

**Recommendations on Future Regulation
Of the Financial Planning Profession**

*Submitted by the FPA Board of Directors
to Membership*

On behalf of the Regulation Task Force

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Background on the Regulation Task Force

The Financial Planning Association Board of Directors, at its 2004 summer retreat in Skamania, Washington, approved "Transition for Transformation," a strategic plan for the association that included special emphasis on FPA's advocacy program. One of the priorities suggested by Chief Executive Officer Marv Tuttle, CAE, was to explore "opportunities for appropriate regulation of financial planning." Pursuant to the Board's direction, in January 2005, FPA President James A. Barnash, CFP®, appointed a task force with the express purpose of examining in greater detail the questions about future regulation raised in a 2002 FPA white paper and a mandate to report back to the Board with its findings.

Because of the strategic implications of the report, the composition of the Regulation Task Force (the "Task Force") was carefully considered and broadened to include not only representatives from the Board of Directors and national Government Relations ("GR") Committee, but from chapter leadership and members-at-large as well. The latter category included members who had served previously in leadership positions at FPA and who had expressed a special interest in future regulation of the profession. For example, one member-at-large, Don Pitti, was directly involved in the 1980s effort by the International Association for Financial Planning ("IAFP") to establish a national, self-regulatory organization for financial planners.

The 14-member Task Force appointed in early 2005 resulted in a cross-section of FPA leadership: five members-at-large, three Board members, two GR Committee members, two chapter leaders, and two chapter board members also serving on the GR Committee. All share a long-term commitment to the practice of personal financial planning. Related experience in the financial services industry averages 23.2 years with 19.4 of those years in financial planning. Their financial planning experience ranges from 10 to 34 years, and 15 to 38 years in the financial services sector. Two members began their careers in the financial services industry in 1967, just as financial planning was getting started.

All have dedicated significant volunteer time to FPA or its predecessor organizations, averaging 11 years in leadership positions at the chapter level and 8.3 years at the national level. Nearly half have served on a national Board. In addition to two current Board members, the task force includes four others who served on FPA, ICFP or IAFP boards, starting in 1972.

Most of the task force members hold the CFP® designation and are principals in small, independent financial planning firms. Of the remaining individuals, one is employed by a major regional bank as a financial planner, one is an academic, one is an attorney specializing in compliance issues, and one a retired financial services executive. Nearly all have held various securities and insurance licenses at some stage of their careers. Their methods of compensation are roughly split between fee-only and fee-and-commission. Two are salaried.

The task force did not self-select a chair, nor was one appointed by the FPA President. The group relied on a consensus-making approach in its review.

Terminology

The following terms are used in the Report to generally describe the primary regulatory options and current regulatory environment.

Consumer Litigation Option. This option, as first proposed in the 2002 FPA white paper, would require greater involvement by FPA in defining financial planning standards in case law. FPA would monitor litigation on federal and state levels and identify key cases on appeal where FPA might participate through amicus briefs, or as a co-litigant, if it had standing. For example, FPA could support a private right of action under the Investment Advisers Act of 1940 as an alternate dispute resolution process to binding arbitration. FPA would be able to help build a public record of trends in case law that define professional standards for financial planners.

Federal Professional Regulatory Organization (“PRO”) Option. FPA under this option would support creation of what may appear to be a self-regulatory industry organization similar to the NASD or New York Stock Exchange, but with professional standards applied to persons holding out as a financial planner. One of the principal distinctions between state licensing and a PRO would be the PRO would not have financial planners as “members” who govern the body, like a SRO. The PRO instead would regulate the profession in the public interest, under the oversight of a federal agency. Its principal obligation, like a state-licensing body, would be to develop and apply national standards which serve the public, and which also advance and maintain professionalism in the field of financial planning.

State Licensing Option. In this scenario, FPA would support traditional state licensing for professions to apply to persons holding out as financial planners. It would support appropriate standards of conduct along the lines of the CPA licensing model for examination, continuing education, peer review, and disciplinary standards. These standards would be similar to requirements for holding the CFP designation.

Status Quo Option. This option refers to regulation of financial planners today in their capacity as registered investment advisers, agents of a broker-dealer or insurance firm, or in a bank, credit union, or trust company. This option also assumes continued private sector regulation of financial planners by the CFP Board of Standards in their capacity as financial planners. In considering this option, the Task Force assumed FPA would continue to actively lobby on financial planning issues before Congress and other public policy bodies, but it would not proactively seek to change or reform existing laws to establish professional regulation.

Subset Regulation. A term used in the white paper and this Report to describe specific regulation of financial planners when acting in the capacity as an investment adviser, broker-dealer agent, or insurance producer. For example, many regulators, journalists and the public frequently confuse investment advisers with financial planners, but the Task Force finds significant distinctions between the two based on the much broader, multidisciplinary role of a financial planner in providing advice on a person’s overall goals and objectives, not simply advice regarding securities.

I. INTRODUCTION

In April 2002, the Financial Planning Association published a white paper titled “Regulation of Financial Planners.” Written by Yale law professor Jonathan R. Macey,¹ the white paper reviewed the existing regulatory climate for financial planners and examined options for future regulation as a distinct, stand-alone profession. At the time of publication, the white paper was publicized to membership and was made available on FPA’s website, http://www.fpanet.org/member/govt_relation/whitepapers/index.cfm. Booklets were also distributed to regulators, key congressional staff, and the media.

The original Request for Proposal (“RFP”) envisioned a report providing the public with a general overview of past and current regulation of financial planners in their roles as investment advisers and their other functionally regulated areas, or subsets, of the industry. Of greater interest to FPA members was the second part of the white paper that examined specific options for future regulation of the financial planning profession. However, the RFP did not authorize the development of a specific recommendation or future course of action by the white paper author. At the time, it was assumed that any specific recommendation would be controversial – just as the Task Force believes it would be true today -- and would require discussion first in the financial planning community. In these formative, initial years of FPA, much of the Board’s energy was absorbed in internal changes at the organization. Moreover, the issue of self-regulation was not pressing. Until the recent introduction of financial planning legislation in Pennsylvania,² the regulatory question hadn’t been addressed by policymakers since 1991, when the last congressional hearing on the topic was held.

The white paper nonetheless identified a number of critical issues that need to be eventually addressed by FPA if it wishes to be proactive in establishing professional regulation. The white paper reviewed basic issues related to this topic such as:

- whether financial planning should be viewed as a separate profession;
- how might the practice of financial planning be defined in any future regulatory scheme; and
- what are the ethical and disciplinary standards under which financial planning services are delivered to the public.

The Task Force took the white paper’s examination of regulatory options a step further. Under each option, the Task Force examined in greater detail what might be the most appropriate regulatory body for the profession and its public accountability through a legislature or oversight agency. It attempted to weigh in general terms the benefits and costs to FPA members if financial planners were regulated separately from subset regulation as investment advisers/asset managers, securities brokers, and insurance agents. While the Task Force represented a cross-section of membership, they were

¹ At the time the FPA white paper was written and published, Mr. Macey was a professor of law at Cornell University, Ithaca, N.Y. He is now a law professor at Yale University.

² Pennsylvania H.B. 2179, introduced in November 2005.

sensitive to the fact that as veteran planners, compliance was less of a significant cost factor for them, and not a barrier to entry, unlike planners just entering the business. They therefore attempted to be cognizant of the proportionately higher costs of a regulatory scheme for planners just entering the business.

The Task Force also reviewed how the different regulatory options might work in practice, and how effective each option would be in prohibiting an unethical or otherwise unqualified person from practicing or holding out as a financial planner. Although impossible to quantify costs, they believe that the major tradeoff between subset regulation and professional licensing would be greater credibility in the eyes of the public. The actual value of financial planning to the public, if licensing was clearly associated with financial planning, would lead to a commensurate, higher demand for licensed financial planners.

In addressing all of these questions, the Task Force met monthly during the first half of 2005, including a five-hour, in-person meeting in Clearwater, Florida, following FPA's May 2005 Retreat. The Task Force narrowed down the white paper's regulatory options to what it considered to be four realistic alternatives that would meet FPA's primary aim of "helping to ensure that financial planning is delivered through competent, ethical financial planners." The four options examined by the task force are described briefly in the terminology section on page 6 of this Report. The Task Force determined that it would first outline its goals and objectives, as members would in a financial planning engagement, followed by discussion of each option.

The Board of Directors carefully reviewed this report and determined to submit the group's findings and recommended goals and objectives to membership for feedback via emails, meetings, surveys, or other means. At the appropriate time the Board may take action, if necessary, on the report and in response to any areas of consensus identified in the feedback from members.

II. FINDINGS

The Task Force was requested last year by then-President James Barnash to examine in detail the regulatory options raised by the 2002 white paper, and to report back to the Board with its findings. Its extensive examination of the basic regulatory options led the Task Force to the following conclusions:

1. Financial planning is not widely recognized as a profession, notwithstanding growing recognition of the CFP marks as a sign of professionalism.
2. The public generally does not understand the financial planning process, nor is it able to easily identify a competent, ethical financial planner.
3. FPA currently does not have a long-term plan for addressing future regulation of the profession.
4. If financial planners are to be eventually recognized as a separate, stand-alone profession, continued subset regulation as investment advisers, brokers, insurance agents, or in banking departments will hinder reaching that goal.

5. The financial advisory industry – which straddles the securities, insurance and banking sectors -- is highly fractured and at this stage, disinterested, unwilling, or unable to reach consensus on the best form of regulation and what role financial planning should play in delivering advice to the public.
6. FPA must embrace change as inevitable and develop a strategic and opportunistic approach to establishing a framework for professional regulation, either through changes to law or within the legal system.

III. FPA GOALS AND OBJECTIVES

Based upon an extensive review of the current regulatory environment, the Task Force believes FPA must establish some basic goals and objectives in establishing a regulatory framework for the profession. These goals and objectives also should align closely with FPA's Primary Aim.³ In other words, no matter the eventual regulatory model, these principles and FPA's Core Ideology should be compatible and exist within that framework in order for FPA to successfully achieve its regulatory objectives.

In the past, various legislative or regulatory proposals have been offered in Congress, the states, and by the media on how to regulate financial planners. Some of these were thoughtful, serious proposals, others were less so and doomed from the start for various reasons. In many ways, the occasional speculation over regulating financial planners amounts to 'legislative noise,' not unlike the 'market noise' that clients ask their financial planners about after watching CNBC. The Task Force believes it is critical that FPA not be distracted by the proposal *du jour*, but rely upon the goals and objectives as an important filter in viewing any serious regulatory proposal. Listed below are the goals and objectives for future regulation that the Task Force believes FPA should rely on in crafting meaningful standards for a profession.

- Clear identification by the public of a licensed financial planner.
- Uniform competency and ethical standards for regulating the financial planning process.
- Exemption from duplicative regulation where licensed financial planners meet or exceed existing regulatory standards.
- Fiduciary standard in law for financial planners.
- Peer review process for financial planners.
- Statutory authority to censure, discipline or otherwise bar individuals from holding out as financial planners or practicing financial planning.
- A governance framework that includes professional representation.

³ FPA's Primary Aim states:

- FPA's Primary Aim is to be the community that fosters the value of financial planning and advances the financial planning profession.

- Said regulatory board is ultimately accountable to a public agency and/or legislative entity.

IV. DISCUSSION OF OPTIONS

A. Status Quo Regulation

The “status quo” option is generally viewed by the Task Force as the baseline for comparing regulation of financial planners under existing laws to the advantages and disadvantages of the untested options. However, the status quo option should not be confused with doing nothing. The Task Force interprets the status quo option as meaning business as usual in regards to lobbying on issues important to the profession, as it has in the past. FPA would continue to lobby in support of uniform state regulation, and advocate a level playing field for ethics and competency standards for anyone holding out as a financial planner. In addition, FPA would continue to oppose exemptions for persons seeking to avoid registration from the Investment Advisers Act of 1940 when offering financial planning; and to continue other advocacy efforts.⁴

The major distinction between status quo regulation and the other options is that under the former, FPA would not undertake any strategic, proactive effort to reform regulation affecting financial planners, such as creating a federal or state professional board that would have the legal authority to set standards and bar unqualified or unethical planners from practicing.

The Task Force determined not to consider as an option regulation of investment advisers and financial planners through expanded testing, which was mentioned in the FPA white paper. It is true that securities laws cover investment advice and asset management, core components of financial planning, through a framework that requires extensive disclosure and fiduciary conduct, similar to standards that many FPA members regard as a basic requirement for financial planners. However, as discussed extensively in the white paper, federal and state securities laws focus primarily on securities fraud, not on issues related to professionalism. As one Task Force member noted, the client generally measures damages based on how far the portfolio went down. But there are many other non-securities issues related to professionalism that can harm a client significantly, such as failing to update property and casualty insurance, ensuring that beneficiary designations are correct, and that a living trust is properly funded. The SEC or state securities regulators examine only for securities violations, not professional omissions or ethical conduct.⁵

⁴ Some of FPA’s other advocacy work covers numerous public policy areas not directly related to the regulation of financial planners. To cite a few examples, FPA:

- monitors uniform model state legislation covering trusts and portfolio diversification;
- lobbies for regulation of equity-indexed annuities as securities products;
- lobbies the SEC to include transaction fees in the mutual fund expense ratio; and
- encourages greater savings incentives in federal legislation and portability of qualified plan assets in the federal tax code.

⁵ SEC and some states have ethics requirements, but these generally apply to securities trading

If financial planners wish to be regulated differently from investment advisers, the trend is currently against them. Model securities laws commonly adopted by the states generally include financial planners in the statutory definition of “investment adviser.”⁶ Two states, Maryland and Washington, implicitly require anyone holding out as a financial planner to register as an investment adviser. The SEC decades ago viewed the regulatory status of financial planners as requiring registration as investment advisers. If FPA continues to support the status quo, the commingling of financial planners and investment adviser in the minds of the public and regulators will only increase.

Another important and practical reason for examining status quo regulation is that the marketplace is dynamic and ever-changing. There are no guarantees that whatever success financial planning has had up to this point in defining itself as a profession will not change tomorrow. Since the repeal of the Glass-Steagall Act in 1999, and even before then, the financial services industry had begun to aggressively cross-market services and products within a single retail firm, resulting in greater conflicts of interest at the point of sale. The marketing and advertising of these financial conglomerates has steadily shifted to emphasize a relationship based on trust between the client and adviser when, in reality, regulation governing that relationship has remained stagnant since the Great Depression by continuing to reflect the laws of agency that divide the loyalty of the agent between the firm and the client. Not only are firms that promote the marketing concept opposed to reform, financial planning is often viewed internally as a product, or a platform for identifying other products to sell, not as a professional process in helping clients achieve their financial goals.

1. *The Broker-Dealer Rule and Financial Planning*

FPA’s lawsuit challenging the expansion of the broker-dealer exemption from the Advisers Act, despite a major commitment in organization resources, is an example of reacting to current rules and regulation, not a pro-active initiative designed to change the status quo.

and investment advisory, not financial planning, activities. SEC ethics rules address trading activities. State rules are more extensive, and in addition to trading activities, may restrict an adviser from borrowing or loaning money to a client, disclosing nonpublic information, or charging an unreasonable fee. See Rule 204A-1(a), Investment Advisers Act of 1940, requiring every registered investment adviser to establish, maintain and enforce a written code of ethics that, among other things, requires the reporting of securities transactions by an investment adviser’s access persons. See also “Unethical Business Practices of Investment Advisers,” Rule 102(a)(4)-1, as adopted by the North American Securities Administrators Association (“NASAA”), on April 27, 1997, and amended April 18, 2004.

⁶ The current definition of “investment adviser” in the Uniform Securities Act of 2002, which has already been enacted in at least 10 states, includes “a financial planner or other person that, as an integral component of other financially related services, provides investment advice to others for compensation as part of a business or that holds itself out as providing investment advice to others for compensation.”

The Report of the Committee on Compensation Practices, or so-called “Tully Report” requested by SEC Chairman Arthur Levitt in 1994, eventually led to the Broker-Dealer Rule proposal exempting broker agents from a fiduciary law. Ironically, the Tully Report noted the conflicts inherent in brokerage regulation up to that point:

The RR [registered representative], however, is not just a representative of the customer, but is also an employee of the firm. This means that the RR and the firm each have three interests to balance: the broker has the customer, the employer, and his or her own well-being; and the firm has the customer, the broker, and the firm's own interest (including its shareholders, if it is publicly held).⁷

The Tully Report's most controversial recommendation, in hindsight, was to reduce conflicts by allowing brokerage firms to charge fees for their services instead of commissions, and better align their interests with the customer. The recommendation wasn't so much controversial as the fact that the report failed to address how brokers would be able to charge fees absent any clear exemptions under the Investment Advisers Act of 1940 (“Advisers Act”). As a result, Chairman Levitt directed the SEC staff in fall of 1999 to draft an exemption from the Advisers Act. In proposing the new fee-based exception from the Advisers Act, the Commission failed to recognize the questionable trade-off in reduced churning and unsuitable trades in exchange for a loss of fiduciary protection.

Even before the SEC introduced the so-called Broker-Dealer Rule⁸ to exempt fee-based brokerage programs from the jurisdiction of the Advisers Act, FPA became increasingly concerned by the aggressive marketing practices of the brokerage industry in adopting terms such as “financial planner” and “financial consultant” for their agents, and suggesting that the broker acted solely in the client's interest in their advertising campaigns. **In a sense, a new way of defining financial planning was happening, not as a result of efforts by the profession, or regulators, but as a result of advertising campaigns by Madison Avenue.**

Three years after the release of the Tully Report, the SEC responded to the requests of Merrill Lynch and other wirehouses by proposing a rule in 1999 to allow brokerage firms to charge a fee for advisory services, as mentioned previously. FPA, other adviser organizations, and consumer groups reacted immediately to the proposal by strongly protesting the rule. On Jan. 14, 2000, FPA filed a comment letter to the SEC opposing the rule, the first formal regulatory position taken by the new organization.

Since then, of course, FPA has become increasingly involved in a highly publicized and controversial regulatory and legal battle with the SEC. Yet, the Broker-Dealer Rule

⁷ See Tully Report at 4, <http://www.sec.gov/news/studies/bkrcomp.txt>.

⁸ Known in various quarters as the “Merrill Lynch Rule,” “Broker-Dealer Rule,” or “Rule 202,” the SEC rule was proposed in 1999 to permit brokerage firms to charge fees for advisory services without triggering the special compensation requirements of the Advisers Act that had been in place for nearly 60 years.

should not be viewed as a watershed change in regulation. FPA's decision to sue the SEC, while debated internally for nearly four years, was more of a question over resources, public perception, and its effect on the financial planning community as investment advisers, not on how to shape future regulation of the profession.

In short, the litigation strategy fits within the status quo option. If FPA prevails in its lawsuit, and brokerage firms are required to provide financial planning services under the Advisers Act as they did prior to 2000, FPA would have essentially been successful in restoring the status quo. Winning the lawsuit would not create new standards for financial planners, nor would it materially change the way financial planners are regulated as investment advisers. It would simply level the regulatory playing field for financial planners in subset regulation and require brokers who offer financial planning services for a fee to register as advisers and be subject to disclosure and fiduciary standards, roughly comparable to those under the *CFP Code of Ethics and Professional Responsibility*.

The Task Force also considers the ongoing debate over the SEC's broker-dealer exemption an important lesson in how financial planning can be defined – not just in marketing materials – but in regulatory terms by the financial services industry that literally turned the meaning of financial planning on its head. Before final adoption of the Broker-Dealer Rule in April 2005, the brokerage industry had asserted in comment letters to the SEC that sales representatives should be able to hold out as financial planners. They argued that financial planning was part of the suitability process used in full-service brokerage and therefore solely incidental to the kinds of advisory services that would normally require registration under the Advisers Act. In other words, instead of financial planning being a six-step process, the brokerage community considered it a one-step process: the data collection and analysis that was a part of their “know your customer” requirement.⁹

Broker-dealer comment letters also contended that financial planning could be as simple as a free questionnaire to help a broker develop investment recommendations.¹⁰ Some brokerage firms suggested that Adviser Act registration should only be required for “second-tier” advisory services, i.e., where the client was charged directly for a detailed, written financial plan.¹¹ In summary, there were widely divergent views of what financial

⁹ See e.g., comments of UBS. “We view financial planning as a tool that can help us better serve our brokerage customers; it is an analysis that is part of the suitability determination...” Comments of James D. Price, executive vice president, UBS Financial Services, to SEC, Feb. 7, 2005.

¹⁰ See e.g., comments of UBS. “Our fee-based financial planning services vary in scope and complexity.... We have basic reports that can be made available to any brokerage customer, free of charge.” *Id.* Smith Barney website touts the ‘value of financial planning’ and offers “financial planning analyses free of charge.” https://www.smithbarney.com/pdf/planning_services/making-plans.pdf.

¹¹ See e.g., comments of Morgan Stanley, that financial planning is advice incidental to brokerage and should not be regulated under the Advisers Act; and suggesting that there are two levels of financial planning, one a free diagnostic test identifying risk tolerance and shortfalls in

planning was, all of which were subordinate to what a broker did, or as a product for which there was a separate charge.

FPA strongly disagreed and approached the debate from a totally different direction. In its own response to the Commission over this inverted definition of financial planning, FPA noted that the *CFP Code of Ethics* and related practice standards require a sequential, six-step process in developing, implementing and monitoring a financial plan, and must be performed under a more comprehensive disclosure framework than the suitability questionnaire in a typical brokerage account agreement. Brokerage services, then, were part of the implementation process of financial planning. Financial planning could not be solely incidental to itself. The debate illustrated the tremendous gulf in views by industry as well as by the SEC, the primary regulator of financial planners charged with attempting to help the public understand the distinctions.

FPA's 2002 white paper described financial planning in this way:

The breadth and scope of the advice given by financial planners is what distinguishes them from other, more specialized participants in the financial services industry. Unlike stock brokers, insurance salesmen, accountants, tax planners, lawyers, and trust and estate experts, financial planners may give advice on investments, savings, taxes, insurance, retirement, estate planning, trusts, and real estate.¹²

When the SEC adopted the final rule in April 2005, it provided a similar description of financial planning. According to the SEC adopting release

A financial plan generally seeks to address a wide spectrum of a client's long-term financial needs, including insurance, savings, tax and estate planning, and investments, taking into consideration the client's goals and situation, including anticipated retirement or other employee benefits. Typically, what distinguishes financial planning from other types of advisory services in the breadth and scope of the advisory services provided.

....[F]inancial planners today belong to a distinct profession, and financial planning is a separate discipline from, for example, portfolio management.¹³

FPA warmly welcomed the Commission's description of financial planning as a separate profession, not as an investment adviser activity. Even though its declaration did not have the force of law, for the first time ever a federal agency had expressed a clear distinction between financial planning and subset regulation. Yet having pronounced financial planning to be different, the SEC completely undermined the significance of its groundbreaking interpretation by insisting that the terms "financial consultant" and

investment goals; and a second, more comprehensive planning process. Feb. 7, 2005, Morgan Stanley letter to SEC.

¹² FPA white paper at 5.

¹³ Adopting Release at 54.

“financial advisor” were not misleading terms. These particular terms were indicative of the services traditionally provided by the brokerage industry.¹⁴ Further, the SEC insisted that the “solely incidental” restriction on investment advice provided by a broker was not what it sounded like, but rather meant incidental advice rendered in connection with and reasonably related to brokerage services.

In subsequent guidance to brokerage firms last December, the SEC removed any uncertainty of whether brokerage firms could offer core financial planning services, requiring only that brokerage firms refrain from labeling these services as financial planning. In a letter to the Securities Industry Association, the SEC staff determined that using the same financial calculators used by planners, and later adapted by brokers, was not financial planning if the brokerage services were not bundled together to look like a plan:

A financial plan generally seeks to address a wide spectrum of a client’s long-term financial needs, and can include recommendations about insurance, savings, tax and estate planning, and investments.⁵ *This is distinct from a financial tool [emphasis added] that is used to provide guidance to a customer with respect to a particular transaction or an allocation of customer funds and securities based upon the long-term needs of a client, but that is not applied in the context of the more comprehensive plan described above.*

Stated another way, the SEC backtracked on its previous definition of financial planning. Instead of an unqualified pronouncement that financial planning was a distinct profession, the SEC hedged its interpretation by defining the practice of financial planning as such only when it is done in a comprehensive manner. Since many, if not most, financial planners do not draft financial plans daily (although they may “practice” financial planning by offering a variety of services that are a part of the discipline) a broker could easily evade the SEC’s restrictions by making recommendations involving only one or two aspects of a financial plan, such as estate or retirement planning.¹⁵ As FPA President Dan Moisand observed in a recent trade publication:

This [SEC] interpretation rejects the idea that planning is a process and, importantly, a professional discipline. When a patient goes into the emergency room with a broken arm, isn’t the treating physician practicing medicine? The SEC would argue “no” because a complete physical was not conducted.¹⁶

¹⁴ “We have decided not to include in [the broker-dealer rule] any other limitations on how a broker-dealer may hold itself out or titles it may employ without complying with the Advisers Act.” *Id.* at 58.

¹⁵ As implementation of the Broker-Dealer Rule continues, FPA has heard of ways that brokerage firms are attempting to evade the financial planning restrictions. For example, some firms are setting limits on modular financial planning to avoid appearances of practicing comprehensively. One firm limits advisory services to no more than two areas of modular financial planning every six months (insurance, savings, tax and estate planning, education or investments) before turning to other recommendations. Other firms are deleting sophisticated estate planning tools and instituting policies that restrict the use of financial planning software.

¹⁶ *Wealth Manager*, May 2006.

Adoption of the Broker-Dealer rule and subsequent guidance by the SEC staff did not end the controversy. As a result of the marathon debate six years in the making and still going strong, the SEC also called for a study of overlapping advisory services offered by brokers and advisers. According to the 2005 adopting release, the scope of the study would address whether the SEC should seek legislation to “integrate the existing regulatory schemes for brokers and advisers that provides services to retail clients.”¹⁷ Chairman Christopher Cox, who was sworn in August 2005, recently confirmed that the study would proceed after nearly a year of inaction and no previous public announcements by the SEC.¹⁸

Whether the SEC study leads to any actual change in the laws governing brokers and advisers is of course speculative at this point. The Task Force believes that FPA should adhere to clear, long-term goals and objectives in responding to any future ‘legislative noise’ or other demands for reform.

2. Inevitability of Change

The Task Force believes that there is a steady and growing recognition by Washington policymakers and industry insiders that status quo regulation of the financial services industry simply no longer makes sense. This may create opportunities for change down the road. When and how is uncertain. Notwithstanding widespread dissatisfaction with the current system, change will not come easily. Federal and state regulators will be reluctant to give up jurisdiction, and product-oriented industry groups will only support change where there are specific cost savings to an industry or company shareholders, such as exemptions from fiduciary advisory activities.¹⁹

The insurance, banking and securities industries are among the most powerful lobbies in Washington, D.C. and the state capitols. Given the political hurdles to reforming financial services laws, and the fractured nature of the financial planning profession at this stage in its development, the Task Force believes that any regulatory outcome that addresses financial planning is subject to significant political event risk, and may not ever take place absent a financial crisis, such as with retirement planning, that demands greater consumer protection.

Episodic, limited reform does occur, spurred by crises such as the savings and loan failures of the 1980s, and the securities analyst conflicts, undisclosed payments for

¹⁷ Adopting Release at 68.

¹⁸ Opening Remarks to the Practising Law Institute's SEC Speaks Series by SEC Chairman Christopher Cox, Washington, D.C., March 3, 2006.

¹⁹ See, e.g., in securities regulation, NASD Notice to Members 91-32, 94-44, and 96-33 to expand broker-dealer oversight of “selling-away” activities by registered representatives, including outside financial planning activities; in Congress, banking legislation that would exempt credit unions and thrifts from the Investment Advisers Act of 1940; and ERISA legislation that would exempt all financial services industries from self-dealing restrictions on providing personalized investment advice on 401(k) and other qualified plans to employees.

pushing specific investment products, and rapid trading of mutual funds uncovered by state regulators several years ago. None of these events, though, caused wholesale change to federal laws except to create tougher rules for industry participants.

Despite the political road blocks to reform, the Task Force believes that growing conflicts in the financial services industry through cross-selling, regulatory responses restricted to increased fines and new compliance mandates, and the growing need for objective advice by consumers, will eventually make reform more desirable and even compelling to industry, consumers, and public policymakers. The Task Force believes that FPA should be prepared to seize the opportunity, if it arises, to advance FPA's primary aim through higher standards for advice-givers.

3. GAO Report

Major federal agencies are already starting to look seriously at reform. Reinforcing the SEC's view that a broader look of financial services is needed, the General Accountability Office ("GAO"), which is the independent auditing arm of Congress, in 2004 determined that the U.S. financial services regulatory system is not working efficiently as it could on a macro-level. GAO concluded that the regulatory structure has "worked well on some levels, but not on others."²⁰ More importantly, GAO noted that while the U.S. system has contributed to development of the U.S. capital markets and the U.S. economy overall, it nonetheless "does not facilitate the monitoring of risks across firms and markets, and does not provide for a proactive, strategic approach to system wide issues." While the regulatory system has generally been successful, it "lacks overall direction," the GAO reported.²¹

Although much of the GAO report focused on the regulatory system's need to respond to global markets, it also made specific recommendations to Congress in considering in modifications to the internal regulatory structures:

- consolidating the regulatory structure within the "functional" areas of banking, securities, insurance and futures, partly through integration of state and federal regulation;
- moving to a regulatory structure based on regulation by objective, or a "twin peaks" model: one entity overseeing safety and soundness of financial institutions, and the other ensuring compliance with marketing and point of sale practices;
- combining all financial regulators into a single entity, similar to the United Kingdom's Financial Services Authority; or

²⁰ See "Industry Changes Prompt Need to Reconsider U.S. Regulatory Structure," GAO report to the Senate Committee on Banking, Housing, and Urban Affairs, Oct. 6, 2004, at 1.

²¹ *Id.* at 113.

- creating or authorizing a single regulatory entity to oversee all large, multinational financial services firms and leaving the bulk of the U.S. regulatory structure in place.

The Task Force cites this as an example of a growing recognition that the existing regulatory framework that has not kept up with the marketplace. FPA's core membership has not been affected as much by the recent compliance mandates of the SEC as have larger firms, but many members support regulatory reform for an entirely different reason, and that is to use the catalyst of change to achieve identification as a true profession. Many of the older, successful financial planning firms have developed practices with all of the characteristics of an established profession and a clear professional culture offering a sophisticated array of financial planning services, including custodial and trust services. They operate in a professional environment. What they lack is formal recognition as an established profession.

The Task Force examines this question from the premise that there is little evidence that the widespread public confusion over financial planning is abating. Consumers continue to question the intrinsic value of financial planning, notwithstanding the strides many financial planners have made in having their clients recognize the value of their services and in developing the characteristics of a profession.²² The fight over the Broker-Dealer Rule illustrates the political reality that opposition by an entrenched and powerful industry group can outweigh persuasive, common-sense arguments supporting consumer protection. In summary, while market demand illustrates the growing need for competent, ethical financial planners, there is little evidence that other industry groups are interested in embracing higher standards at the cost of greater liability.

An equally important question debated by the Task Force is who should and should not be permitted to legally provide financial planning. The Task Force believes relying on current regulation of financial planners through subset regulation will not eventually lead to widespread public acceptance of financial planning as a profession until those who violate the standards or are otherwise unqualified are barred from the business. This, they believe, can be done only through changes to the law explicitly licensing planners and enforcing rules that lead to disbarment. Education in the marketplace of the value of financial planning, or by private, voluntary certification alone will not be enough to help the public recognize ethical, competent planners.

FPA currently has no strategic plan or position on the best way to regulate financial planners. If FPA were to endorse the status quo, either formally or by not taking a pro-

²² A recent joint survey by FPA with the Consumer Federation of America suggested that a surprisingly high percentage of Americans think that the most practical way for them to accumulate several hundred thousand dollars is to win the lottery. When asked about the most practical way for them personally to accumulate several hundred thousand dollars, over half (55%) said "save something each month for many years." Yet, more than one-fifth (21%) said "win the lottery," and among the least affluent and those over 55 years of age, these percentages were much higher -- 38% and 31% respectively.

active approach to other possibilities, FPA could be placed under severe time constraints to respond to serious efforts at reform. At best, if FPA were not to take a position on future regulation, or preferred to avoid the controversial aspects of taking a position, this might ultimately restrict FPA's ability to influence the process and allow other organizations to define the profession.

B. State Licensing of Financial Planners.

The Task Force defines state licensing as similar to the licensing and disciplinary procedures for established professions, namely accountants, lawyers, doctors, architects, and engineers. The state laws regulating these professions and protecting the consumers to whom they provide professional services were generally enacted in the late 1800s and early 1900s by state legislatures for the purpose of protecting the public interest if the unregulated practice would otherwise harm or endanger the public's health, safety or welfare. The laws were generally based on the legislative premise that the public would not receive adequate protection by any other means.²³

Today, a bewildering array of different occupations and professions are licensed by the states. Besides the aforementioned professions, New York has 47 licensed occupations and professions, ranging from acupuncture to massage therapy and veterinary medicine; California has 40, including cosmetology, home furnishings and structural pest licenses. Even Delaware, one of the smallest states, has 55 licensing categories for professions and occupations, including Deadly Weapons Dealers, Dieticians, Adult Entertainment Establishments, and Bounty Hunters. Yet no state has a professional licensing requirement for financial planners, or for that matter, insurance agents, brokers or investment advisers.

The Task Force believes that the traditional approach to state licensing of professionals warranted careful examination. Indeed, many financial planners consider state licensing as the next logical step for an emergent profession. However, because the barrier to interstate commerce is the most commonly cited problem with professional regulation, the Task Force believed that exploring this issue was also an imperative.

1. Defining a Profession in Statute.

Nearly all licensing laws provide a definition of the occupation or profession in order to define who should be licensed. Professions that overlap to an extent, like engineers and architects, often use limited exemptions to avoid redundant registration requirements. The same holds true for financial regulation, which was largely enacted by Congress during the Great Depression, when many banks failed, and investors suffered major losses in a largely unregulated securities market. In the 1930s, Congress passed a series of financial services laws defining broker-dealers, investment companies, banks, investment advisers, and various exemptions for different groups.

²³ See, e.g., South Carolina's Board Regulation of Professions and Occupations, Sec. 40-1-10, Extent of Regulation.

The question naturally arises how should financial planning be defined in a statute, if at all. The Task Force notes with interest the legal profession's practical solution to the question, which is to create barriers to entry by prohibiting the unauthorized practice of law, but without actually defining the practice of law or "attorney" or "lawyer." After considerable discussion, the Task Force returned to this minimalist approach as an appealing alternative than attempting to define a multidisciplinary profession. The Task Force notes the past challenges faced by other organizations and volunteer groups within FPA in attempting to do so.

The Task Force also observes that CFP practitioners are subject to definitions of financial planning under the CFP *Code of Ethics*. However, these definitions are often more descriptive than useful as a statutory definition for licensing purposes. The CFP *Code* defines "financial planning" as

[T]he process of determining whether and how an individual can meet life goals through the proper management of financial resources.

The CFP Code's terminology goes further in defining the "financial planning process" as including, but not limited to, six steps:

- 2) establishing and defining the client-planner relationship;
- 3) gathering client data;
- 4) analyzing the client's financial status;
- 5) developing and presenting the recommendations;
- 6) implementing the recommendations; and
- 7) monitoring the plan.²⁴

Further, the CFP Board's terminology "fleshes out" the core areas of expertise within financial planning by describing the general subject areas as including, but not limited to:

- Financial statement preparation and analysis
- Investment planning (including asset allocation and management)
- Income tax planning
- Education planning
- Risk management
- Retirement planning
- Estate planning

Finally, each of the general topics above are covered in the CFP exam in even greater detail – by being broken out into a total of 80 or so subject areas. The CFP Board definition of financial planning by necessity needs to be extremely broad to cover the

²⁴ These six steps also serve as the core requirements for the practice standards that CFP practitioners and all FPA members are required to follow in a financial planning engagement.

myriad number of topics which a CFP practitioner must be able to address in a client engagement.

In practical terms, developing a clear terminology to *describe* financial planning activity is necessary to comply with the *Code of Ethics* and to address consumer and professional complaints filed for violations of the *Code*. But there is a critical difference between voluntary certification and mandatory licensing in establishing a profession. Many of the CFP practitioners who went through the certification process were already regulated under existing subset law. They did not have a problem with the new ethical and compliance requirements because they voluntarily elected to learn more about their chosen career and to abide by those rules. Moreover, while the post-certification burden is not inconsiderable – each CFP certificant must maintain 30 hours of continuing education credit bi-annually, it is not overly burdensome compared to securities regulation. The CFP Board does not make surprise audits or require peer review. As a result, other industry groups don't object to voluntary certification, since it does not create any new compliance or liability costs for the firm.

The primary problem with the generic description of services in the terminology section of the CFP *Code* is that these broad characterizations of financial planning services, such as the CFP Code's definition on page 20, would pick up so many other regulated subsets of financial planning, that any financial planning definition would inevitably trigger licensing requirements for individuals who provide any personal financial advice, including those in a specialty area of financial planning. The insurance and brokerage industries, which provide services related to investments, retirement, and education planning, would strenuously oppose new regulation. Attorneys would object to having to become dually licensed if their specialty practice area was estate planning, and so on.

In order to properly license financial planners who provide various financial planning services, but avoid sweeping in lawyers, accountants, insurance producers and broker agents whose services contain broad elements of financial planning, the Task Force concluded that broadly defining the practice of financial planning is impractical. The Task Force describes the "practice of financial planning" as occurring when a financial planner handles a specific task for a client, such as recommending insurance amounts or performing an IRA rollover, but keeping in mind other considerations that may affect the client's situation as a result of the more limited engagement. But to take a functional description of what a financial planner considers in handling a specific client situation would be difficult to define in law for purposes of licensing a financial planner.

An alternative that the Task Force also rejected would be to define comprehensive financial planning or a financial planning engagement as a means to identify and regulate the 'real' planners. Taking this narrow approach might result in only covering the minority of persons who develop comprehensive financial planning on a daily basis, and not the others who "practice financial planning" in other ways as described above. For example, FPA in the past has objected to the SEC's characterization of financial planning in the Broker-Dealer Rule as occurring only when someone was engaged in providing a full range of financial planning services. Not many financial planners do comprehensive financial planning every day. The SEC's recent guidance is flawed by

basically suggesting that only those brokers who offer comprehensive financial planning need to register as investment advisers, but brokers providing *de facto* modular planning can thereby avoid registration and the fiduciary standards of the Advisers Act.

As a result, the Task Force examined another traditional method for licensing professionals. Instead of defining financial planners by what they do, financial planners could be defined with a simple holding out restriction. In this way, anyone who holds out to the public as a “financial planner,” or a similar-sounding title, would be prohibited from practicing financial planning unless properly licensed.²⁵

In reaching consensus on this approach to defining financial planning, the Task Force then proceeded to examine how financial planners might be held to commensurate standards. The Task Force assumes that if FPA supported state licensing, just as it does in examining proposals that regulate the subsets of financial planning, it would use the CFP *Code of Ethics* and qualifications as a baseline. Thus, any state licensing requirements or standards promulgated by a licensing board should include education and examination standards, continuing education requirements, and strict ethical standards for financial planners generally consistent with the same standards administered by the CFP Board of Standards. Unlike certifying bodies that can only bar someone from using a trademark on their business card, however, state law would provide enforcement teeth by actually prohibiting someone who has been suspended or otherwise disqualified from state licensing to continue to practice or hold out to the public. In addition, the Task Force strongly believes that licensed financial planners should be required to undergo a peer review process through periodic or surprise audits to ensure ongoing competency.

The Task Force further notes that simply passing the CFP exam does not allow someone to use the registered marks when practice financial planning, just as holding a medical degree does not allow someone to practice medicine without first meeting an experience requirement. The experience requirement for CFP designees requires three years of experience in some aspect of financial planning. And while most professions require evidence of competency or experience in the field, industry laws often do not.

²⁵ Similarly, the SEC refrained from defining “financial planning” in the recently adopted broker-dealer rule by opting for a holding-out approach. The Commission initially seemed to suggest that it would look beyond a simple ‘holding out’ restriction for financial planners as a factor, by including the delivery of a financial plan or providing investment advice in connection with financial planning as triggering registration. “Whether a particular document is, under the rule, a financial plan will turn on whether the document or representation bears the characteristics of a financial plan,” the adopting release stated. “Whether a communication represents that the services provided are financial planning services will depend on how a reasonable investor would understand the services described in the communication.” However, subsequent guidance by the SEC appeared to backtrack from regulating persons who providing financial planning services when it stated brokers could use financial calculators – the same data collection and analysis processes used by financial planners – as long as they did not ‘hold out’ as financial planners or offer recommendations that appears to be a financial plan. It appears highly unlikely, in light of this new guidance, that the SEC will make any serious effort to further define financial planning in practice. Adopting Release at 58.

Securities and banking laws, for example, do not restrict someone from being able to provide services if they have no relevant experience, distinguishing these occupations from other professions. The Task Force felt the experience requirement should be a core component of any professional licensing requirement.

The Task Force observes that the lack of enforcement authority of the CFP Board of Standards to subpoena, bar or otherwise sanction someone for violations of the CFP Code -- other than taking away their use of the CFP marks -- does not effectively protect the public from unethical or incompetent financial planners. The Task Force notes that up to 250,000 persons in the financial services industry may currently hold out as financial planners to the public, whether they are registered as investment advisers or work in the banking industry. Only 50,000 of those persons in the U.S. are certified by the CFP Board to practice financial planning. No other established profession has only one out of five professionals clearly qualified to practice under a uniform set of standards and subject to a rigorous set of ethical requirements. In any other profession, the others would be barred from doing business, thereby protecting the public from dishonest, unqualified or unethical members of the profession, and thereby enhancing and protecting the overall reputation of the profession itself.²⁶

2. Exemptions

Exemptions from statutory licensing for related professions are problematic at best and do not always offer a “bright-line” between different occupations. Exemptions usually result from the fact that a similar or related business activity must be differentiated to avoid redundant regulation. Most laws address this problem by providing limited exemptions for related professions unless those persons meet certain criteria for full exemptions. Engineers, for example, and even farmers who erect barns and silos, generally have limited exemptions from state laws that license architects. Attorneys and CPAs may practice before the Internal Revenue Service without taking an exam. Enrolled Agents, however, must meet the IRS examination requirements. Banks were fully exempted from the Advisers Act in 1940, presumably because their primary business was banking, not investment advice, and because they, too, have a fiduciary obligation to their banking clients. Even though attorneys are fiduciaries, they have a limited “solely” incidental exemption when giving investment advice.

The obvious challenge in creating reasonable exemptions in financial planning regulation is that financial planning was developed originally by the very same registrants who sell insurance policies, stocks and bonds, and give their clients investment advice. As a result, the core disciplinary areas of financial planning were regulated before financial

²⁶ The recent adoption of ISO standards for financial planning were not actively considered by the Task Force as a viable alternative. ISO standards, which are comparable to CFP standards for qualifications, experience and ethics, nonetheless allow someone to self-certify and hold out as such. They cannot be barred by any state or federal agency or private certifying body from referring to themselves as qualified, unless such agency in the future determines the practice was deceptive and misleading to consumers.

planning became popular. Many today still consider these other areas to be their primary business, not financial planning.²⁷

The problem is that most of the existing regulation occurs on the implementation side of financial planning. Implementation of the financial planning recommendations, or the fifth step in the financial planning process, is already regulated, although usually with little disclosure of conflicts and accompanied sometimes by suitability – not fiduciary -- standards. The insurance, brokerage and investment advisory industries have been heavily regulated since the Great Depression. In each area of regulation, laws and rules have developed over the years permitting registrants under those laws to provide advice in connection with the products or services provided. Increasingly, regulators are expanding their interpretation of those services to include key components of financial planning.

The challenge in creating effective exemptions from financial planning regulation is twofold: 1) making the exemption reasonably exclusive so that it doesn't require other professionals to have to register as financial planners because they are portfolio managers or sell insurance or investment products (part of the implementation phase of financial planning); and 2) making the exemption reasonably inclusive so that the advice provided by these other professionals doesn't permit them to offer financial planning advice outside of their specific area of expertise. Drafting a successful exemption that prohibits financial planning by other industries may be the biggest challenge, since industry groups are typically attracted to financial planning as a marketing and data-collection platform to gather assets or sell products. Overly restrictive exemptions that require licensing for holding out as a financial planner could generate intense opposition in a legislative or rulemaking process.

3. Pennsylvania Proposal

While the Task Force discussed state licensing in concept, several months after its discussions ended a proposal to license financial planners was introduced in the Pennsylvania General Assembly. The proposal, House Bill 2179, appealed in some ways to the Task Force because of its professional standards for financial planners, but some of the provisions were clearly irrelevant. The proposal was introduced at the behest of a CFP practitioner who said he was concerned about abusive sales practices, but also wanted to see financial planners licensed.²⁸

²⁷ Many FPA members continue to hold three licenses in order to legally give advice as part of the financial planning process. They do not always earn a fee directly for their financial planning, but offset the upfront costs of data collection and analysis, and developing the client recommendations, through compensation received in the sale of products, or managing assets when the plan is implemented.

²⁸ Regulators are beginning to address some of the problems in the insurance industry related to annuity sales. The NASD recently announced it would start examining the sales of equity-indexed annuities by registered representatives, even though such products are not considered 'securities' and therefore not under its jurisdiction. The National Association of Insurance Commissioners ("NAIC") several years ago proposed a model suitability requirement for the sale

The bill seems to be a blend of CFP educational standards and accounting and auditing requirements. HB 2179 establishes a State Board of Financial Planners and imposes licensing requirements and penalties. It also requires the registration of financial planning firms.

Some of its highlights:

Definition. In addition to unrelated auditing and attest activities that were inexplicably included under the definition, financial planning” is defined as including:

Other financial services involving the use of financial planning skills, including, but not limited to, management advisory or consulting services, business valuations, accountancy, preparation of tax returns or furnishing of services as a financial analyst, financial advisor, financial consultant, financial planner, investment consultant or wealth manager, advice on tax matters by a person holding out as a financial planner or firm.

In addition to the above functional definition (which captures several other areas of subset regulation), the definition includes a “holding out” provision that states

Any representation of the fact that a person, or an individual associated in any way with a person, holds a certificate of financial planner, a registration as a financial planner or a license, made in connection with the performance of, or an offer to perform, services for the public. A representation shall be deemed to include any oral or written communication conveying the fact that the person or individual holds a certificate, registration or license, including, without limitation, the use of titles or legends on letterheads, business cards, office doors, advertisements and listings or the displaying of a certificate, registration or license.

Standards. The proposal also requires a peer review by a licensed financial planner who is not affiliated with the individual or firm being reviewed; creates a financial planning board appointed by the governor to include among the eight members “at least six of whom are actively engaged in the practice of financial planning;” the authority to revoke or suspend licenses; to collect fees; and to promulgate rules for professional conduct. Regarding the examination requirements for individuals, the bill borrows from the CFP Board of Standards’ educational requirements by requiring the course work to cover the same areas covered in the CFP curriculum;²⁹ the proposal would require an exam covering the curricula and allowing the Board to contract out to a professional testing organization for developing and administering the exam. The legislation also

of annuity products to persons age 65 or over, but recently amended the suitability rule to include sales to all ages. NAIC model rules, like NASAA’s, must be adopted on a state-by-state basis and are sometimes adopted in whole, sometimes amended, and sometimes ignored.

²⁹ The listed items in the bill are: general principles of financial planning; insurance planning and risk management; employee benefits planning; investment planning; income tax planning; retirement planning; and estate planning.

allows for certain professionals to challenge the exam by not having to take the courses, including CPAs, ChFC/CLUs, CFAs, and others, similar to the CFP Board's challenge requirements.

Uniformity. While the bill has reciprocity requirements for persons licensed in other states who have met comparable testing requirements, there is no provision for client *de minimis* exemptions or other uniform regulation such as is contained in the Advisers Act. In other words, if the legislation were to become law – and it appears very unlikely given regulatory opposition as well as from industry groups – financial planners would be faced with paying a licensing fee for each state in which they maintain at least one client. The lack of uniformity in other state licensing models, of course, is one of the principal concerns of the Task Force.

The bill appears unlikely to pass or receive significant political support in the current session.

C. Professional Regulatory Organization.

Federal regulation of financial planners anticipates a federal professional regulatory organization (“PRO”) authorized by Congress to license and oversee professional financial planning activities of anyone holding out as a financial planner. The regulatory framework for a PRO was anticipated to be similar to that of a state licensing board inasmuch as the PRO would presumably have the authority to develop standards and qualifications for registration.

The principle distinction between a PRO and a state licensing board involves oversight. It was envisioned that a PRO, like SROs today, would be subject to rule review and approval by the SEC. In the case of a state financial planning standards board, it would be subject to oversight by the governor who has the authority to appoint and remove members of the Board. Both would also be subject to legislative oversight, directly or indirectly, through the appropriation process or changes to the law establishing the regulatory agency. The Task Force believes the obvious advantage of the federal model over state licensing is the ability to establish uniform regulation across state boundaries and thereby allow an individual licensed with a federal board to be able to practice in multiple states without the regulatory costs or barriers associated with state licensing.

The Task Force envisions the PRO governance structure, however, as substantially different from a self regulatory organization (“SRO”), or securities industry regulator like the NASD or the New York Stock Exchange. The regulatory functions of SRO and PRO may appear to be similar, but in general a PRO would distinguish itself from an industry model by supporting professional standards of conduct applicable to the financial planning process, not to the sale and distribution of financial services products, or to trading activities of an exchange. Moreover, a more important difference to the Task Force was that the SRO is more influenced by industry, rather than professional or consumer criteria, even though both, as mentioned earlier, would likely be held accountable for their rules and regulations to a federal agency, like the SEC.

The Task Force believes that for the federal concept to work, any federal law authorizing the creation of a financial planner PRO would need to mandate development and enforcement of standards that not only place greater emphasis on serving the public, but that also advance and maintain professionalism in the field of financial planning. Similar to industry funding of the SROs, however, the PRO likely would be funded by financial planners through licensing fees. The PRO would have the authority to set appropriate standards of competency and ethical practices for the profession, and again, such rules would be subject to oversight by an existing federal agency, such as the SEC.

Unlike the CFP Board, which is not accountable to its certificants in terms of regulatory decisions, budgets or fee structures, PRO registrants would have avenues of appeal to the SEC or Congress if there were ever any controversial action taken by the PRO.

Several years ago the SEC issued a “concept release” soliciting comment on a SRO for investment advisers and fund companies. FPA responded by opposing a SRO for investment advisers, and recommending that it study a PRO for financial planners. No action was ever taken by the SEC after receiving strong opposition to the SRO concept.

As with any effort to claim a legal stake in the regulation of financial advice, the PRO proposal is not without controversy. It is not necessarily a ‘clean’ option that would work without compromise and specific state involvement.

First, most state securities commissioners consider financial planning to be one of their principal areas of jurisdiction, even if most regulate only the investment advisory activities of financial planners, like other registered investment advisers. State securities administrators would likely oppose any exemption or loss of jurisdiction over financial planners who provide investment advice.³⁰

Moreover, state insurance commissioners and states attorney general might also object to the loss of regulatory jurisdiction for insurance advice and enforcement actions. Even if state objections could be overcome, industry groups with a vested interest in providing financial planning advice would oppose what they may consider a new layer of regulation or added liability. Recall the reaction of Wall Street firms’ opposition to FPA’s efforts to get rid of the Broker-Dealer Rule. In any pro-active effort to establish a federal PRO for the profession, FPA would need support from a number of different organizations.

Even if it were possible to move a PRO proposal through Congress, governance would also come up as a controversial issue. Should the regulatory board be weighted more toward consumers, to members of the profession, or to other regulators? Should the states be offered seats, such as one for a NASAA and one for a NAIC representative? Other jurisdictional issues arise in connection with governance: because financial

³⁰ The state securities administrators bitterly fought preemption in the mid-1990s when the National Securities Markets Improvement Act divided regulation of investment advisers between the states and the SEC. The states were granted continued authority to investigate fraud by any adviser, state or federally registered; to continue to charge notice-filing fees; and to license and test investment adviser representatives of SEC advisers with a place of business in their state.

planners typically give advice on retirement planning and employee benefits, would the Department of Labor want to be involved somehow, or reserve the right to continue to regulate qualified plan advice under ERISA? Would NASD, concerned with losing jurisdiction over some advisory activities of brokers, also actively oppose a financial planning board on the federal level?

How galvanized would industry groups become in opposing the legislation? There is no simple solution if FPA were to endorse and actively lobby for federal regulation of financial planners. Many of the same problems associated with a state licensing scheme – the definition of financial planning, who's in and who's out of regulation, and costs of setting up the regulatory structure – would arise as similar issues under a federal model – only on a national scale.

D. Consumer Litigation Option.

The consumer litigation model envisioned by the Task Force would require FPA to dedicate resources to monitoring litigation on federal and state levels, and identify key cases where FPA could influence the development of professional standards through case law, not legislation.

The 2002 white paper spent considerable space reviewing this option. It quoted Dick Wagner, a pioneer in the financial planning profession, as endorsing the concept. “[Financial planning] has never bothered to look at individual litigation or attempted to provide guidance to a given court as to the potential implications of a particular decision,” Wagner said.³¹ White paper author Macey noted that regulators focus primarily on anti-fraud regulation in securities laws, and not on regulating professionalism. It is far more difficult to legislate ethical standards than it is for fraud or quantitative problems, Macey observed, thus one of the advantages of shaping ethical standards in case law.³²

The Task Force spent considerable time reviewing this option as well. It believes that consumer litigation, if applied effectively by FPA, could over time develop case law to shape professional standards for financial planners as it has for well-established professions. Case law precedent could decide once and for all when a planner is a fiduciary and when he or she is not, or acting in a different capacity. Unlike the other regulatory options, the Task Force viewed consumer litigation as a flexible option: one that could serve as FPA's primary strategy for developing professional standards, or to be used in coordination with any one of the other options.

An example illustrating the case law approach is the CFP Board of Standard's amicus brief filed in connection with *Ibanez v. Florida Board of Accountancy*.³³ The U.S. Supreme Court reviewed the appeal of Silvia S. Ibanez, CFP®, who was also a Florida

³¹ FPA white paper, at 99.

³² *Id.* at 98.

³³ See *Silvia S. Ibanez v. State of Florida, Department of Professional Regulation, Board of Accountancy* [legal cite (1994)].

attorney and certified public accountant. Ms. Ibanez was disciplined by the Florida State Board of Accountancy for using the CFP designation in a yellow pages ad and on stationery and business cards. As a basis for her legal challenge, she asserted the Accountancy Board's rules violated her right to freedom of speech. The Supreme Court agreed, holding that the Accountancy Board's censuring of Ibanez was incompatible with her First Amendment rights, and that use of the CFP and CPA designations qualified as commercial speech. According to the Supreme Court, a state could only ban such speech if it were false, deceptive or misleading.

The current litigation initiated by FPA against the SEC should not be considered a consumer litigation strategy, as noted under the status quo option. Although the lawsuit has the effect of enhancing consumer protection, and prompted the SEC to respond by distinguishing financial planning as a profession separate and apart from portfolio managers and other investment advisers – its legal challenge has nothing to do with shaping case law affecting financial planning standards. The lawsuit itself is over an interpretation of the SEC's discretionary authority to create new classes of exemptions, not over financial planning standards.

In researching case law for the white paper, Macey was unable to find much in the way of anything related to financial planning. Two cases raised the issue of factors used in assessing whether financial planning was a profession. FPA and the CFP Board were unaware of these cases at the time they were being litigated. One case, an appeal to the North Dakota Supreme Court by a CFP practitioner, held that the planner was not a "professional" for purposes of meeting a malpractice statute of limitations because a CFP practitioner is not required to possess a college degree. In light of that opinion, the CFP Board subsequently set a deadline for future candidates to be college graduates prior to taking the exam.³⁴

A second case reviewed by the New York Court of Appeals did not address financial planners, but it did determine that insurance agents and brokers were not professionals in the same context of the state's statutory time limit on filing malpractice suits. This court held that the work experience and education requirements for insurance agents and brokers simply were not rigorous when compared to recognized professions.³⁵

There are a handful of other cases that touch on standards for financial planning. In an administrative proceeding by the SEC (which has no effect on case law), an SEC administrative law judge held that an IFG broker, who was also registered as an investment adviser, differentiated his roles as adviser and broker by being aware of his fiduciary capacity in developing a financial plan for his customers and then disclosing the change in regulatory status when he offered load products to them, including the fact that in his role as a salesman, he held a self-interest.³⁶

³⁴ White Paper at 79; *Kuntz v. Muehler*, 603 N.W.2d 43, 47 (N.D. 1999).

³⁵ *Id.* at 80; *Chase Scientific Research v NIA Group, Inc.*, 749 N.E.2d 161 (N.Y. 2001).

³⁶ See *In the Matter of IFG Network Securities, Inc.*, William Kissinger, Kissinger Advisory, Inc. Bert Miller, Glenn Wilkinson, and David Ledbetter, Feb. 10, 2005, before Carol Fox Foelak,

Finally, a federal court last year considered, albeit indirectly, the issue of when does the advisory part of a financial planning relationship end and a brokerage relationship designed to implement the plan begin. In the investor's suit, *Safer v. Nelson Financial Group*, the Louisiana plaintiffs had entered into various agreements with Nelson, an independent RIA based in Ohio who was affiliated with a broker-dealer. The plaintiffs, who lost 50 percent of their portfolio value over a three-year period, argued the dispute involved the advisory agreement and should be tried in court, while Nelson countered that the claims involved brokerage services and should be submitted to arbitration. The investors responded that they had no problem with the trades, or implementation of the financial plan, but it was the advice, a methodology based on predicting stock market behavior by tracking birth rates, that was flawed. The Fifth Circuit Court of Appeals overturned a lower court decision, and held that the matter should be submitted to arbitration. The advisory agreement, the Appeals Court held, terminated upon delivery of the financial plan.

In reviewing this case, the Task Force did not have consensus on how FPA might get involved were it to employ the consumer litigation strategy, illustrating the complexity of this regulatory option. The key issue for the Task Force is to what extent should the financial planner be held to a fiduciary standard in implementing and monitoring the plan. The advisory agreement clearly stated that the clients were under no obligation to implement the plan with the planner, but if they did, the planner would implement his recommendations in his role as an agent of the broker-dealer. At least one Task Force member felt that while it was important to protect the client, planners should be afforded protection, too, under the law. Another Task Force member wasn't sure if the lines between recommendations and implementation could be drawn precisely in determining a financial planner's duty to the client.

The discussion of how to best use consumer litigation led to many more questions than answers:

- How would FPA be able to define financial planning in case law if it could not control the pace of litigation, e.g., be able to pick and choose key cases?
- Would FPA be able to identify an adequate number of cases involving financial planning, since many would be hidden in NASD arbitration, where there are little or no public records available?
- How would FPA assess the validity of the case and whether it's merely a nuisance suit?
- How much impact would FPA have on a case merely by filing an amicus brief at the appellate level, which rarely offers decisive arguments in comparison to the litigants' briefs?
- Since many cases usually involve unsuitable investments, the financial planning process itself may not be the focus of litigation.

- Would an energetic consumer litigation program backfire and draw criticism from FPA members by exposing liabilities for planners that might otherwise go unnoticed?
- Would FPA be able to effectively track the hundreds or thousands of cases filed in state or federal courts to identify the appropriate ones, and would it have the resources to get involved?

The Task Force noted that while litigation is an option to resolving a disagreement between an investment adviser and a client if there is no alternative dispute remedy stipulated in the client contract, the consumer litigation strategy would not reach beyond independent financial planners since those affiliated with brokerage firms would nearly always require binding arbitration.

FPA would then face the choice of a fairly limited choice of cases from which to select. Or it could take a more controversial approach by pushing for reform of the arbitration process in Congress, such as allowing forum choice by brokerage customers. FPA could also revisit a position of the Institute of Certified Financial Planners and National Association of Personal Financial Advisors which, in the early 1990s embraced a private right of action under the Advisers Act. The legislation failed in Congress, but a private right of action – which is rare in federal laws and contrary to the Federal Arbitration Act – would have permitted a client to sue an adviser based on a violation of the law, not of a contract. Currently only federal agencies have the authority to bring litigation and criminal actions against investment advisers for violations of the Advisers Act.

Alternatively, FPA could work more aggressively to encourage expert witness work by financial planners in cases involving professional issues. This would not materially change the way case law or arbitration addresses financial planning issues, but it would afford greater recognition of financial planners as authoritative experts.

In summary, the Macey proposal raises some intriguing alternative and untried prospects for defining financial planning as a profession.

V. RECOMMENDATIONS

The Task Force encourages the Board to review and discuss the analysis as laid out in this Report. It welcomes the opportunity to interface with the Board in connection with any specific questions or issues that are raised in the Board's deliberations. It offers its recommendations as a two-step process: 1) encourage member feedback; and 2) assuming consensus on goals and objectives, to embark on a specific strategy and tactics for achieving its objectives.

A. Member Communications and Feedback

Should the Board agree with the Task Force's findings, in particular that the status quo is unacceptable and that a long-term plan is needed to clearly identify and set standards for the profession, then it believes buy-in from membership is critical. More specifically, the Task Force sees a successful outcome as a dialogue with members reaching consensus

on the goals and objectives, not on the specific regulatory option or tactics. Once membership – through a combination of surveys and meetings with the Chapter Leadership Resource Council, chapter leaders, and various other leaders of the profession – reaches consensus on goals and objectives, and fully understands the risks and costs involved in a pro-active effort, then it would be up to the Board to dedicate the resources and approve the general strategies needed to achieve the objective.

Given the ever-changing political dynamics in the nation's capitol, the strategies employed to reach this objective should be fluid and flexible, anchored by resource allocations of the Board and adherence to the goals and objectives in any legislative or litigation initiative.

VI. CONCLUSION

The Task Force recognizes the controversial nature of its recommendations, and that the Board and FPA members who have not had the opportunity or time to examine the issue in-depth as has the Task Force, will require considerable time and effort to achieve consensus.

No matter the outcome of this review, we wish to thank Jim Barnash for his foresight and interest in looking to advance the profession in regulatory terms. We greatly appreciate the opportunity to serve on what we consider to be one of the most important volunteer works groups ever appointed by this association. We are pleased to submit this report as evidence of our careful consideration of the issues involved in financial planning regulation. We look forward to responding to any questions or comments.

Sincerely,

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