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MILITARY PERSONNEL FINANCIAL SERVICES PROTECTION ACT

JULY 13, 2006.—Ordered to be printed

Mr. SHELBY, from the Committee on Banking, Housing, and Urban Affairs, submitted the following

R E P O R T

[To accompany S. 418]

The Committee on Banking, Housing, and Urban Affairs reported a bill (S. 418) to protect members of the U.S. Armed Forces from unscrupulous practices regarding sales of insurance, financial and investment products, and for other purposes. The Committee reports, favorably on the bill, as amended by the Committee, and recommends that the bill, as amended, do pass.

INTRODUCTION

In 2004, Committee Chairman Shelby and Ranking Member Sarbanes directed the U.S. Government Accountability Office ("GAO") to assess the range and quality of financial products available to service members on U.S. military installations, the manner in which such products were marketed and sold, and, in particular, whether the regulatory oversight of these offerings differs from the consumer protections provided to the civilian population. The GAO published its findings in "*Financial Product Sales: Actions Needed to Better Protect Military Members*," (GAO–06–23, November 2005).

In its investigation, the GAO found widespread abuses and systemic regulatory failures relating to sales of financial products to service members and urged Congress to pass corrective legislation.

PURPOSE OF THE LEGISLATION

The purpose of the "*Military Personnel Financial Services Protection Act*" ("the Act") is to protect service members from predatory sales practices for financial products and the sale of inappropriate

financial products on U.S. military installations located in this country and overseas.

HEARINGS

On November 17, 2005, the Committee held a hearing entitled "*A Review of the GAO Report on the Sale of Financial Products to Military Personnel*." The following witnesses testified at the hearing: Mr. Richard J. Hillman, Managing Director, Financial Markets and Community Investment, U.S. Government Accountability Office; Ms. Lori Richards, Director, Office of Compliance Inspections and Examinations, U.S. Securities and Exchange Commission; Mr. John Molino, Deputy Under Secretary of Defense for Military Community and Family Policy, U.S. Department of Defense; Ms. Mary Schapiro, Vice Chairman and President, Regulatory Policy and Oversight, NASD; and Mr. John Oxendine, Insurance and Safety Fire Commissioner, State of Georgia.

BACKGROUND AND NEED FOR LEGISLATION

Since the Vietnam War era, members of the Armed Forces have been targets of unscrupulous salesmen marketing costly [1] and superfluous [2] financial products. A select number of small financial services companies, typically employing retired military personnel as sales agents and senior executives, have engaged in abusive practices to sell outdated and inferior insurance, securities, and banking products exclusively to service members. Those companies have directed their sales activities at junior grade enlisted personnel, who are often young, financially unsophisticated, and trained not to question authority figures.

Numerous reports over the past quarter-century, many of them issued by or at the request of the Department of Defense ("DoD" or "Department"), have documented this longstanding exploitation affecting morale, recruitment, and re-enlistment of service members. A comprehensive report issued in 2000 by a retired general retained by DoD found that "for nearly 30 years the sale of life insurance on military bases has been the subject of controversy and repeated violations of [DoD] policies by insurance sales agents." [3] An earlier report by the Navy Judge Advocate General Corps found similar abuses and violations.[4] In addition, securities regulators have been aware of abusive sales practices involving an archaic securities product for decades.

For many years, DoD has been aware of these predatory sales tactics yet has been incapable of curbing them. A 1986 DoD Directive restricts personal solicitations to licensed and approved enti-

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[1] Diana B. Henriques, Basic Training Doesn't Guard Against Insurance Pitch to G.I.'s, *The New York Times*, July 20, 2004, at A1. See also the testimony of Lori Richards, Director, Office of Compliance Inspections and Examinations, U.S. Securities and Exchange Commission, before the Committee on Banking, Housing, and Urban Affairs, U.S. Senate, November 17, 2005, at 7–11.

[2] For example, many service members who are young and unmarried likely do not need to purchase additional life insurance to supplement the coverage available to them under the government-subsidized program.

[3] *Insurance Solicitation Practices on Department of Defense Installations* (the "Cuthbert Report"), Final Report Presented to the Deputy Under Secretary of Defense for Program Integration, May 15, 2000, p. iv. See also the Written Statement of Mr. John Molino, Deputy Under Secretary of Defense for Military Community and Family Policy, before the Committee on Banking, Housing, and Urban Affairs, U.S. Senate, November 17, 2005, at 3–4.

[4] Litigation Report, *Investigation of NCOA Standard Procedures for Selling Insurance*, November 19, 1997.

ties that have arranged meetings with particular customers.[5] The Directive prohibits, among other practices, solicitation of recruits, trainees, and transient personnel in a "mass" or "captive" audience, using misleading advertising and sales literature, and giving the appearance that DoD endorses any particular company.[6] Despite these prohibitions, solicitation violations occur routinely. For example, DoD's Inspector General randomly visited 11 military installations in a 1999 investigation and found violations of the Department's solicitation policies at all 11 bases.[7] The violations included misleading sales presentations, presentations by unauthorized personnel, presentations to captive audiences, solicitations during duty hours, solicitations in the barracks, and solicitations in other unauthorized areas.[8] Sanctions against violators have been rarely imposed, and when imposed, have been weak.[9]

Rampant sales practice abuses continued unabated after 1999, according to the GAO investigation ordered by Senators Shelby and Sarbanes. The GAO found that a half-dozen financial services companies target junior enlisted service members, even those in basic training, with a product that combines high-cost life insurance and a savings fund. Most of the purchasers of this product—unmarried individuals with no dependents—did not need the additional life insurance coverage.[10] In addition, given the way the product was designed, few purchasers accumulated any savings due to the frequent relocations and short tenures that are a staple of military service.[11] Moreover, the life insurance policy was often intentionally and misleadingly marketed as an investment product; salesmen failed to disclose that service members were actually purchasing life insurance. Many state regulators, prompted by GAO's investigation to review the insurance offerings available in their jurisdictions, subsequently held that the product, although previously approved, was in fact illegal under existing insurance laws.[12]

Addressing these longstanding abuses at this moment is particularly timely. Solicitation violations involving members of the Armed Forces may intensify during times of war, when service members' keen interest in life insurance provides increased selling opportunities for sales agents.

As indicated above, it is beyond dispute that DoD's commercial solicitation rules, adopted to protect service members from unethical sales conduct, have failed to curb the well documented abuses.[13] It is the Committee's hope and expectation that the revised policies will protect service members. But even if the results of the past three decades are reversed and the updated DoD rules are suddenly enforced effectively, the Committee believes that leg-

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[5] DoD Directive 1344.7, *Personal Commercial Solicitation on DoD Installations*, February 13, 1986, at Sect. 6.1. Revised policy guidelines, DoD Instruction 1344.07, will likely go into effect later this year.

[6] Ibid., at Sect. 6.4.

[7] Office of the Inspector General, Department of Defense, *Commercial Life Insurance Sales Procedures in DoD*, Report No. 99–106, March 10, 1999, at 5.

[8] Ibid., at 27–30.

[9] Henriques, op. cit., at A1.

[10] U.S. Government Accountability Office, *Financial Product Sales: Actions Needed to Better Protect Military Members* ("GAO report"), November 17, 2005, at 12–20.

[11] One of the features of the product stipulated that, in the event a service member stops making payments and fails to request a refund, the money accumulated in the savings fund is directed to paying continuing life insurance premiums.

[12] GAO, op. cit., at 12–20. The explanation offered by the state regulators was that various features of the product in question had been submitted separately for approval.

[13] Even DoD acknowledges this point. See e.g., Molino, op. cit., at 3–4.

islation is necessary to enact the important policy changes included in the Act.

To protect service members from unsuitable products, the Act bans the sale of the mutual fund contractual plan, an obscure investment vehicle that virtually disappeared from the civilian market 25 years ago due to its unusually high and front-loaded sales charge. The hallmark of contractual plans is a sales load of 50 percent, paid by the investor to the broker selling the plan, assessed against the first year of contributions. Created so that investors able to make only small monthly contributions could reap the rewards of stock market investing, contractual plans have been associated with rampant abuses since their introduction in 1930.[14] In the 1960s, the SEC asserted that contractual plans were likely to be unsuitable products for investors of modest means[15] and recommended that Congress abolish the front-end load on contractual plans.[16]

In recent years, the contractual plan has fallen further into disrepute. In its report, released at the November 2005 hearing, the GAO identified several reasons supporting its recommendation urging Congress to ban contractual plans. First, less-costly and widely accessible alternatives exist for small investors to begin and maintain investments in mutual funds, particularly no-load funds available to service members through the Thrift Savings Plan, the defined contribution retirement program for federal employees. Second, only 10 to 43 percent of investors that purchased contractual plans between 1980 and 1987 had completed the full 15 years required under the contract. The investors who did not complete the contract paid much higher effective sales loads than investors in conventional mutual funds. Third, and perhaps most important, contractual plans have been associated with sales practice abuses for decades.[17]

Vanguard Group Founder John C. Bogle has stated that he would never recommend contractual plans to an investor.[18] A Morningstar fund analyst agreed, asserting that "there are really no advantages to these contractual plans; they are old fashioned, based on old ideas of how to force people to commit to systematic investing."[19] NASD expressed support for a ban on contractual plans; its Vice Chairman, Ms. Schapiro, testified that "[w]e agree with Senator Enzi that the excessive sales charges of these contractually-based financial products make them susceptible to abusive and misleading sales practices and that a small group of individuals have targeted these products almost entirely to the military."[20] For these reasons, the Committee believes that service members will benefit from a prohibition on contractual plans.

To improve the quality of life insurance products offered in the military market, the Act directs the National Association of Insur-

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[14] Securities and Exchange Commission, Public Policy Implication of Investment Company Growth, at 224 (1966).

[15] H.R. Doc. No. 95, 88th Cong., 1st Sess., at 207 (1963).

[16] H.R. Rep. No. 2337, 89th Cong., 2d Sess., at 246–247 (1966).

[17] GAO, op. cit., at 12–13.

[18] Henriques, op. cit., at A1.

[19] Gary S. Mogel, *Congress Questions Sale of High-Fee Funds to Military: Contractual Plans Come Under Scrutiny*, Investment News, Vol. 8, Issue 34, Sept. 13, 2004, at 21.

[20] Testimony of Ms. Mary Schapiro, Vice Chairman and President, Regulatory Policy and Oversight, NASD, before the U.S. Senate Banking, Housing, and Urban Affairs Committee, November 17, 2005, at 6.

ance Commissioners ("NAIC") to consider ways to ensure that such products comply with state laws and are appropriate for the particular needs and circumstances of service members. GAO supports this provision.[21]

In its report, the GAO concluded that inadequate information sharing between state and Federal financial regulators and DoD was the primary reason that regulators did not generally identify the problematic sales of financial products to service members.[22] To address this issue identified by GAO, the Act requires the establishment and maintenance of a registry that lists all brokers and agents who have been barred or otherwise restricted from military bases and is accessible to installation commanders and state and Federal financial regulators. Regulators will be notified promptly whenever a person under their jurisdiction is added to or removed from the registry.

To remove any legal and regulatory uncertainty relating to who has jurisdiction over financial product sales on military installations of the U.S., a problem identified by the GAO, the Act clarifies that state insurance and state securities laws apply to insurance and securities activities conducted on Federal lands and facilities, including military installations.[23]

To help ensure that military consumers make informed financial decisions, the Act requires insurance agents to make a comprehensive series of written disclosures prior to making a sale or solicitation of life insurance products on a military installation. The sales agent must disclose: the availability, amount, and cost of term life insurance under Servicemembers' Group Life Insurance program ("SGLI"); the fact that the Federal Government has not sanctioned, recommended, or encouraged the sale of the life insurance product being offered; any terms stipulating that amounts accumulated in a savings component of the life insurance product may be diverted to pay, or reduced to offset, premiums due for continuation of coverage under such product; and the fact that no person has received any referral fee or incentive compensation in connection with the offer or sale of the life insurance product. The Act also authorizes military personnel, or their dependents, to cancel the policy if there are violations of this section. Finally, agents and companies intentionally violating or willfully disregarding the provisions of this section—as determined by a state or Federal agency or in a final court proceeding are banned from selling insurance to Federal employees on Federal land. The Committee believes that these provisions will help service members make better-informed decisions regarding life insurance products.

COMMITTEE CONSIDERATION

On June 14, 2006, the Senate Committee on Banking, Housing, and Urban Affairs considered a Committee Print offered by Chairman Shelby that revised the base text of S. 418, the "Military Personnel Financial Services Protection Act," sponsored by Senator Enzi. In addition to the Chairman's substitute text, the Committee

[21] GAO, op. cit., at 59.

[22] GAO, op. cit., at 59. Insurance regulators in most states generally rely on complaints from purchasers to indicate that potentially problematic sales are occurring. Securities regulators suffered from a similar lack of complaint sharing from DoD personnel.

[23] GAO, op. cit., at 59.

adopted one amendment, by voice vote. The amendment, offered by the Chairman, along with Ranking Member Sarbanes, Senator Enzi, and Senator Schumer, made conforming and other changes to the Committee Print. On a unanimous vote, the Committee reported the bill, as amended, to the Senate for consideration.

SECTION-BY-SECTION ANALYSIS OF THE ACT

Section 1. Short Title; Table of Contents

This section provides the short title, "*Military Personnel Financial Services Protection Act*," and the table of contents for the Act.

Sec. 2. Congressional findings

This section asserts that regulation of high-cost securities and life insurance products marketed to members of the Armed Forces by some financial services companies engaging in abusive and misleading sales practices has been inadequate and requires Congressional legislation.

Sec. 3. Definitions

This section defines "life insurance product" as "any product, including individual and group life insurance, funding agreements, and annuities, that provides insurance for which the probabilities of the duration of human life or the rate of mortality are an element or condition of insurance." The term includes the granting of (i) endowment benefits; (ii) additional benefits in the event of death by accident or accidental means; (iii) disability income benefits; (iv) additional disability benefits that operate to safeguard the contract from lapse or to provide a special surrender value, or special benefit in the event of total and permanent disability; (v) benefits that provide payment or reimbursement for long-term home health care, or long-term care in a nursing home or other related facility; (vi) burial insurance; and (vii) optional modes of settlement or proceeds of life insurance. The term excludes workers compensation insurance, medical indemnity health insurance, and property and casualty insurance.

Sec. 4. Prohibition on future sales of periodic payment plans

This section amends section 27 of the Investment Company Act of 1940 by banning the issuance and sale of periodic payment plan certificates, effective 30 days after the date of enactment of the Act. This section preserves preexisting rights related to existing plans. These preexisting rights, which existed prior to the effective date of this legislation on periodic payment plan certificates, might include administrative transactions, conversions, transfers, or amount or name changes.

It also directs the SEC to submit a report to Congress within six months of enactment on refunds, sales practices, and revenues from periodic payment plans over the five years preceding the date of the report.

Sec. 5. Required disclosures regarding offers or sales of securities on military installations

This section amends section 15A(b) of the Securities Exchange Act of 1934 by directing NASD to issue rules requiring brokers on

military installations to clearly and conspicuously disclose that the securities offered are not offered or provided on behalf of, or recommended, sanctioned or encouraged by the Federal Government, and the identity of the registered broker-dealer offering the securities. The rules must also require brokers to perform an appropriate suitability determination, including consideration of costs to the potential investor and the potential investor's knowledge about securities, prior to making a recommendation to a member of the Armed Forces. Finally, the rules must prohibit referral fees or incentive compensation to persons not associated with a registered broker-dealer.

Sec. 6. Method of maintaining broker and dealer registration, disciplinary, and other data

This section amends section 15A(i) of the Securities Exchange Act of 1934, which requires a registered securities association to maintain a toll-free telephone listing to receive inquiries regarding disciplinary actions involving its members and their associated persons, and to respond to those inquiries in writing. The amended language requires the association to establish an easily accessible electronic or other process, in addition to the toll-free telephone listing, to respond to inquiries about registration information. The registered securities association also will be required to adopt rules relating to inquiries and responses, and on the establishment of an administrative process for disputing the accuracy of registration information. Consistent with current law, the association and participating exchanges will not be liable to any persons for actions taken or omitted in good faith under this provision.

Sec. 7. Filing depositories for investment advisers

This section reorganizes and codifies in section 204 of the Investment Advisers Act of 1940 provisions of the National Securities Markets Improvement Act of 1996, in which Congress directed the SEC to establish an electronic filing system, and mandated the creation of a public disclosure program, for investment advisers. Pursuant to this directive, the SEC designated NASD to operate the electronic filing system, which is called the Investment Adviser Registration Depository ("IARD"), and created an Internet-based public disclosure program containing investment adviser registration and disciplinary information.

This section codifies the SEC's designation of NASD as the operator of the IARD, although it requires a toll-free telephone listing, or electronic means, for receiving and responding to inquiries for registration information. It also provides NASD with immunity from liability for actions taken in good faith in operating the investment adviser public disclosure program.

Sec. 8. State insurance and securities jurisdiction on military installations

This section clarifies that state insurance laws and state securities laws apply with certain exceptions to insurance and securities activities conducted on Federal land and facilities, including military installations in the U.S. and abroad. The state within which the base is located would have primary jurisdiction in cases when multiple state laws would otherwise apply. With respect to over-

seas military bases, the state that issued the resident license of the agent in question and the state in which the insurance company in question is domiciled would have jurisdiction.

Sec. 9. Required development of military personnel protection standards regarding insurance sales; administrative coordination

This section states Congress' intent that the states collectively work with the Secretary of Defense to ensure implementation of appropriate standards to protect service members from dishonest and predatory insurance sales practices while on military installations in the U.S. and abroad. Congress also intends that each state identify its role in promoting these standards in a uniform manner, not later than 12 months after the date of enactment of this Act. This section includes a sense of Congress that the NAIC should conduct a study to determine the extent to which the states have met the requirement of developing such standards and report the results to Congress. It also includes a second sense of Congress that senior representatives of the Secretary of Defense, SEC, and NAIC should meet at least twice each year to coordinate their activities to implement this Act and monitor enforcement of relevant regulations relating to the sale of financial products on U.S. military installations.

Sec. 10. Required disclosures regarding life insurance products

This section requires the following information to be disclosed, in plain English and appropriate font size, prior to a sale or solicitation of life insurance to service members on a military installation of the U.S.: (i) that subsidized life insurance is available from the Federal Government under SGLI; (ii) the amount of insurance coverage available under SGLI and the costs to the member of the Armed Forces for such coverage; (iii) that the Federal Government is not offering or providing and has not sanctioned, recommended, or encouraged the sale of the life insurance product being offered; (iv) any terms stipulating that amounts accumulated in a savings component of the life insurance product may be diverted to pay, or reduced to offset, premiums due for continuation of coverage under such product; (v) that no person other than a licensed agent of the issuer of the product has received any referral fee or incentive compensation in connection with the offer or sale of the life insurance product; and (vi) in the case of solicitations on military installations outside the U.S., the address and phone number of the location where consumer complaints are received by the state insurance commissioner with primary jurisdiction over the sale of the products in question. This section also allows military personnel, or their dependents, to cancel the policy if there are violations of this section. Agents and companies intentionally violating or willfully disregarding the provisions of this section—as determined by a state or Federal agency or in a final court proceeding—are banned from selling insurance to Federal employees on Federal land.

Sec. 11. Improving life insurance product standards

This section expresses the sense of Congress that the NAIC should, not later than six months after enactment of the Act, after consultation with the Secretary of Defense, study and report to Congress on ways of improving the quality of and sale of life insur-

ance products on military installations. The NAIC is directed to consider limiting such sales authority to persons that are certified as meeting appropriate best practices procedures, creating standards for products specifically designed for members of the Armed Forces, regardless of the sales location, and the extent to which life insurance products marketed to members of the Armed Forces comply with otherwise applicable provisions of state law. If the NAIC fails to submit the report within six months of the date of enactment, the GAO is to issue the report.

Sec. 12. Required reporting of disciplinary actions

This section requires insurers serving the military market to implement a system, within one year of enactment of the Act, to report to the appropriate state insurance commissioner any disciplinary actions that the insurer knows or in the exercise of due diligence should have known were taken against agents by government entities or insurers (only "significant" actions taken by insurers) with respect to the sale or solicitation of insurance on military installations. Also, this section expresses the sense of Congress that the states should collectively implement a system within one year to receive such reports of disciplinary actions and to disseminate such information to all other states and to the Secretary of Defense. This section defines "insurer" as a "person engaged in the business of insurance."

Sec. 13. Reporting barred persons selling insurance or securities

This section requires the Secretary of Defense to maintain a list of the names, addresses, and other appropriate information relating to persons engaged in financial services activities that have been barred or otherwise restricted from military bases or have engaged in any transaction prohibited by the Act. The registry must be accessible to installation commanders and appropriate Federal and state securities and insurance regulators. These regulators shall be notified promptly upon the inclusion or removal of a person under their agencies' jurisdiction. The Defense Secretary shall submit proposed regulations implementing this registry to Congress within 60 days of enactment of the Act and draft final regulations within 90 days. The proposed regulations may not be published until the expiration of 15 days from the date of submission. The final regulations may not be published until 30 days from the date of submission.

Sec 14. Study and reports by Inspector General of the Department of Defense

This section requires DoD's Inspector General to conduct a study on the impact of DoD's Instruction 1344.07 (as in effect on the date of enactment of the Act) and the reforms included in the Act on the quality and sales of securities and insurance products marketed or otherwise offered to members of Armed Forces.

CHANGES IN EXISTING LAW (CORDON RULE)

On June 14, 2006, the Committee unanimously approved a motion by the Chairman to waive the Cordon rule. Thus, in the opinion of the Committee, it is necessary to dispense with the require-

ment of section 12 of rule XXVI of the Standing Rules of the Senate in order to expedite the business of the Senate.

REGULATORY IMPACT STATEMENT

In accordance with paragraph 11(b), rule XXVI, of the Standing Rules of the Senate, the Committee makes the following statement concerning the regulatory impact of the bill.

The Act seeks to protect members of the Armed Forces from unethical sales of superfluous financial products. It would result in no significant costs to either the Federal Government or state, local, and tribal governments. The Act's provisions banning contractual plans, requiring life insurance disclosures, establishing suitability rules for securities sales to military members, and providing Internet access to brokers' disciplinary records would impose mandates on the private sector resulting in de minimis costs.

COST OF LEGISLATION

Section 11(b) of rule XXVI of the Standing Rules of the Senate, and Section 403 of the Congressional Budget Impoundment and Control Act, require that each committee report on a bill contain a statement estimating the cost of the proposed legislation. The Congressional Budget Office has provided the following cost estimate and estimate of costs of private-sector mandates.

U.S. CONGRESS,
CONGRESSIONAL BUDGET OFFICE,
Washington, DC, June 23, 2006.

Hon. RICHARD C. SHELBY,
Chairman, Committee on Banking, Housing, and Urban Affairs, U.S. Senate, Washington, DC

DEAR MR. CHAIRMAN: The Congressional Budget Office has prepared the enclosed cost estimate for S. 418, the Military Personnel Financial Services Protection Act.

If you wish further details on this estimate, we wi1l be pleased to provide them. The CBO staff contacts are Gregory Waring (for federal costs), and Craig Cammarata (for the private-sector impact).

Sincerely,

DONALD B. MARRON,
Acting Director.

Enclosure.

S. 418—Military Personnel Financial Services Protection Act

Summary: S. 418 would ban the sale of mutual funds sold though contractual plans. The bill also would require insurance companies to provide certain notices about insurance policies offered by the U.S. government when selling an insurance policy to servicemembers or while marketing on military installations. The bill would require the Department of Defense to maintain a list of agents and advisors barred from doing business on military installations. Finally, the bill would amend securities law to require registered securities associations to provide public access to certain consumer information and to file certain financial information with the Securities and Exchange Commission.

CBO estimates that implementing S. 418 would result in no significant cost to the Federal Government and would not affect direct spending or revenues.

S. 418 contains no intergovernmental mandates as defined in the Unfunded Mandates Reform Act (UMRA); any costs to state, local, or tribal governments would be voluntary.

S. 418 contains private-sector mandates, as defined in UMRA. related to the sales of mutual fund and life insurance products. Based on information provided by industry and government sources, CBO expects that the aggregate direct costs of complying with those mandates would fall below the annual threshold established by UMRA for private-sector mandates ($128 million in 2006, adjusted annually for inflation).

Estimated cost to the Federal Government: CBO estimates that implementing S. 418 would result in no significant cost to the Federal Government and would not affect direct spending or revenues.

Estimated impact on state, local, and tribal governments: S. 418 contains no intergovernmental mandates as defined in UMRA. The bill would encourage, but not require, state insurance regulators to coordinate with the Department of Defense to protect military personnel from predatory life insurance schemes and to issue a report to the Congress. Based on information from state insurance commissioners, CBO estimates that the costs of such cooperation would not be significant.

Estimated impact on the private sector: S. 418 would impose private-sector mandates as defined in UMRA on registered investment companies, registered securities associations, insurers and those selling life insurance products to members of the Armed Forces on military installations of the United States. Specifically, the bill would impose mandates by:

- Prohibiting the sales of periodic payment plan certificates;
- Requiring insurers and producers of life insurance products to make certain disclosures when selling or soliciting life insurance products on military installations;
- Requiring a registered securities association to include new rules governing the sales of securities on the premises of military installations; and
- Requiring a registered securities association to provide an electronic or other process to receive and respond to inquiries about disciplinary actions taken against brokers and dealers.

CBO estimates that the aggregate direct costs of the private-sector mandates in the bill would fall below the annual threshold established by UMRA ($128 million in 2006, adjusted annually for inflation).

Prohibition on the sales of periodic plan certificates

Purchasers of periodic payment plan certificates make monthly investment payments into mutual funds, typically for a period of 15 years or more. Under current law, the Investment Company Act limits the sales load on such certificates to 9 percent of the total payments to be made during the life of the plan, but allows that sales load to be significantly front-loaded.

Specifically, up to half of the monthly investment payments made in the first year may be deducted for sales load. According to industry sources, current practice is to charge a sales load that

amounts to 3.3 percent of the total payments expected to be made over the life of the plan, and to collect that sales charge for the entire plan period by deducting half of the first 12 investment payments.

S. 418 would impose a private-sector mandate on registered investment companies by prohibiting them from selling any more periodic payment plan certificates. The cost of complying with the mandate would be the income (sales load) forgone net of any operating expenses to generate that income. Based on information from industry sources on sales in 2003 and 2004, CBO estimates that the annual sales load that would be forgone by the prohibition of new sales of periodic payment plan certificates would range between $30 million and $35 million. CBO was unable to obtain sales data for 2005, but according to industry sources, sales decreased significantly from 2004 and are expected to continue to decrease in the future in the absence of this bill. Thus, the expected loss of income from the prohibition of sales of such products would be lower than the amounts presented using 2004 data.

Disclosure and inquiry response requirements

The bill also would impose private-sector mandates regarding additional disclosures by those selling life insurance or securities products on military bases, and responses to inquiries about broker or dealer registration information. Based on information from industry and government sources, CBO estimates that the direct cost to comply with those mandates would be small. Those mandates would:

- Require insurers and producers of life insurance products selling or soliciting those products on military installations to provide a written disclosure to the consumer that subsidized life insurance may be available from the Federal Government, and that the U.S. government has in no way sanctioned, recommended, or encouraged the product being offered;
- Require a registered securities association to include provisions, within the rules of the association, governing the sales, or offer of sales, of securities on the premises of any military installation to any member of the Armed Forces; and
- Require a registered securities association to establish and maintain a readily accessible electronic or other process to respond to inquiries regarding registration information about brokers and dealers and their associated persons, including disciplinary actions taken against them.

Previous CBO estimates: On April 4, 2005, CBO transmitted a cost estimate for H.R. 458, the Military Personnel Financial Services Protection Act, as ordered reported by the House Committee on Financial Services on March 16, 2005. S. 418 is nearly identical to H.R. 458. H.R. 458 does not include the mandate that would require associations registering as a national securities association to include new rules regarding the sales of securities on the premises of military installations. CBO concluded that the cost of the private-sector mandates in both bills would not exceed the threshold established by UMRA.

Estimate prepared by: Federal Costs: Gregory Waring; Impact on state, local, and tribal governments: Sarah Puro; Impact on the private sector: Craig Cammarata.

Estimate approved by: Peter H. Fontaine, Deputy Assistant Director for Budget Analysis.

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