

FiduciaryNow.com – January 12, 2009 Update: One View In Support of Professional Regulation For Personal Financial Advisors

I applaud the “Statement of Understanding” formulated by the CFP Board, FPA, and NAPFA, and announced on January 7, 2009. (See box, below.)

In this *Update* I explore a vision for the regulation of personal financial advisors, answering a series of questions regarding how individual personal financial advisors could be regulated. *The principles and suggestions set forth herein are mine alone; they do not represent the views of the “Financial Planning Coalition.”*

I hope that the views expressed herein will positively contribute to the process of drafting legislation, at either the federal or state level, to move the practice of personal financial planning toward professional status.

Statement of Understanding of the Financial Planning Coalition

Financial planning is the process of determining whether and how an individual can meet life goals through proper management of financial resources. Financial planning services are critical to the individual and collective financial health of Americans. The financial planning profession provides needed financial literacy to the public, effective methodologies, and guidance in choosing appropriate behaviors and making sound financial decisions. In an increasingly complex world, the profession is valued as essential to the financial well-being of Americans.

Certified Financial Planner Board of Standards (CFP Board), the Financial Planning Association® (FPA®) and the National Association for Personal Financial Advisors (NAPFA), leading national organizations representing the development and advancement of the financial planning profession, share this vision and will collaborate as Congress undertakes regulatory reform to achieve the following objectives:

- Financial planning services are delivered to the public with fiduciary accountability and transparency, serving the client's best interest first and always.
- Financial planning services are specifically regulated to distinguish and differentiate professionals who have met essential requirements to practice, including, examination, education, experience and ethics as modeled and enforced by the CERTIFIED FINANCIAL PLANNER™ certification (CFP® certification).
- The public can easily identify who is a financial planner and subject to these standards.

The public understands the benefits of and values the services provided by financial planners; views financial planning as a legitimate and accepted profession; and demands competent and ethical professional services provided by financial planners.

Through this shared vision, we resolve to move forward with the best of intent and collective effort to achieve these desired outcomes. We invite all groups and organizations who share in this vision to work with us to achieve these goals for the benefit of the public and the profession.

Signed,

Certified Financial Planner Board of Standards, Inc.

Financial Planning Association

National Association of Personal Financial Advisors

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any fee is imposed in connection with such distribution.*

1. *What is the current status of the regulation of “personal financial advisors”?*

Financial planners, which I refer to as “personal financial advisors,” are not regulated as such. A lot of persons hold themselves out as “financial planners,” “financial advisors,” “Certified Financial Planners™,” “financial consultants,” “estate planners,” “wealth managers,” and other terms which connote relationships based upon trust and confidence. Some are regulated under the Investment Advisers Act of 1940 (and similar state laws), others are regulated as registered representatives of broker-dealer firms, and others are regulated under state law as insurance agents or brokers. Still others are mortgage brokers, subject to various levels of mainly state regulation. Others perform financial services as employees of banks and trust companies, and may be exempt from registration as investment advisers and registered representatives in those capacities. Generally, “financial planning” is not, in itself, regulated, as a separate profession. And some of the activities of financial planners – i.e., those that don’t relate to “investments” or “investment advice” – may not be regulated at all.

2. *But does not the Advisers Act regulate financial advisors?*

Arguably most of the activities of personal financial advisors fall within the purview of the Investment Advisers Act of 1940 (“Advisers Act”), and they should be regulated as investment advisers (or as representatives thereof). But the U.S. Securities and Exchange Commission (“SEC”) has not enforced this application of the Advisers Act. This was seen most recently with the SEC’s Sept. 2007 re-definition of “solely incidental” (which essentially guts the application of the Advisers Act to many investment advisory activities as well as financial planning activities). Also recently seen from the SEC (in the same Sept. 2007 release) was the proposed “Special Rule,” which would permit a customer of a broker-dealer firm to be treated as a brokerage client with respect to one account, while being in an advisory relationship with respect to another account. This does not make sense under the Advisers Act or general common law, since fiduciary duties apply to relationships, not accounts. (In other words, “switching hats” and “dual hats” is not permitted.)

3. *What about state laws? Do they regulate financial advisors?*

The provisions of the Uniform Securities Act which prohibit fraudulent conduct in connection with the sale or recommendation of a security are potentially quite broad in their application, at least in states where “constructive fraud” (i.e., breach of fiduciary duty) is considered “fraud” under the state securities statute.

Also, a few states and state regulators have attempted to expand investment adviser regulation with state statutes or rules that provide that those who hold out as “financial planners” must be registered as investment advisers. But difficulties have occurred in applying these statutes and rules. There has been a lot of pressure from the securities industry in opposition to these states’ efforts. And “implied preemption” of state law by federal law might be an issue which states have to confront should they continue to seek to expand the reach of state investment adviser statutes.

While state legislation and regulation may develop in the years ahead, a framework established by federal legislation for dual federal-state professional regulation of personal financial advisors may spur on state efforts to regulate financial planners as such.

4. *Why has regulation of financial advisors come to the forefront? What are the prospects for federal and/or state legislation affecting the regulation of personal financial advisors?*

In recent years, due in large part to the scandals affecting the securities industry and the dispute regarding whether the Advisers Act applies to fee-based brokerage accounts (a dispute the Financial Planning Association won through the March 2007 U.S. Court of Appeals decision in *Financial Planning Association vs. SEC*), the issue of the application of fiduciary duties to financial planning activities has been near the forefront of discussions in the industry on the future of regulation. The CFP Board's revisions to its *Standards of Professional Conduct* and other organizations' efforts have also kept the "fiduciary issue" near the top of discussion topics among industry insiders.

The "Rand Report" (December 2007) and the "U.S. Treasury Department Blueprint" (March 2008) fueled the fire as to possible regulatory overhauls. More recently, the "financial crisis" has provided the impetus for the U.S. Congress to enact an overhaul of federal securities legislation. While the financial crisis was not caused (directly) by either registered representatives or investment advisers, it is likely that any bill to come out of the U.S. Congress in 2009 or 2010 will address their regulation.

It usually takes a crisis for Congress to enact major legislation, and enact dramatic changes. The recent financial crisis is the driving force at present, at least at the federal level. The public expects (and some say "demands") some form of regulatory reform, and legislators don't want to stand for re-election in 2010 having done nothing.

Once Congress acts, it is unlikely to re-address financial services regulation in any detail for many years. Hence, this may be the only opportunity for several decades to come to promote the professional regulation of personal financial advisors at the federal level.

5. *Will broker-dealer and investment adviser regulation be consolidated?*

At the House Financial Services Committee hearing on January 5, 2009 (on the Madoff scandal), Representative Spencer Bachus, Republican of Alabama, criticized the split regulation of broker-dealers and investment advisers. Moreover, he recommended that the Financial Industry Regulatory Authority (FINRA) add the regulation of investment advisers to its oversight of broker-dealers and their registered representatives. Representative Bachus stated, with respect to the Madoff Ponzi scheme, "One factor that allowed his alleged fraud to continue as long as it did was the differential regulatory treatment of broker-dealers and investment advisers." I don't agree with Representative Bachus' statement, but it does reflect a view, touted by FINRA and SIFMA quietly for some time (especially since the *FPA vs. SEC* decision disallowed fee-based brokerage accounts), that regulatory overhaul should occur.

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Yet, calls for consolidation of regulation of brokers and investment advisers really don't make sense. Registered representatives and investment advisers perform wholly different functions. Their legal relationships with their customers or clients, respectively, are therefore wholly different. It just does not make sense to "consolidate" their regulation, given the different functions the types of entities perform.

By way of explanation, there exist three business models for the delivery of financial services and products to consumers:

Issuer or Product Manufacturer → Customer

Under the first model, the issuer of a security or financial product (whether it be a certificate of deposit, stock, bond, mutual fund, insurance product, or otherwise) engages in marketing of the product directly to the consumer. In this situation an arms-length ("caveat emptor") relationship exists between the parties.

Issuer or Product Manufacturer → Broker-Dealer or Insurance Agent → Customer

Under this second model, a registered representative (i.e., stockbroker) or insurance agent functions as the representative of multiple issuers of products. Generally the financial intermediary is compensated by the product issuer. This situation also involves an arms-length relationship between the parties.

Client → Investment Adviser → Issuers or Product Manufacturers

In this third business model, the client engages a trusted advisor for financial and/or investment advice. The investment adviser acts as the client's representative in choosing the best investment products to meet the client's needs. This situation involves the imposition of fiduciary status upon the financial or investment adviser.

As seen, broker-dealers act as representatives of product manufacturers. Investment advisers act as representatives of the client, and only the client. While broker-dealers are generally governed by the "commercial good faith" standard (enhanced through mandated "casual disclosure" and the "suitability" standard when selling a security), investment advisers are bound by the much higher fiduciary standard of conduct (including its requirements to fully disclose all material facts, and its very high fiduciary duties of loyalty, due care, and utmost good faith).

There is certainly a lot of confusion in consumer minds about the distinctions between registered representatives and investment advisers, and what duties are owed by which. But the cause of this confusion has been inadequate application of the Advisers Act by the SEC. Having created confusion by persuading the SEC to not apply the Advisers Act (as Congress intended, strictly, according to the courts), FINRA and SIFMA now want to dismantle it entirely, it seems.

6. *What is the difference between “arms-length” and “fiduciary” relationships under the law?*

There are two types of relationships between product and service providers and their customers or clients, under the law. The first form of relationship is an “arms-length relationship.” This type applies to the vast majority of service provider – customer engagements. In these relationships, the doctrine of “caveat emptor” generally applies, although this doctrine is always subject to the requirement of commercial good faith. Under most circumstances there is no obligation to undertake affirmative disclosures to the other party to the contract; however, if statements are made the requirement of commercial good faith prohibits “actual fraud” – i.e., the knowing making of false statements. It should be noted that the “caveat emptor” doctrine may be modified by imposition of specific rules or doctrines by law, such as the “full disclosure” regime contemplated by securities laws and “suitability” requirements imposed upon registered representatives of broker-dealer firms (i.e., stockbrokers). Indeed, much of the 1933 Securities Act and the Securities and Exchange Act of 1934 involved the imposition of consumer protections through disclosure.

The second type of relationship is a “fiduciary relationship.” This involves a relationship of trust, which necessarily involves vulnerability for the party who is reposing trust in another. In such situations one's guard is down; one trusts another to take actions on one's behalf. Under such circumstances, to violate a trust is to violate grossly the expectations of the person reposing the trust. Because of this, the law creates a special status for fiduciaries, imposing duties of loyalty, care, and full disclosure upon them. Hence the law creates the “fiduciary relationship,” which requires the fiduciary to carry on with their dealings with the client (a.k.a. “entrustor”) at a level far above ordinary, or even “high,” commercial standards of conduct. The Advisers Act (as interpreted by the U.S. Supreme Court in *SEC vs. Capital Gains Research Bureau*) imposes broad fiduciary duties upon investment advisers.

7. *But are not registered representatives already fiduciaries?*

In several ways registered representatives of broker-dealer firms are, or could be found to be, fiduciaries under the law.

First, all registered representatives and their broker-dealers have limited fiduciary duties to their clients in association with taking custody of client funds. There are limited, or “quasi-fiduciary” duties owed to clients with respect to the handling of those funds.

Second, there are many cases in which registered representatives are deemed to have “discretion” over client accounts. Generally in such cases a customer with diminished capacity (or elderly, or highly unsophisticated) always accepts the recommendations of the registered representative. In these cases the courts in essence apply a principal-agent relationship to the customer – registered representative. Under agency law, fiduciary duties apply with respect to the scope of the agency; in this instance, with respect to the recommendations being made.

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Third, the Advisers Act may apply to registered representative activities, or similar statutes of the states. But, as alluded to above, there is a great deal of confusion over the scope of the broker-dealer exclusion from the application of the Advisers Act. SIFMA and FINRA have generally argued that the broker-dealer exclusion is quite broad (and in recent years the SEC has gone along with them), while the federal courts have noted that the broker-dealer exemption is quite limited. Barring changes to federal legislation, this is likely to be an ongoing battle in the courts.

Fourth, as Professor Tamar Frankel noted in her oral testimony before the House Financial Services Committee on January 5, 2009, in her view registered representatives (“brokers”) are already fiduciaries. This is as a result of the application of state common law. State common law applies fiduciary status to many of those who provide financial and/or investment advice in relationships of trust and confidence, regardless of how they are regulated. In each instance it is a fact-based decision. A variety of facts might give rise to a finding fiduciary status for a financial intermediary. Actually providing financial advisory services to an unsophisticated client is a key factor. However, nearly as important in some of the decisions is the use of titles, such as “financial planner,” “financial advisor,” “investment planner,” “investment counselors,” and “estate planner,” which denote the existence of a relationship based upon trust and confidence. Also, in determining whether a fiduciary relationship exists, state courts consider a variety of other factors, including whether there is dependence and inequality based on weakness of age or mental strength, lack of business intelligence, inferior knowledge of facts involved, or other factors giving one side an advantage over the other. A growing body of case law is building up around the common law application of fiduciary duties; for more information see the “Fiduciary Financial Advisor Case Law Review” found in the “State Law” section of the www.FiduciaryNow.com web site.

I would argue that 95% or more of registered representatives serving the general public are fiduciaries, under the common law. But there is certainly a need for clarity in this area, rather than case-by-case examination. Future legislation could provide some greater certainty. And, since legislation often follows developments in the common law, it seems proper that legislation would apply broad fiduciaries duties of due care, loyalty, and utmost good faith upon broker-dealer firms and their registered representatives when they provide personal financial advisory services.

- 8. Has not the financial world changed? Does it not make sense to reconcile broker dealer and investment adviser regulation now, given all that has transpired over the past seven decades since federal securities law was largely enacted?*

SIFMA has often argued that the financial world has changed a lot since the 1930’s, and hence financial services regulation is out-dated. In reality, the world has changed – a great deal ... and as a result the principles of the Advisers Act have *greater* reason for application, not less so.

With the continuing evolution of Modern Portfolio Theory and its offshoots, the explosion in the number and type of mutual funds and other products, the presence of exotic products designed to either assume or alleviate risks, and the “hidden fees and costs” of many investment products, it is a far more complex world for consumers than that which existed in 1940. The “knowledge gap” between consumers and

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financial advisors has never been greater. Hence, fiduciary principles – which are imposed when there is a placement of trust and a substantial disparity in knowledge – are even more relevant now. The fiduciary principles of the Advisers Act, and those arising from state common law, are indeed more relevant today than ever in this ever-more-complex financial world, not less so.

What has changed is the move of broker-dealer firms from trading in stocks and bonds to providing what consumers want – financial and investment advice. Yet, broker-dealer firms want to be free to provide advisory services free of the fiduciary obligations which consumers have the right to receive. That is really what has changed.

9. *Would the imposition of fiduciary duties stifle innovation and competition?*

A frequent buzzword utilized by the broker-dealer industry is “preservation of competition.” With the scheme of broker/dealer – investment adviser regulation, this argument is but a **red herring**. Broker dealers should be able to do what they did in 1940 – sell stocks, bonds, and other financial instruments, provide general economic forecasts to their customers, and provide analysis of individual stock or bond issues. But what the broker-dealer community really wants to be able to do is undertake what *investment counsel* did in 1940 – provide investment and financial advisory services to clients. In essence, the broker-dealer industry wants to be able to provide financial advisory without the imposition of fiduciary standards of conduct. Why? Because acting under a lesser standard of conduct is more profitable. The reality is that the position of the broker-dealer industry, in consistently opposing fiduciary standards of conduct, is all about money. It’s all about greed.

Fiduciary standards won’t stifle innovation. Except that form of innovation which is designed to extract from American investors as much as possible into the hands of financial intermediaries, usually without the individual consumer knowing what is really going on. The sad fact is that 25% to 40%, by many estimates, of the returns of the capital markets end up in the hands of financial intermediaries and don’t make their way to the holders of the securities. This is far too much a percentage, by any measure of what is decent and just.

Will fiduciary standards stifle *competition*? Fiduciary standards of conduct do impose upon the financial advisor restrictions upon his or her conduct. Rather than serve the advisor’s own interest, the advisor is bound, by law, to serve the best interests of the client. Losing a bit of “freedom” (to do what one wants, without regard for the interests of others) is necessary, *in order to serve the public interest*. (That’s what being a fiduciary is all about.) This is all about applying standards of conduct to those who provide advisory services. It’s about having the same high standards of conduct for all those who provide advisory services.

In another sense fiduciary principles are the ultimate in “principles-based” regulation. In fact, with the application of fiduciary standards, and a fiduciary culture within firms, comes the ability to not possess so many of the complex specific rules we see applied in the broker-dealer industry, which rules have been complained about over and over by the broker-dealer community as stifling competition and innovation.

Fiduciary duties are imposed in situations in which that which is most precious to us, in our society, can be extracted through abusive use of expert knowledge. What is most precious to us? We need only look at that document which is perhaps most sacred to Americans. “Life, liberty, and the pursuit of happiness” is one of the most famous phrases in the United States Declaration of Independence. These three aspects are listed among the “inalienable rights” of man. Let’s consider them.

“Life” is so precious. Yet in decisions about life and death individuals must often turn to physicians, armed with knowledge of the complex world of medicine. So much power can be wielded by these professionals that the law has seen fit to impose upon them a code of conduct under which they must provide advice and counsel in the best interests of their patients.

Similarly, “liberty” may be deprived by force of law. And the law is a complicated beast, and understanding both its substantive and procedural aspects is another hurdle to ordinary Americans. So, in order to protect our citizens, and to accord them due process of law, every citizen in a criminal trial has the right to legal counsel. And that legal counsel is bound by fiduciary duties of due care and loyalty to his or her client.

The right of men and women to pursue their “happiness” has been said to mean the “right to pursue any lawful business or vocation” and the “right to seek an increase in one’s own prosperity” - in any manner not inconsistent with the equal rights of others, so as to give to them their highest enjoyment. Yet we see that the financial world has become complicated over the centuries (and especially in recent decades). Gone are the days where investing in “stocks” and “bonds” alone were the only options available. Today there exist a plethora of investment products, all with different risk, tax, and potential return attributes. Some products today are solely designed to shift risks (and many of these can only be understood with the greatest of care). Modern Portfolio Theory and its many offshoots have led us to greater understanding of the relationships between risk and return, and of the complex manner in which seemingly risky individual assets can be combined to actually reduce the overall risk (as measured by volatility) of an investment portfolio. Behavioral finance, though still in its infancy, is also having a great impact on our understanding of the interplay of human psychology and the varying risks and rewards seen in the capital markets over time. Moreover, tax laws relating to investments and personal financial planning decisions are ever-changing. Put this (and much more) all together, and the fact is that we can no more assume that the average American today is capable of making intelligent choices about his or her family’s financial future, without professional guidance, than they would be if they were faced with a medical problem or a legal problem. Advisors who are stewards of their client’s financial hopes and dreams (the pursuit of “happiness”) – and who provide advice on *other people’s money* – should be held to the same fiduciary standards of conduct as those professional advisors who champion their health care or their dealings with our legal system.

10. What legislative proposals are possible in Congress?

There are a large number of possibilities. Here is what I've discerned so far.

- (1) FINRA is, without a doubt, posturing to become the single regulator for broker-dealers and investment advisers. FINRA may seek to have its jurisdiction extended over registered investment advisers through Congressional legislation (it is uncertain whether the SEC could actually go ahead and delegate its inspection and enforcement powers to FINRA under current law).
- (2) SIFMA (which represents the larger broker-dealer firms) is likely to seek greater exemptive authority for the SEC in providing relief from the application of the Advisers Act. In essence, SIFMA would like to see the SEC possess authority to permit fee-based brokerage accounts. The SEC may itself promote this idea (see comments about “regulatory capture” in later portions of this document).
- (3) There are certainly calls for “consolidation” of broker-dealer and investment adviser regulation from FINRA and SIFMA and broker-dealer firms in general. Many observers believe this is just a smoke-screen for the elimination of fiduciary duties, and these observers fear a “rush to the bottom” in terms of establishing standards of conduct. Many consultants to broker-dealer firms have told them that investment adviser business models are just not as profitable as selling products under the broker-dealer business model, and this is undoubtedly true. Broker-dealers want to be free to sell expensive products under the guise of providing “financial advice.”
- (4) Surprisingly, FINRA might actually seek, in connection with seeking “consolidation” of broker-dealer and investment adviser regulation, the imposition of fiduciary duties on everyone. But many observers, including this writer, are highly suspect about this occurring. There are many means (through rule-making) to not apply fiduciary duties, or when applying them to so weaken the fiduciary standards of conduct that they fail to provide meaningful protection.
- (5) The state securities regulators are sick and tired of federal preemption of their authority. Who can blame them, given their long-standing historic role of protecting individual consumers (and their taking of the lead in prosecuting so many scandals of late affecting the securities industry – from stock analyst conflicts of interest to auction rate securities)? In a regulatory roundtable hosted by the North American Securities Administrators Association (NASAA) on December 11, 2008, the states outlined the need to strengthen the standards of conduct that apply in all financial sectors. Maryland Securities Commissioner Melanie Senter Lubin called for the imposition of a fiduciary duty — in addition to existing standards — on all securities professionals who dispense investment advice, including broker-dealers. “This will enhance investor protection, eliminate confusion and even promote regulatory fairness by establishing conduct standards according to the nature of the services provided, not the licensing status of the provider,” she said. However, the actual form of legislative proposals which may be offered by NASAA is not yet known.

- (6) As seen by their statement today, the “Financial Services Coalition” (CFP Board, FPA, and NAPFA) desire that financial planning services be “specifically regulated to distinguish and differentiate professionals who have met essential requirements to practice, including, examination, education, experience and ethics as modeled and enforced by the ... CFP® certification.”
- (7) Lastly, status quo at the federal level is always an option. In the absence of federal legislation, the various state legislatures may act, over time, to regulate financial planners as such.

What scheme of regulation will prevail? Unfortunately, “money talks” in Congress, and in Washington, D.C. in particular. How much money? Tons of it. For example, on January 8, 2009 it was disclosed that nearly one-fifth of all of the contributions to fund the Jan. 20th inauguration were made by financial services executives. The amount of contributions made by them? \$5.7 million. A staggering sum, especially considering that President-elect Obama banned corporations themselves from funding his inauguration.

Nor is Congress immune. On September 23, 2008, the Los Angeles Times reported that since 2002 the financial services industry had contributed more than \$1.1 billion to Congressional candidates, and further noted: “The figure does not include millions more donated to the favored charities of prominent politicians and the hundreds of millions spent on lobbying. The [financial services] sector is among the biggest donors overall.”

Is there any real chance that a pro-consumer agenda can prevail in Congress, calling for broad application of fiduciary standards of conduct upon all financial advisors? Yes, but it won’t occur as a result of winning the “political contributions” battle. The opportunity to enhance standards of conduct only comes about because of:

- (1) the logic of the position;
- (2) the ability of a (hoped-for) broad coalition of financial planning and related industry associations – and consumers groups – to wield influence on policy makers themselves, through the media, and through the public in general; and
- (3) the fact that Congress is, right now, fairly angry at Wall Street for causing the “financial crisis” and the resulting deepening of the economic downturn.

11. Will FiduciaryNow.com be submitting a proposal to Congress?

No. FiduciaryNow.com is not a separate organization nor does it desire to be one. It is only an avenue for promoting application of fiduciary duties upon all those who provide financial advice to our fellow American citizens.

It must be recognized that we have enough organizations to represent our interests in Washington, D.C. I firmly believe that the “Financial Planning Coalition” (CFP Board, FPA, and NAPFA) should be provided the opportunity to formulate specific proposals to Congress – although I implore them to act with all deliberate speed.

Having said that, I do believe that all personal financial advisors should let their views be known to the leadership of their industry associations.

What are my views? In addition to the past documents posted on the FiduciaryNow.com site, some new documents are included with this “Update.” Attached as a separate document to this “Update” is a “Draft Report to Congress” – which could be modified by our industry associations and presented to Congress at some point in the future. Additionally, a separate document is also attached which sets forth “Draft Legislation” for the regulation of personal financial advisors. Again, the content in these documents reflects only my views, and not necessarily the views of any industry organization.

Moreover, as our industry associations lobby Congress, they will need our help. Given all of the opposition to the imposition of fiduciary duties which is likely to occur from vested economic interests, the greater the “grass roots” support for our industry associations and their proposals, the better.

12. Do you advocate for federal or state regulation of personal financial advisors?

There are sound arguments for either national regulation or state regulation. I believe the best platform is a combination of same. In essence, I would advocate for a national professional regulatory organization (PRO), but permit states to legislatively create state-specific PROs (and, as they do so, membership of individual personal financial advisors switches from the national PRO to the state PRO). As the states assume retail-level regulation of personal financial advisors, the national PRO would retain national standards-setting policies, and also be able to examine all personal financial advisors (but, in so doing, it may confine itself to “big issues” affecting a large number of personal financial advisors).

My primary rationale for dual federal/state regulation is that it guards against “regulatory capture” by an industry. For example, many in the financial planning community believe that the non-application of the Advisers Act results from regulatory capture of the SEC by the influence of large broker-dealer firms. Unfortunately, most of the policy personnel at the SEC, and many of the Commissioners, possess very close ties to Wall Street firms – either having worked there before joining the SEC, or being very likely to

work there afterwards (or work for law firms which provide legal services to broker-dealer firms and investment product manufacturing firms). That's not to say that there are not a lot of good people with great intentions at the SEC. But I've heard comment after comment from them that the "ideals" which they promote get beaten down by the "reality" of what the senior policy makers will and will not permit.

Also, with respect to the need for dual national/state oversight, the fact is that fraud (actual or constructive) is pervasive when people deal with "other people's money." As a result, we need all of the "cops on the street" that we can. For this reason, I believe that federal preemption of state securities law should be rarely undertaken, and certainly not in any manner which would deprive consumers of important protections, even if some duplication of supervision results.

Additionally, another reason I support dual regulation by the federal government and the states is that, deep down, I'm likely to be a "federalist." I don't believe the federal government has to do "everything." Yes, lead the states, and ensure minimum national standards. But don't usurp states' rights, in my view, to combat fraud.

However, having said all of that, national standards of conduct should be established for personal financial advisors, in order to ensure minimal standards nationwide. (Even then, the states should be free to elevate, but not lower, standards of conduct established nationally. This leads to better consumer protections over time by permitting their evolution and adaptation to new products, etc. I believe the financial advisor community can easily adopt to higher standards in a few states, provided the bulk of standards are uniform nationally.)

Also, the states need to adopt an easier, and less costly, method of registering personal financial advisors nationwide. A once-a-year "nationwide registration" should be permitted, for a reasonable flat fee, with most of the fee flowing to the home state of the personal financial advisor (which will likely provide examination of the personal financial advisors) and a portion of the fee shared with each and every other state. I doubt this would decrease state registration revenue much (and it might actually increase state revenues), compared to fees received from current registrations of investment adviser representatives.

13. How should personal financial advisors be regulated?

The "Draft Report to Congress" and the "Draft Legislation" (found in separate documents) provide some of the details as to the regulatory scheme I envision. To summarize this scheme, it makes sense for professionals to be regulated by other professionals. If commercial interests (such as FINRA, whose members are broker-dealer firms) seek to regulate fiduciary advisors, the commercial interests will seek at every opportunity to either not apply fiduciary duties or to weaken the fiduciary standards of conduct. Such would be inevitable.

Moreover, how does one have the ability to enforce fiduciary duties relating to investment advice and personal financial planning, if one does not have substantive knowledge of these areas? Professional regulation exists because the ability to delve into, examine, probe, and evaluate the conduct of another

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professional requires a high degree of expertise. In connection with adherence with fiduciary duties, it is essential that examiners be able to determine if a prudent process was followed in the decision-making process involving the decision at hand, and if good judgment was exercised during that process. FINRA's examiners are not capable of this. It requires experts to review the conduct of other experts.

I've heard the arguments advanced by some in the securities industry that fiduciary standards of conduct are "too ambiguous" to be enforced. There is certainly a need for better, more specific rules of professional conduct. But already a great deal of effort has occurred with respect to same (see the ISO 22222 standards, and suggested "model rules of conduct" at FiduciaryNow.com).

FINRA may be incapable of enforcing professional standards of conduct. But personal financial advisors know how to evaluate the conduct of other personal financial advisors. Just as attorneys evaluate other attorneys' conduct, and the same goes for doctors and CPAs.

Hence, a *Professional Regulatory Organization* (PRO) is the desired solution, and only logical solution. Only in this manner will fiduciary standards of conduct – the highest standards of conduct under the law – be maintained.

A PRO is not a "self-regulatory organization." A PRO exists to serve the public interest, whereas an SRO largely serves its members' interests. A PRO is formed to enforce fiduciary standards of conduct, whereas an SRO only enforces contract obligations and some minor consumer protection rules.

I would also like to give advance notice of the June 3, 2009 "Fiduciary Duties and Compliance" conference of the National Association of Personal Financial Advisors (NAPFA), at the Gaylord National Resort outside Washington, D.C. This full-day conference will devote several hours to understanding fiduciary duties as they apply to personal financial advisors. Professor Tamar Frankel of Boston University School of Law, for many years the nation's expert on the application of fiduciary duties to securities professionals, is but one of the noted speakers at the conference. A panel discussion of leaders in the financial planning community will also directly address many of the questions which arise under fiduciary duties and their application. Look for details on the www.napfa.org web site within a few weeks. It promises to be an educational conference which will provide real insight into recent developments, as well as a greater understanding of fiduciary principles and how they are applied.

14. *In the “Financial Planning Coalition” statement, it appears that the Coalition desires everyone to become a Certified Financial Planner™ certificant in order to practice financial planning? Does FiduciaryNow.com support the CFP® designation as a prerequisite to providing financial planning services?*

First off, I’m not certain that the Coalition’s statement can be construed in such a fashion. The pertinent part of the statement is: “Financial planning services are specifically regulated to distinguish and differentiate professionals who have met essential requirements to practice, including, examination, education, experience and ethics as modeled and enforced by the CERTIFIED FINANCIAL PLANNER™ certification (CFP® certification).” There are a couple of ways to interpret this statement. For example, what does the word “modeled” mean?

However, I do believe that financial planning should only be provided by those who possess minimal standards of education, and the CFP® certification exam is an excellent model for what a test of foundational knowledge should be. Yet, it is my understanding that the CFP® exam was initially designed as a test of experience, not just knowledge. (I’m not certain if the CFP® exam is still fashioned this way.) There are good arguments that the CFP® examination is a test of basic knowledge for financial planners. If the CFP Board were to propose that the CFP® examination serve as the one and only entry exam for the profession, I would support such a proposal. If the CFP Board were to suggest a slightly different exam, with the CFP® certification being somewhat elevated to become a “superior certification” of some kind, I would also likely support such a proposal.

Professional entrance exams (outside of medicine) don’t require “hands-on experience” for the most part. I believe that a graduate of a 4-year college curriculum in personal financial planning, or a college graduate with any degree but with supplementary education in financial planning along the lines of the CFP® course curriculum, should be able to take the test and gain entrance into the profession, without any need for an “internship” period. We need to be careful about making entry into the profession too difficult, lest claims of elitism and restriction on competition be levied by others.

15. Should the CFP Board become the national “Professional Regulatory Organization” for personal financial advisors?

As I’ve stated previously, professionals should regulate professionals. It is wholly inappropriate for commercial interests to regulate fiduciary advisors. Hence, the CFP Board, whose Board members all hold (I believe) the CFP® designation (except, perhaps, for consumer representatives on the Board), seems a logical choice for the Professional Regulatory Organization, if it is to be formed at the national level.

However, the CFP Board is a 501(c)(3) organization. Such a tax structure does not easily accommodate individual members. But, it would be easy for the CFP Board to form a separate organization to serve as a national professional regulatory organization. The existing 501(c)(3) organization could then be utilized as a means of preserving professional independence in the setting of standards, much in the same fashion as a foundation supports the work and standards-setting functions of the (national) Financial Accounting Standards Board.

Where else are we going to find a commitment to fiduciary standards of conduct, along with experience in exam formulation, developing and enforcing standards of conduct, etc. The CFP Board seems like a logical choice to serve as the foundation of the new profession of personal financial planning.

I hope these comments aid those interested in these issues to gain further understanding of the many issues involved. The “Draft Report to Congress” and the “Draft Legislation” (separate documents) are likewise efforts to stimulate discussion and debate on these issues. But please be aware, if you dare to delve into these documents, that there are many issues left unaddressed in drafting legislation, such as the issues of private remedies and mandatory arbitration.

Through a vigorous exchange of information, ideas, and varied perspectives, I hope that the likely regulatory reform of the delivery of personal financial advice will be robust, efficient, and protective of the public interest. I am also hopeful that soon I will be able to call myself a member of a true regulated profession – of personal financial advisors.

Thank you.

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