develop efficient solutions to investor needs.

Second, clear SEC guidance on the form and content of **client disclosures**. FSI supports effective disclosures, which are good business as well as good public policy, but please note the distinction between "effective" disclosure and "comprehensive" disclosure. Investor understanding should be our goal. Comprehensive disclosure that results in information overload can be the enemy of effectiveness. Clear, concise disclosures help investors make wise choices about their broker-dealer or investment adviser, and the products and services being offered. Therefore, we believe disclosures should be written in plain English, consolidated wherever possible, and appropriate to the level of investor involvement. For example, concise point-of-engagement disclosures should focus on information that will affect a typical investor's decision-making process, not on arcane details of interest to a select few or designed solely to avoid liability. Disclosure statements must provide information about costs, but should balance this information with other relevant considerations.

More detailed disclosure information should be made available to customers through broker-dealer websites or brochures offered free of charge to those without Internet access. Since information overload is always a risk, the amount and frequency of mandated post-engagement disclosures should be balanced in order to make these disclosures more meaningful and effective. Finally, the form of client disclosures should be investor focus group-tested to ensure they provide the information investors want and need in a format they can understand. A layered and measured approach to disclosure will enhance customer understanding and help investors make wise choices about their financial advisors.

Finally, **effective regulatory supervision** must accompany clear regulatory guidelines and effective client disclosures. Our current regulatory structure is dangerously flawed, with significant gaps that must be closed. We discuss this element further below.

Developing an Effective Supervisory System for Investment Advisers

Title IX, Section 914 of Dodd-Frank specifically required the Securities and Exchange Commission to review and analyze the need for enhanced examination and enforcement resources for investors. FSI supports Dodd-Frank's objective of improving examination and enforcement, which seeks to correct a significant regulatory gap that exposes retail investors to possible harm.

The need to address these supervisory issues is grave and immediate. While the SEC and self-regulatory organizations currently examine more than half of the nation's approximately 4,900 registered broker-dealer firms at least once a year, the SEC projects it will examine fewer than 10 percent of the more than 11,000 federally registered investment adviser firms during the fiscal years 2009 and 2010. The percentage of advisers audited is expected to fall to seven percent in 2011. Worst of all, the head of the SEC's examinations program testified in March that "approximately one-third of advisers registered with the SEC have never been examined."

The supervisory disparity between broker-dealers and investment advisers has become much more severe over the past 10 years. Between 1998 and 2002, the SEC examined every retail investment adviser at least once every five years, and made an effort to examine newly registered advisers early in their operations. As the number of RIAs has grown by more than 50% since 2002, the SEC's ability to maintain this schedule has diminished significantly. Except for examinations "for cause" and "sweep" examinations focused on specific risk areas, the examinations they do conduct tend to be limited in scope. Before 2010, the SEC had implemented a risk-based program for selecting RIAs for examination, but suspended this program early last year in favor of an approach that gives examination priority to investment advisers who have been the subject of tips or complaints. The bottom line is that federal regulators simply do not have sufficient personnel or resources to devote to examining these businesses and, as SEC Commissioner Elisse Walter has indicated, this problem will not be resolved through the imposition of user fees.

State supervisory programs are also inadequate. These supervision efforts vary widely, but even the strongest state investment adviser examination program does not provide the same level of oversight broker-dealers receive. The State of Texas, for example, reports that its examiners “try to get to every adviser once every five years.” Meanwhile, Colorado, Georgia, Michigan, Minnesota, South Dakota and West Virginia conduct “desktop” regulatory exams of investment adviser firms. These so-called “exams” involve reviewing the contents of the state regulator’s registration file for the investment adviser in the comfort of the regulator’s own office. Clearly these efforts fall short of reasonable investor expectations for government oversight.

This is not a theoretical dilemma, but a problem with real consequences for retail investors. The State of New York, to cite one example, does not routinely conduct examinations of registered broker-dealers or investment advisers. Bernard Madoff was able to run a massive Ponzi scheme from an office on Third Avenue in New York City, defrauding thousands of institutional and retail investors. The Cohmad Securities Corporation, located within the offices of Madoff’s firm, brought additional investors into the scheme. At no time did the New York Investor Protection Bureau ever examine the offices or activities of either Bernard L. Madoff Investment Securities or the Cohmad Securities Corporation.

While the SEC or a state securities regulator might examine an investment adviser, it is much more likely that the only oversight of an adviser’s activities comes from an internal compliance officer, who may be the investment adviser himself. We believe it is simply unacceptable to allow a huge segment of the financial services industry to engage in self-supervision. Investors who do business with investment advisers deserve the same supervisory protection as their counterparts who invest through broker-dealers.

The SEC recognized these problems in its study and recommended three possible solutions, all of which would require additional authorization from Congress:

- Authorize the SEC to collect user fees from RIAs to generate revenue necessary to fund examinations;
- Authorize the SEC to approve one or more SROs to examine RIAs; or
- Authorize FINRA to examine dual registrants.

Authorizing FINRA as SRO for Retail Investment Advisers

Since the start of the legislative process that resulted in Dodd-Frank, FSI has urged Congress to adopt legislation that would allow the SEC to close the regulatory gap by approving an SRO for retail investment advisers. If adopted, the legislation proposed by Chairman Bachus would accomplish that goal and bring about significant improvements in investor protection and a balanced playing field for all financial advisors. Therefore, FSI supports the adoption of the draft legislation.

In addition to supporting legislation that would authorize the SEC to approve an SRO to examine and supervise retail investment advisers, we have endorsed FINRA to assume the responsibilty of SRO. This approach is based in both practicality and precedent, with several clear benefits for consumers, the industry, and the economy as a whole.

Experience. The SEC has more than 70 years of experience with SROs and, more specifically, with FINRA and its predecessor organization, the National Association of Securities Dealers. In addition to FINRA, the SEC works with and provides an additional level of oversight to the Municipal Securities Rulemaking Board (MSRB), and the Public Company Accounting Oversight Board (PCAOB). Thus, the SRO model has a long proven track record.

Precedent. Sections 15A and 19 of the Exchange Act provide the basic outline of an SRO governance structure and can be adapted to ensure transparent and publicly accountable regulatory structure for retail investment advisers.

A layered regulatory system. A self-regulatory organization for retail investment advisers should mirror the supervisory system in place for broker-dealers. Under this structure, the SEC would review the SRO's supervisory activities, creating a layered regulatory system to provide two levels of oversight. Both the public and the industry would have input into the rulemaking process, preventing disruptions and unintended adverse consequences. Additionally, assigning supervisory responsibilities to FINRA would allow for consolidated examinations of dual-registered firms, limiting disruption and keeping unnecessary regulatory burden to a minimum.

Ease of implementation. FINRA has experience with both regulatory examinations of financial service providers and the operation of an SRO whose governing body, committees and staff act in the public's best interests. As a private-sector organization, it has greater flexibility to set user fees and hire staff as needed. FINRA already has more than 1,000 examiners on staff. Its private funding structure for broker-dealer examinations can serve as a model for funding the examinations of other entities at no additional cost to the taxpayer. If FINRA lacks necessary expertise, it possesses the resources to hire the needed staff.

A proven track record. FINRA has a solid track record of handling complex regulatory responsibilities and a deep understanding of the overlapping financial services provided by organizations registered as both broker-dealers and retail investment advisers.

Targeting of supervisory priorities. Finally, assigning routine examination responsibilities to FINRA would free up SEC resources to focus on capital market concerns, a comprehensive regulatory approach to all regulated industries and the supervision of the SRO itself.

Authorizing FINRA to provide that supervisory protection is the best possible approach and will be a win-win for advisers, investors and the SEC. It will create a supervisory system parallel with the one now in place for broker-dealers, leveling the playing field for industry participants, and providing a consistent level of consumer protection to all investors. More regular examinations will boost investor confidence, especially critical in turbulent economic times. Confident investors are not only better for the industry, but better for the economy overall, and critically important at this economic juncture.

Conclusion

Now more than ever, individual investors need to have confidence in the reliability of the investment advice they receive. The members of FSI do everything within their power, every day, to provide thoughtful investment advice to their clients with integrity and transparency. A new uniform fiduciary standard of care and a coordinated system of enhanced supervisory oversight will provide our members' clients with additional measures of confidence, and will ensure that all Americans have access to competent, affordable financial advice, products and services with the highest possible level of consumer protection.

We urge Congress to take appropriate steps to encourage the adoption of this new uniform standard of care, and to authorize the SEC to partner with a self-regulatory organization such as FINRA, in order to provide enhanced oversight for all registered investment advisers.

Main Street investors deserve an efficient, effective and unified system of oversight when it comes to investment advisers and independent broker-dealers – a smarter system that ensures true consumer protection coupled with access to the best possible independent financial advice. Congress has the opportunity to make that happen, and the members of FSI look forward to working with you toward this goal.

I would be happy to answer any questions the Subcommittee may have.

Background on Independent Broker-Dealers, Independent Financial Advisors and FSI

For more than 30 years, independent broker-dealers and independent financial advisors have brought Wall Street to Main Street, offering comprehensive financial planning services and unbiased, affordable investment advice to millions of individuals, families and businesses large and small. The approximately 201,000 independent financial advisors make up 64% of all practicing registered representatives nationwide, offering services that include financial education, planning, implementation and investment monitoring. While we serve a broad cross-section of clients, our members' typical clients are middle class, Main Street investors – those investing tens or hundreds of thousands of dollars, not millions.

Independent broker-dealers and independent financial advisors also share a number of other business characteristics. They generally clear their securities business on a fully disclosed basis; primarily engage in the sale of packaged products, such as mutual funds and variable insurance products; take a comprehensive approach to their clients' financial goals and objectives; and provide investment advisory services through either affiliated registered investment adviser firms or such firms owned by their registered representatives. The independent business model allows our members to tailor their products and services to support both the small investors opening their first IRAs and the more affluent clients who need more complex wealth management services.

These financial advisors operate as self-employed independent contractors, not as employees of their affiliated broker-dealer firms. They are small business owners with strong ties to their communities. In fact, their standing in their communities is critical to their success, as word-of-mouth and reputation are their primary sources of new clients. Independent financial advisors generally meet their clients in person and provide their services face-to-face or over the telephone, forming personal, trust-based relationships. Thus, independent financial advisors have a powerful incentive to pursue their clients' investment goals with integrity and transparency, and every reason to want to make sure their clients receive personalized investment advice that is in their best interest.

Since 2004, the Financial Services Institute (FSI) has represented the interests of independent financial service firms and independent financial advisors. Through FSI, these financial professionals work together to promote the independent business model and a regulatory environment that serves all its constituents effectively.

Independent broker-dealers and independent financial advisors formed the Financial Services Institute not only to serve as an advocacy organization, but also to be a forum for improving compliance efforts and promoting our business model. FSI is committed to preserving the crucial role of independent broker-dealers and independent financial advisors in helping Main Street Americans plan for their futures and meet their long-term financial goals. As part of this mission, FSI conducts industry surveys and research, and provides a forum for members to share their best practices in compliance, operations, and marketing. FSI also serves as an advocate in Washington, using the information it collects to help shape a regulatory environment that is fair and balanced and serves all its constituents.

United States House of Representatives
Committee on Financial Services

"TRUTH IN TESTIMONY" DISCLOSURE FORM

Clause 2(g) of rule XI of the Rules of the House of Representatives and the Rules of the Committee on Financial Services require the disclosure of the following information. A copy of this form should be attached to your written testimony.

1. Name:	2. Organization or organizations you are representing:
William E. Dwyer III	Financial Services Institute
3. Business Address and telephone number:	
[redacted]	
4. Have you received any Federal grants or contracts (including any subgrants and subcontracts) since October 1, 2008 related to the subject on which you have been invited to testify?	5. Have any of the organizations you are representing received any Federal grants or contracts (including any subgrants and subcontracts) since October 1, 2008 related to the subject on which you have been invited to testify?
☐ Yes ☑ No	☐ Yes ☑ No
6. If you answered .yes. to either item 4 or 5, please list the source and amount of each grant or contract, and indicate whether the recipient of such grant was you or the organization(s) you are representing. You may list additional grants or contracts on additional sheets.	
N/A	
7. Signature: William E Dwyer III	

Please attach a copy of this form to your written testimony.