



U.S. SENATE COMMITTEE ON

Finance

SENATOR CHUCK GRASSLEY, OF IOWA - CHAIRMAN

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For Immediate Release

Wednesday, May 31, 2006

Grassley Questions Nonprofit Investment Group's Practices, Seeks IRS, SEC Comment

WASHINGTON – Sen. Chuck Grassley, chairman of the Committee on Finance, is concluding a review of a nonprofit investment association's practices by referring his concerns to the Internal Revenue Service (IRS) and the Securities and Exchange Commission (SEC) for review and comment.

For the past several months, Grassley has been reviewing the National Association of Investors Corp. (NAIC), a nonprofit group based in the Detroit suburb of Madison Heights. The group, now known as BetterInvesting, says it has 161,670 members, including members in 16,174 investment clubs nationwide, and a total members' investment portfolio of \$117 billion. Grassley is concerned that this group – like some other nonprofit groups he has reviewed – has a lack of independence between its nonprofit and for-profit entities, over-compensated its employees, and tried to stifle a whistleblower who questioned expenses.

"Tax-exempt status is a privilege that has to be earned," Grassley said. "There has to be a clear, bright line between non-profit activity for the public good that deserves tax-exempt status and for-profit activity that should be taxed like any other business. I've been working to draw the line more clearly, and I hope the IRS and the SEC will continue to help."

Grassley has developed a package of charitable giving incentives and improvements to nonprofit practices to help protect charities from individuals who abuse them for personal gain. He is working to get the package enacted as soon as possible, with the strong support of charities nationwide.

Following is the text of his letters today to the NAIC and the SEC.

May 31, 2006

Richard A. Holthaus, President and CEO
National Association of Investors Corp.
711 West 13 Mile Road
Madison Heights, MI 48071

Dear Mr. Holthaus:

In your letter dated March 6, 2006, you highlight the Corporate Governance Initiatives that the National Association of Investors Corporation (“NAIC”) has recently implemented. I appreciate NAIC’s efforts to examine itself and institute changes. However, it is troubling that these changes would not have occurred but for the Senate Finance Committee’s (“Committee”) investigation of NAIC.

You state that NAIC’s current structure, operations and activities remain in compliance with and consistent with its tax-exempt mission. However, my staff’s review of the documents NAIC provided in response to my letters leads to the following observations and questions. As you are aware, it is not the Committee’s responsibility to conclude whether these activities are in fact illegal or impermissible. Thus, the Committee is providing copies of this letter to the Securities and Exchange Commission (“SEC”) and the Internal Revenue Service (“IRS”) for their comments and evaluation.

NAIC’S Educational Activities

NAIC was founded in 1951 and requested tax-exempt status under section 501(c)(3) of the Internal Revenue Code (“IRC”) during the 1970’s. The IRS denied this request for reasons not immediately known. NAIC asked for reconsideration in 1998 and IRS approved NAIC’s application in which NAIC states that its mission is “to educate the masses in the principles of investing.” NAIC sought IRS reconsideration of its tax-exempt status in 1998 for the following reasons:

- 1) The broad educational nature of the NAIC which is recognized and respected by public officials, including those at the SEC;
- 2) The then current public attitude toward investment education, which included growing demand for investor education across middle-class America;
- 3) The IRS’ approval of tax-exempt status in May 1998 of Alliance for Investor Education (“AIE”), an organization of which NAIC was a member; and,
- 4) The IRS’ approval of tax-exempt status of other investment education entities, including the American Association of Individual Investors (“AAII”), which was also a member of the AIE

NAIC’s primary sources of revenues are membership dues, product sales and advertising revenue. It does not appear that NAIC’s activities changed significantly since its founding in 1951 or since IRS’ initial denial of tax-exemption. Thus, this raises questions about the IRS’s rationale in granting NAIC tax-exemption.

NAIC justifies its tax-exempt status by comparing itself to AIE and AAII. It is not clear whether these organizations also began as taxable entities, whether they maintain complex organizational structures similar to NAIC, and whether they also maintain close ties to publicly traded mutual funds.

Trustee Compensation, Independence & Conflicts of Interest

My staff prepared the attached list of NAIC’s trustees and their positions with NAIC affiliated organizations. According to this analysis, there are at least seven other entities that are situated at

NAIC's headquarters and there are five NAIC trustees that are directors of five or more of these other seven entities. My staff's review of the tax returns of all seven entities indicates that of these seven, only Growth Fund Advisor ("Advisor") and the NAIC Growth Fund ("Fund"), both for-profit entities, appear to be active. This raises questions as to whether NAIC's board is sufficiently independent to ensure that NAIC's mission takes priority over the success of the Advisor and the Fund.

NAIC states that "[l]egal, accounting, public relations, communications, marketing, human resources and systems consulting contracts are typically not bid out due to NAIC's requirement of a very high level of expertise and service specific to the NAIC's individual needs." This is troubling because the majority of NAIC's initial and founding trustees remained active in NAIC after it became tax-exempt and it appears that they rely on longstanding relationships for key services.

For example, NAIC chose to pay Mr. Lewis Rockwell, Secretary of NAIC, \$5,000 a month because he was providing legal services that his old law firm used to provide for NAIC. It appears that NAIC stopped these payments as a result of the Committee's investigation and it has decided that non-management trustees will no longer be compensated by NAIC beyond a nominal stipend for meeting attendance. While NAIC's actions in this area are appreciated, it was not NAIC's decision to compensate Mr. Rockwell for his legal services that was troubling in this situation. Rather, it was that his legal services were not considered separately from his duties as Secretary when his compensation was determined. There are benefits to retaining the legal expertise of someone who is intimately familiar with your organization. However, this raises questions as to whether compensation for such a person can be determined at arms-length when that person is a trustee and his compensation is determined by fellow trustees who are his friends.

It is also troubling that you yourself were a trustee of NAIC prior to becoming President and CEO of NAIC. This raises questions as to whether your contract really was negotiated at arms-length. In addition, the fact that NAIC's fees paid to your old employer, Fleishman-Hillard, increased from a little over \$13,000 for the year 2000 to close to \$200,000 for the year 2004 raises further questions as to whether such compensation can be negotiated at arms-length when one of the key factors in selecting a vendor is a long-standing relationship.

There are two other NAIC transactions that raise concerns. First, the contract with Mort Crimm Communications for the television program was executed prior to NAIC's implementation of a purchasing policy. Second, it appears that NAIC executed an employee benefits contract with Sigma, which was not bid out according to the NAIC's no-bid policy for professional services. There appear to be at least four ties between Sigma and NAIC or NAIC trustees: a) a Sigma employee was a former NAIC advisory board member; b) three members of Sigma are members of the Editorial and Stock Selection Committee for NAIC's publication *Better Investing Magazine*; c) a Sigma principal is a member of the Mutual Investment Club of Detroit of which NAIC trustees Thomas O'Hora, Kenneth Janke and Richard Holthaus are founders and/or members, and d) NAIC trustee Ruberta Hague was previously affiliated with Sigma.

Use of NAIC Assets for Activities of the Advisor and the Fund

Review of the tax returns also indicates that neither the Advisor nor the Fund has its own employees. Rather, it appears that the Fund pays an advisory fee to the Advisor which incurs the Fund's expenses and that the Advisor reimburses NAIC for its primary expenses which are human resources and officers and directors insurance policies.

NAIC's Form 990 for the year ended September 30, 2004, indicates the average hours worked per week to be the following: Thomas O'Hora – 20 hours, Kenneth Janke – 48 hours, Lewis Rockwell – 3 hours and Richard Holthaus – 55 hours. In light of the duties and responsibilities these individuals have with respect to the Advisor and the Fund, the accuracy of these numbers is questionable. It is not clear how these individuals can devote this much to time NAIC while simultaneously actively managing a \$25 million mutual fund.

It appears that neither the Advisor nor the Fund reimburses NAIC for office space, equipment, utilities, or other expenses that they would incur if they maintained separate offices. It also appears that the Fund was initially incorporated under the name "Better Investing Fund" before changing its name to the NAIC Growth Fund and that it appears that NAIC does not receive any royalties or licensing fees for the use of its name. These facts could indicate that NAIC assets may be being used impermissibly for the benefit of the Advisor and the Fund.

Employee Compensation & Benefits

It appears that that NAIC has chosen to eliminate your country club membership and automobile lease. However, other directors continue to receive benefits such as social club memberships, company cars and entertainment expense accounts. While such benefits may be equally common in non-profit and for-profit entities, Congress casts a hard eye on such expenditures with respect to for-profit entities. The tax code prohibits for-profit entities from deducting such expenses for tax purposes. Thus, it raises the question of whether these should be legitimate expenses for charities and whether IRS should permit these to be included in the calculation of "program service" expenses.

Such benefits indicate that NAIC thinks and operates more like a for-profit corporation than a charity. For example, it is not clear how membership dues for the Detroit Athletic Club or the National Investor Relations Institute further NAIC's charitable mission.

My staff's review of your compensation agreement raises further questions. It appears that NAIC hired a compensation consultant to assist NAIC with your hiring and that NAIC appears to have jumped through all of the hoops required by Internal Revenue Code ("IRC") section 4958. However, the fact that your compensation consultant studied the salaries of executives of other investment education organizations does not provide comfort. It just raises the question of whether the other organizations are over-compensating their executives, particularly since it appears that some of these organizations are smaller than NAIC. It is also troubling that the president and CEO of NAIC - an organization with less than a hundred employees - receives compensation that is not much different from that of the president and CEO of the American Red Cross, which is a much larger and much more complex organization than NAIC. Further, contract terms such as signing bonuses and NAIC's guarantee of your former employer's bonuses indicate that there is no difference between being an executive of a for-profit entity and being an executive of a charitable organization.

Whistleblower Policy

I am encouraged that NAIC has adopted a new whistleblower policy. However, the fact that the only trustee to be removed in NAIC's history was a long-time trustee who questioned expenditures supported by other key trustees raises significant concerns. It appears that NAIC trustees unanimously voted to remove Robert Seger after he continued to question certain NAIC's expenses. It also appears that Mr. Seger's concerns were echoed by several of NAIC's members. This is again

indicative that trustees and executives who are longtime friends can wield significant control over an organization's operations. I hope that NAIC's new whistleblower policy remedies this situation and provides an effective means for trustees, employees and members to be heard.

I thank you for NAIC's cooperation with the Committee's investigation. Please note that the Committee is not seeking any more information with respect to NAIC's activities but would appreciate being informed of all actions NAIC may take in response to this letter. Should you have any questions, please do not hesitate to contact the staff of the Committee.

Sincerely,

Charles E. Grassley
Chairman

Attachment 1

cc: The Honorable Christopher Cox, Chairman, Securities & Exchange Commission
Lois Lerner, Director, Internal Revenue Service, Office of Exempt Organizations

May 31, 2006

The Honorable Christopher Cox, Chairman
Securities and Exchange Commission
Attn: Office of Investor Education and Assistance
100 F Street, NE
Washington, DC 20549

Dear Chairman Cox:

Enclosed please find a copy of a letter I recently sent the to National Association of Investors Corporation ("NAIC") highlighting questions and concerns regarding NAIC's operations and activities. I would appreciate receiving comments from the Securities and Exchange Commission ("SEC") on the issues raised in this letter as well as answers to the following questions.

- 1) Does the SEC endorse investor education organizations? If yes, please provide details on the SEC's policies and procedures on endorsement.
- 2) Is the Alliance for Investor Education or the American Association of Individual Investors affiliated, directly or indirectly, with any regulated investment companies?
- 3) Are there any general SEC policies governing investor education organizations, tax-exempt or otherwise?
- 4) Are there any SEC policies governing conflicts of interest between directors of investor education organizations and related regulated investment companies or other public companies?

I would appreciate receiving a response within thirty days.

Sincerely,

Charles E. Grassley

Chairman

Enclosures: NAIC letter

cc: Lois Lerner, Director, Internal Revenue Service, Office of Exempt Organizations