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Comments: Regulation of Financial Planners

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COMMENTS

REGULATION OF FINANCIAL PLANNERS

In the last ten years, financial planning has grown from a business practiced by a small number of persons into a large and sophisticated industry. This expansion has come as a result of recent changes and developments in the financial services industry, including increases in the availablility of financial products and services. The substantial increase in the number of individuals engaged in financial planning has not been accompanied by the creation of a corresponding system of financial planner regulation. This situation has led the federal government, certain state governments, and several securities and financial planner associations to consider regulating the financial planning industry. In this comment the author presents an overview of the financial planning industry and examines the federal and state regulatory structures within which financial planners currently are regulated. The author then addresses whether new or additional financial planner regulation is necessary and surveys new proposals and legislative initiatives that have been advanced to regulate financial planners. The author concludes with recommendations for an effective approach to financial planner regulation.†

I. THE FINANCIAL PLANNING INDUSTRY

The financial planning industry is comprised of individuals and financial service companies that hold themselves out as having the expertise to help people manage their money. However, because of the lack of a statutory definition and the large number of persons from various professions who provide financial planning services, a commonly accepted definition of "financial planner" does not exist. Generally, a financial planner is an individual who provides a comprehensive plan that sets forth strategies designed to achieve a client's financial needs and goals.[1] The plan is prepared based upon a detailed evaluation of the client's personal and financial concerns, needs, and objectives.[2] A planner ordinarily holds himself out as having knowledge and experience in long-term investment planning, investment portfolio management, retirement planning, insurance, accounting, business planning, tax planning, and risk management.[3]

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1. Unger, *Financial Planners: To Be or Not To Be Regulated*? in REGULATION OF FINANCIAL PLANNERS IN THE 1980'S, 178-79 (1985); *see also* MacDonald, *Who are the True Financial Planners and Should They Have an SRO?*, NAT'L UNDERWRITER (LIFE/HEALTH INS. EDITION), June 7, 1986, at 15, 21.
2. MacDonald, *supra* note 1, at 15.
3. *Id. See also* Arndt, *Financial Planning is More Than Just Products*, NAT'L UNDERWRITER (LIFE/HEALTH INS. EDITION), July 19, 1986, at 1-2, 14; Sanderson, *Something for Everyone*, BEST'S REV., Apr. 1985, at 48, 50.

The financial planning process is a confidential and personal service provided to aid individuals or families in managing all of their finances in such a way that they achieve their financial goals within a specified period of time.[4] The planning process focuses upon the needs, objectives, desires, and fears of the client.[5] Planning begins with a subjective and objective collection of information from the client.[6] The planner then performs a detailed analysis and evaluation of the information.[7] This procedure yields a plan that reflects objective recommendations on a course of activity based upon the particular circumstances of the client.[8] The plan may be updated and amended over time to reflect changes in the client's economic position or financial objectives.[9]

The planner's task requires a broad working knowledge of many aspects of the financial services industry. In comparing the services offered by a financial planner with those offered by an investment adviser, it is evident that, at least theoretically, the two practices are not coextensive. An investment adviser is concerned with providing investment advice solely in relation to securities;[10] he is not a financial planner as that indi-

4. *See* Ferrara and Hirschland, *Developments in the Regulation of Financial Planners*, in REGULATION OF FINANCIAL PLANNERS IN THE 1980'S, 25 (1985); Damm, *A Question of Bias*, BEST'S REV., Dec. 1985, at 34; Sanderson, *supra* note 3, at 50; Unger, *supra* note 1, at 178-79.

5. Sanderson, *supra* note 3, at 50. Goals and objectives may include saving money to purchase a house, starting a college fund, increasing insurance coverage, building a retirement fund, or providing income.

6. *Id.* This information normally covers present and anticipated assets and liabilities, including savings, investments, insurance, and benefits such as pensions to be received in the future.

7. *Id.*

8. *Id.* Recommendations may be made that a client obtain insurance or increase present coverage, increase or decrease savings, or invest in securities or other types of investments. The planner may develop tax or estate plans for the client. In some instances the planner may assist the client in implementing the plan; in others, the client may be referred to a broker, accountant, insurance agent, or other professional who aids in implementing the plan. *Id. See also* Hodes, *A Roadmap to Financial Planning*, MD. BAR J., Jan. 1987 at 14.

9. Sanderson, *supra* note 3, at 50. The International Association for Financial Planning (IAFP) has developed a six-step financial planning process. A planner should: (1) collect and assess all relevant data; (2) identify personal and financial goals; (3) identify financial problems; (4) provide written recommendations and alternative solutions; (5) implement or coordinate implementation of the plan; and (6) review and revise the plan periodically. *Building a Capital Base: A Guide to Personal Financial Planning*, (1984) (available from the IAFP) [hereinafter *Building a Capital Base*].

10. The term "investment adviser" is defined in § 202(a)(11) of the Investment Advisers Act of 1940, 15 U.S.C. § 80b-2(a)(11). *See infra* text accompanying note 51. Investment advisers provide services that are not as comprehensive as those provided by financial planners. Investment advice is characterized as an attempt to predict which securities should be bought or sold, and when. 1 T. FRANKEL, THE REGULATION OF MONEY MANAGERS, 15 (1978). Generally an investment adviser makes his predictions in one of two ways. He may focus on the issuer of the securities, "initially examining world and national economy, the political situation and general market trends, then zeroing in on a particular industry and, finally studying a particular company and its offering." *Id.* at 15. Second, he may focus on market behav-

vidual has been described above.[11] As a practical matter, however, most financial planners are investment advisers because of the nature of the services that they provide.[12] This comparison is important as an aid in identifying financial planners, and in distinguishing planners from investment advisers. It is also fundamental to an understanding of how financial planners fit into the current regulatory system.

There are several different ways in which financial planners are compensated. *Commission-only* planners do not charge a fee for planning services.[13] They earn a commission on the sale of financial products that they recommend in the plan.[14] *Fee-plus-commission* planners are paid a fee for developing the plan, a process that typically includes several hours of consultation.[15] Like *commission-only* planners, *fee-plus* planners earn commissions on the sale of financial products.[16] They also may earn an hourly fee or yearly retainer to monitor and update the plan.[17] *Fee-based* planners generally charge a fixed fee for general advice or for preparing a financial plan.[18] The fee may be reduced at a later time if the client purchases financial products through the planner or an affiliated financial services company.[19] Finally, *fee-only* planners are compensated only for their time and expertise in preparing the plan; they do not earn commissions on the sale of financial products.[20]

A financial planner can engage in business as a sole practitioner, or

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ior, "examining the pattern of securities' prices and the volume of trading." *Id.* at 15-16. Typically, investment advisers will offer informational services (portfolio valuation and measurement services), publications (market letters to subscribers, newswires, research publications, seminars), and portfolio management. *Id.* at 17-20. Services provided by a financial planner are more general and comprehensive than the securities-specific services of the investment adviser.

11. *See supra* notes 1-9 and accompanying text.
12. This issue will be discussed in greater detail in Section II.
13. Hess, *Financial Planning: Anatomy of a Marketplace*, TR. & EST., June 1986, at 18, 20.
14. *Id.*
15. *Id.* at 20. *See also Financial Planners: How To Pick The Best for You*, CHANGING TIMES, THE KIPLINGER MAG., May 1986, at 32, 35 [hereinafter *How to Pick the Best for You*]. *Fee-plus* planners make up the largest group of financial planners. *Id.*
16. *Fee-plus* and *commission-only* planners generally sell tax shelters, mutual funds, insurance policies, real-estate partnerships, and other financial products that are recommended in their plans. *See How to Pick the Best for You*, *supra* note 15, at 35.
17. *Id.*
18. *Id.* at 35-36.
19. *Id.* at 36.
20. *Id. See also* Christensen, *Insurance, Regulation Threaten to Drive Many from Financial Planning*, TR. & EST., May 1986, at 14. *Fee-only* planners claim to be the only truly objective planners because their compensation is not tied to products recommended in the plan. *See* Hess, *supra* note 13, at 19; *How to Pick the Best for You*, *supra* note 15, at 36. Many in the profession consider receiving a sales commission to be unethical. Damm, *supra* note 4, at 34. Planners receiving commissions as part or all of their compensation contend that *fee-only* planners lack incentive to encourage a client to implement the plan and to work hard at selecting good investments. *See* Hess, *supra* note 13, at 19; *How to Pick the Best for You*, *supra* note 15, at 36.

in a small or medium-sized financial planning firm, or he may be affiliated with a large financial services company.[21] Planners selling financial products generally are affiliated with insurance companies or brokerage firms.[22] *Fee-only* planners usually are affiliated with banks, accounting and law firms, or operate as sole practitioners.[23] In addition, insurance agents, estate planners, stock brokers, accountants, lawyers, and bankers may offer planning services as an incidental service of their primary business.[24] Consultations between planner and client will vary depending upon whether a planner is in business as a sole practitioner or is affiliated with a financial services company or a financial planning firm. In most planning firms, a client meets individually with a planner who personally develops a plan.[25] In some large financial services companies, the client fills out a questionnaire that is then processed through a computer that generates the financial plan.[26]

There are no recognized standards that must be met before a person may hold himself out as a financial planner, and there are no limitations upon entry into the profession.[27] Minimum educational and competency requirements do not exist. This situation has brought the financial planning industry under the increasing scrutiny of federal and state regulators, and has led to the creation of private organizations that have come into existence in an effort to lend credibility and legitimacy to the industry.[28] Some of these organizations offer designations or degrees that can be earned by a planner meeting certain educational criteria and mimimum experience requirements.[29] However, each association is au-

21. *Financial Planners: What Are They Really Selling?*, CONSUMER REP., Jan. 1986, at 37 [hereinafter *What Are They Really Selling?*].
22. Hess, *supra* note 13, at 19.
23. *Id.*
24. *See id.*; Harris, *Dynamics of Bank Financial Planning*, THE BANKERS MAG., Jan.-Feb. 1986, at 71 (discussing the increase in financial planning in banking, its advantages, and providing guidelines for the training of bank financial planners); Casey, *Training for Planners: At the Starting Gate*, BEST'S REV., Apr. 1985, at 56 (discussing training for planners and the infusion of financial planning into the banking, securities, and insurance industries); *What Are They Really Selling?*, *supra* note 21 (discussing financial planning in large financial services companies).
25. *What Are They Really Selling?*, *supra* note 21, at 37.
26. *Id. See Looking for Mr. Goodplan*, CONSUMER REP., Jan. 1986, at 39 [hereinafter *Looking for Mr. Goodplan*]. This report surveyed financial plans offered by seven major nationwide financial services companies.
27. Kinkade, *Race for Regulation: States, Associations and the Fed Vie to Govern Planners*, CAL. BROKER, Dec. 1985, at 34.
28. The industry's major membership organizations are: the International Association for Financial Planning (IAFP); the Institute of Certified Financial Planners (ICFP); the International Association of Registered Financial Planners (IARFP); the American Society of CLU; and the National Association of Personal Financial Advisers. *How to Pick the Best for You*, *supra* note 15, at 35.
29. The International Board of Standards and Practices for Certified Financial Planners (IBCFP) was created in 1985 by the College for Financial Planning in Denver. It confers the Certified Financial Planner (CFP) designation upon individuals successfully completing a course of study equivalent to 18 hours of upper level college curriculum offered by an institution approved by the IBCFP. Prior to 1985 the

tonomous, and they have not joined together to establish uniform educational criteria or standardized testing procedures.

Financial planning, as well as the financial services industry as a whole, has been experiencing a period of explosive growth.[30] The planning industry has grown because individual consumers have seen the market for financial services change in ways that make professional fi-

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CFP was conferred by the ICFP. The individual is required to pass exams in six areas of study: (1) introduction to financial planning; (2) risk management (insurance); (3) investments; (4) tax planning and management; (5) retirement planning and employee benefits; and (6) estate planning. The course usually takes two years, and the individual must agree to adhere to the IBCFP Code of Ethics. There are about 10,000 graduates of the program, and an additional 23,000 have enrolled. *See* Morrison, *Regulating Financial Planners*, MD. BAR J., Jan. 1987, at 19-20; *How to Pick the Best for You*, *supra* note 15, at 37.

The American College of Bryn Mawr, Pa. confers two degrees. The Chartered Financial Consultant (ChFC) is a correspondence program of six core courses and four electives. It takes approximately four years to complete and the individual must pass 10 two-hour exams. There are approximately 14,000 ChFC's. The Master of Science in Financial Services degree is earned by experienced planners who have taken advanced courses in such areas as pensions and estate planning. *Id.*

The IARFP confers the Registered Financial Planner (RFP) designation on an individual meeting the following criteria: three years full time planning experience; a CFP, ChFC, CPA or a degree in law or business; a securities license; an insurance license; and a clean record with no suspensions or revocations of any license or membership. No courses or tests are necessary. *Id.*

The IAFP sponsors the Registry of Financial Planning Practitioners, which is a type of honorary society. Members must pass a day-long examination involving an actual case and meet the following criteria: three years full-time practice as a planner, have a written plan reviewed by a national committee, and have either a CFP, ChFC, CPA, law or business degree. There are approximately 550 members. *Id.*

In addition, some universities award undergraduate degrees in financial planning. Adelphi, Baylor, Brigham Young, Drake, Georgia State, San Diego State, and the University of California offer certificates or degree programs with either a concentration or major in financial planning or "Family Financial Counseling." Golden Gate University offers a master's degree and an MBA in financial planning. *Id.*

30. As recently as ten years ago, financial planning as an identifiable industry did not exist. Hess, *supra* note 13, at 18. Industry statistics indicate the magnitude of the expansion. The number of investment advisers registered under the Investment Advisers Act of 1940, 15 U.S.C. § 80b-1 et seq., has increased from 4,200 in 1981 to approximately 13,000 in 1986. *Securities and Exchange Commission Roundtable on Investment Advisers and Financial Planners: Background Materials*, May 7, 1986, at 1 (available from the Securities and Exchange Commission) [hereinafter *SEC Roundtable Background Materials*]. About 9,000 financial planners are registered investment advisers. Christensen, *Who Should Register as an Investment Adviser? SEC's Release No. 770 Catches Many Financial Planners*, TR. AND EST., June 1986, at 57. In 1979, membership in the IAFP was approximately 5,500. This number now exceeds 24,000. Pauly and Tsuruoka, *Have I Got a Deal for You*, NEWSWEEK, Feb. 17, 1986, at 51. The IAFP projects a membership of 44,000 by 1989. Unger, *supra* note 1, at 179; *What Are They Really Selling?*, *supra* note 21, at 37. Membership in the ICFP has increased from about 1,200 in 1981 to 18,000 in 1986. During the five-year period ending in 1986, the College for Financial Planning granted over 9,000 Certified Financial Planner designations, and the American College awarded the Chartered Financial Consultant designation to over 11,000 individuals. MacDonald, *supra* note 1, at 15.

nancial assistance a necessity. This situation is due in large part to the development of a broad range of new financial products and services by the financial services industry. Until only recently, investment opportunities were fairly limited. For the average person, investment generally entailed placing money in a passbook savings account or certificate of deposit, purchasing the equity or debt securities of a corporation, or purchasing savings bonds from the government.[31] It was also common for the head of the family to purchase life insurance.[32] Now, in addition to these traditional investments, individuals are able to place their money into such diverse investment vehicles as IRAs and Keogh Plans, money market and mutual funds, precious metals, real estate limited partnerships, municipal bonds, zero coupon bonds, tax-free trusts, and many other new investment instruments.[33]

The increase in investment options has brought investors into the market who traditionally had trusted their money only to banks, the government, and insurance companies.[34] The banking industry has noted a decrease in deposits as money formerly stored in savings accounts is being invested in other ways.[35] Insurance companies, brokerage houses, banks, realtors, and others have brought new financial products and services to the market in order to capture these investment dollars.[36] In the past, these companies had provided separate and distinct services.[37]

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31. Ferrara and Hirschland, *supra* note 4, at 25.
32. *Id.*
33. *Id.* at 26. The increase in available products and services can be attributed in part to increased volatility in interest rates and inflation, frequent major changes in the tax laws, and the mass marketing of high risk investment opportunities and high yield limited partnerships. *Id.*
34. *Id.*
35. Harris, *supra* note 24, at 71. In 1985, the Federal Reserve reported that family and individual assets in the United States had risen from $2.3 trillion to $13.1 trillion in the last 20 years. Of this amount, $8.3 trillion is held in financial assets such as stocks, bonds, market certificates, mortgages, life insurance, savings accounts, and pension reserves. The remaining $4.8 trillion is held in tangible assets such as land, autos, residences, and consumer durables. Damm, *supra* note 4 at 36. "The financial service companies — banks, brokerage houses, insurance companies and realtors — all hope to attract this huge amount of investment capital with their vast assortment of financial products." *Statement of F. Daniel Bell, III before the Subcommittee on Telecommunications, Consumer Protection and Finance, United States House of Representatives*, June 11, 1986, at 3 (available from the North American Securities Administrators Association) [hereinafter *Statement of F. Daniel Bell*].
36. *See* Damm, *supra* note 4, at 36; Hess, *supra* note 13, at 18. The financial services companies believe that the market for financial planning that has not yet been tapped is huge. IDS/American Express, a company which sells financial products such as insurance as well as financial plans, estimates that 35 million households in America could be customers for financial plans, but that only a small percentage have bought plans. *What Are They Really Selling?*, *supra* note 21, at 37.
37. Damm, *supra* note 4, at 36. Historically, the financial services industry was segmented, "[b]rokers sold stocks, insurers sold insurance and banks took savings deposits." *Id. See also* Kurucza, *Financial Planners and Banks*, REV. FIN. SERV. REG., Jan. 15, 1986, at 7 ("Only a few short years ago, the financial services business was a neatly compartmentalized industry consisting of banks, thrifts, securities

They are now in greater competition with each other because they are offering services that integrate products and services offered by other segments of the industry.[38] Most are also providing financial planning services.[39]

Many factors have contributed to these changes in the financial services market and the consequent expansion of financial planning. Deregulation of financial institutions has been instrumental to the creation of new products and services.[40] The increase in two-income households has led consumers to seek professional assistance in managing their increased wealth. Advertising by financial services companies,[41] and increased investor sophistication, have caused individuals to become aware of the growing areas of products and services, and to perceive a need for financial planning and investment management advice.[42] Finally, technological advances in electronic fund transfers, telecommunications, and

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firms, insurance companies, investment advisers and financial planners, and mutual fund complexes, each providing discrete products and services.").

38. It is evident that some financial service providers are developing products in markets in which they have not been previously involved. Banks are providing discount brokerage services, insurance companies are selling financial products which must be registered as securities, and brokers are selling money market accounts which resemble savings and checking accounts. Ferrara and Hirschland, *supra* note 4, at 26.
39. *Id. See also* Damm, *supra* note 4, at 36. For example, at least seven of the major financial services companies offer plans that evaluate a client's entire financial situation, analyze all the relevant data, and then recommend a plan that indicates how the person should invest his money in order to maximize his return and ensure future security. *Looking for Mr. Goodplan*, *supra* note 26, at 39-40. The seven companies are Aetna Life & Casualty, the Consumer Financial Institute, IDS/American Express, Merrill Lynch, Prudential-Bache Securities, the Sears Financial Network, and Shearson/Lehman Brothers. *Id.* at 39. Other companies providing such services include John Hancock, and the Chase Manhattan, Chemical, and Manufacturers Hanover Banks. Pauly and Tsuruoka, *supra* note 24, at 51.
40. Diamond, *Growth of Differentiated Financial Institutions to Accommodate Separate Savings and Investment Goals*, in REGULATION OF FINANCIAL PLANNERS IN THE 1980's, 9, 11 (1985) (discussing factors which have led to the growth of financial planning, and the changing role of banks and others in the financial services industry). *See also* Kurucza, *supra* note 37, at 7. The author cites five factors underlying the rise in inter-industry competition and the increased competitive pressures felt by planners as financial service companies, including banks and insurance companies, move into financial planning. These factors are: (1) deregulation which has allowed banks to compete with financial service companies; (2) integration of the financial services industry as non-traditional competitors find themselves in competition with one another; (3) the emergence of "one stop" financial service companies and the breakdown of interstate banking limitations; (4) technological developments; and (5) joint venture arrangements between different components of the industry relating to the distribution of financial products and services. *Id.*
41. In 1984, the IAFP began a $1.8 million advertising campaign which resulted in 115,000 requests for information. Advertisements to raise consumer awareness appear every six months in the Wall Street Journal, Time, Newsweek, Money, Changing Times, and Business Week. In 1984, IDS/American Express spent $20 million, and Sears spent $50 million, to advertise their respective financial planning divisions. *See Statement of F. Daniel Bell*, *supra* note 35, at 4.
42. Diamond, *supra* note 40, at 12.

financial management computer program software packages have had substantial impact in restructuring financial service systems.[43]

The rapid growth of financial planning has sparked a debate over the actual size of the planning industry. There is considerable uncertainty regarding the number of persons practicing financial planning.[44] The wide variance in the estimates can be attributed to existing conditions within the industry. The lack of an accepted definition of financial planner makes it difficult to identify who is, and who is not, a planner. Moreover, the task of counting the number of planners is complicated by the absence of a regulatory scheme under which all planners must register.[45] The absence of any restrictions upon entry into the profession contributes not only to the difficulties in identifying the number of planners, but also to the continuing increase in the number of individuals offering financial planning services.

II. CURRENT REGULATION OF FINANCIAL PLANNERS

A. Federal Regulation

The federal government currently regulates investment advisers and financial planners through the Investment Advisers Act of 1940 (Advis-

43. *Id.* at 12, 19.

44. Recent estimates regarding the number of financial planners range from 50,000 to 250,000. *See* Pauly and Tsurouka, *supra* note 30, at 51; Christensen, *supra* note 30, at 57; MacDonald, *supra* note 1, at 15. There is some question as to the origin of these estimates; they have appeared without reference to their source. Their accuracy is therefore questionable. A report published by the Consumer Federation of America (CFA) attempts to provide an accurate estimate of the number of planners in the United States. *See* Roper, Financial Planning Abuses and the Need for Regulation, 6-9 (1987) (This report was prepared by and is available from the Consumer Federation of America in Washington, D.C.). The CFA calculated its estimate by first counting the number of financial planners listed in the yellow pages of the twenty largest cities in the country. This number was discounted by 30% based upon CFA data obtained through a survey of financial planners in Washington, D.C. Further adjustments were made using data from an IAFP membership survey. The CFA estimated that 120,000 planners are located in the twenty cities, and that this represented 30% of the total number of planners in the country. Thus, the number of planners was estimated at 400,000. The CFA cautions that this figure should not to be considered an exact total. It concludes that it is reasonable to estimate that 250,000 to 400,000 financial planners advertise as such in the yellow pages. This is the only known attempt to arrive at a figure representing the number of financial planners in this country.

45. A functional problem in determining the number of practicing financial planners arises with planners registered as investment advisers under the Investment Advisers Act. The Advisers Act requires all investment advisers to register with the Securities and Exchange Commission (SEC), but does not require investment advisers to register their employees and agents who perform advisory services. A firm engaging in financial planning that registers as an investment adviser is not required to register the individuals it employs to perform the planning services. As noted above, approximately 9,000 financial planners are registered as investment advisers. The number of persons employed by these planners to perform financial planning services is most likely much higher than the 9,000 planners disclosed through registration.

ers Act).[46] The Advisers Act was the result of a study of investment trusts and investment companies conducted by the SEC in the 1930's.[47] Promulgation of the Advisers Act was intended to eliminate abuses in the securities industry that were believed to have contributed to the stock market crash of 1929 and the Great Depression.[48] The study identified conflicts of interest between advisers and their clients as a significant problem in the investment adviser industry, stating that investment advisers could not perform their function properly unless all such conflicts were eliminated.[49] The Advisers Act reflects these concerns by recognizing the fiduciary nature of the advisory relationship as well as Congress' desire to eliminate, or at least expose, all conflicts of interest that might cause an investment adviser to render advice that is not objective.[50]

The Advisers Act defines "investment adviser" as:

> Any person who, for compensation, engages in the business of advising others, either directly or through publications or writings, as to the value of securities, or as to the advisability of investing in, purchasing, or selling securities, or who, for compensation and as a part of a liberal business, issues or promulgates analyses or reports concerning securities . . . .[51]

The Advisers Act excludes six types of individuals or institutions from the definition of investment adviser: (1) banks or bank holding companies; (2) any lawyer, accountant, engineer, or teacher whose performance of investment advisory services is solely incidental to his or her profession; (3) any broker or dealer whose performance of advisory services is solely incidental to the conduct of his business and who receives no specific compensation therefore; (4) the publisher of any bona fide newspaper, news magazine, or business or financial publication of general and regular circulation; (5) persons whose advice is given solely with regard to obligations of the United States Government; and (6) such other persons as the SEC designates.[52] If a person or entity comes within the definition of investment adviser and does not qualify for one of the six exclusions, that person or entity is an investment adviser.

Status as an investment adviser does not necessarily subject the adviser to the registration requirements of the Advisers Act. The Advisers

46. Investment Advisers Act of 1940, 15 U.S.C. § 80b-1 *et seq.*
47. McGrath, *Investment Advisers, Financial Planners, and Others — An Overview of the Investment Advisers Act of 1940*, in REGULATION OF FINANCIAL PLANNERS IN THE 1980's, 127, 129 (1985). *See Investment Trusts and Investment Companies, Report of the Securities and Exchange Commission, Pursuant to Section 30 of the Public Utility Holding Company Act of 1935, on Investment Counsel, Investment Management, Investment Supervisory, and Investment Advisory Services*, H.R. Doc. No. 477, 76th Cong., 2d Sess. (1939).
48. McGrath, *supra* note 47, at 129.
49. *Id.* at 129-30.
50. *Id.* at 130.
51. Investment Advisers Act of 1940, § 202(a)(11), 15 U.S.C. § 80b-2(a)(11).
52. *Id.*

Act exempts three categories of advisers from registration: (1) advisers whose clients are all within the same state as the adviser's principal business office and who do not provide advice or issue reports about securities listed on any national exchange;[53] (2) advisers whose only clients are insurance companies;[54] and (3) advisers who have had fewer than fifteen clients in the previous twelve months, who do not hold themselves out to the public as investment advisers, and who do not act as advisers to registered investment or business development companies.[55] An exemption from registration under one of these categories does not have the same effect as exclusion from the investment adviser definition. An adviser who is exempt from registration is still subject to Adviser Act anti-fraud provisions, but a person excluded from the definition is not subject to those provisions.

The Advisers Act requires all non-exempt investment advisers using the facilities of interstate commerce to file a registration application with the SEC[56] using form ADV.[57] Form ADV serves the dual purpose of providing information for use by the SEC and for use by the adviser's clients.[58] Either a natural person or a business entity may register as an investment adviser.[59] The SEC has forty-five days from the date of filing either to grant registration[60] or institute proceedings to determine whether registration should be denied.[61] Once a registration becomes effective it remains so indefinitely.

The Advisers Act and the rules promulgated thereunder contain

53. *Id.* § 203(b)(1), 15 U.S.C. § 80b-3(b)(1).
54. *Id.* § 203(b)(2), 15 U.S.C. § 80b-3(b)(2).
55. *Id.* § 203(b)(3), 15 U.S.C. § 80b-3(b)(3).
56. *Id.* § 203(a), 15 U.S.C. § 80b-3(a).
57. 5 FED. SEC. L. REP. (CCH), ¶¶57,001-101.
58. Form ADV is comprised of two parts. Part I calls for identifying information about the registrant: financial status and shareholders; all persons who will be associated with the registrant; authority over client's securities; and any judicial or administrative action against the registrant. The registrant must make specific disclosures regarding financial planning activities including the number of clients and the amount of money these clients invest. 5 FED. SEC. L. REP. (CCH) ¶ 57,101, at 44,349-9. Part II is intended to provide the advisory client with information about the adviser's methods, personnel, and basis for compensation. This includes: types of investments the registrant offers advice on; methods of analysis, sources of information, and investment strategies; basic fee schedule, how fees are charged, and whether fees are negotiable; educational and business standards required of associated persons; educational and business background of each person determining general investment advice to be given to clients; and other financial industry activities or affiliations. The form was amended in 1985 by the SEC, and is now identical to the investment adviser registration form adopted by NASAA for use with the investment adviser provisions of the Uniform Securities Act.
59. The Advisers Act defines "person" as any "natural person or a company." Advisers Act, § 202(16), 15 U.S.C. § 80b-2(16). If an investment adviser registers as a company, separate registration for its officers, employees, agents, or other associated persons is not required, even though these persons are not expressly exempt or excluded in the Advisers Act.
60. *Id.* § 203(c)(2)(A), 15 U.S.C. § 80b-3(C)(2)(A).
61. *Id.* § 203(c)(2)(B), 15 U.S.C. § 80b-3(C)(2)(B).

provisions intended to implement the Advisers Act's major function of eliminating and exposing conflicts of interest. These include reporting and record keeping requirements,[62] the "Brochure Rule",[63] performance fee limitations,[64] assignment of advisory contract restrictions,[65] and prohibitions against fraud.[66] The anti-fraud provisions make it unlawful for an investment adviser to defraud any client or prospective client, or to engage in any act or course of business which is fraudulent, deceptive, or manipulative.[67] Through its anti-fraud rulemaking authority, the SEC has issued regulations that place restrictions on adviser advertising[68] and solicitations,[69] and which regulate an adviser's custody of his client's

62. The SEC is given authority under the Advisers Act to require reports and record keeping. Advisers Act, § 204, 15 U.S.C. § 80b-4. An annual report must be filed by each "registered investment adviser" (RIA). 5 FED. SEC. L. REP. (CCH) ¶ 57,001B-131. The report informs the SEC of any change in business status or address, and requires the submission of annual balance sheets. By rule, the SEC requires RIAs to maintain specified books and records. *See* Rule 204-2, 17 CFR § 275.204-2, 5 FED. SEC. L. REP. (CCH) ¶56,322.
63. Rule 204-3, the "Brochure Rule," requires RIAs to provide clients with a written disclosure statement describing the adviser's qualifications, experience, and advisory practices. 17 CFR § 275.204-3, 5 FED. SEC. L. REP. (CCH) ¶56,323. The RIA must deliver to the client either Part II of Form ADV or another disclosure document which contains equivalent information. 17 CFR § 275.204-e(a), 5 FED. SEC. L. REP. (CCH) ¶ 56,323, at 44,101.
64. Section 205(1) of the Advisers Act prohibits RIAs from entering an investment advisory contract if compensation is based upon "a share of capital gains upon or capital appreciation of the funds or any portion of the funds of the client; . . . . Advisers Act, § 205(1), 15 U.S.C. § 80b-5(1). The prohibition reflects a belief that performance fees lead RIAs to speculate with a client's investments. Performance fees can also be unfair when the RIA gains if the investments do well, but does not lose if the investments do not do well. *See* 2 T. Frankel, THE REGULATION OF MONEY MANAGERS 285-86 (1978).
65. Section 205(2) of the Advisers Act prohibits RIAs from entering an investment advisory contract that "fails to provide, in substance, that no assignment of such contract shall be made by the investment adviser without the consent of the other party to the contract." Advisers Act, § 205(2), 15 U.S.C. 80b-5(2).
66. *Id.* § 205(1),(2), and (4), 15 U.S.C. 80b-(b)(1),(2), and (4).
67. *Id.* The antifraud provisions authorize the SEC to issue rules and regulations defining and prohibiting fraudulent practices. The Commission has adopted three rules pursuant to this section. McGrath, *supra* note 47, at 152. *See infra* notes 77-9.
68. Rule 206(4)-1 describes certain advertising practices as fraudulent, deceptive, or manipulative within the meaning of Advisers Act § 206(4). The rule contains a "catch-all" provision prohibiting advertisements containing "any untrue statement of a material fact or which is otherwise untrue or misleading." 17 CFR § 275.206(4)-1(a)(5), 5 FED. SEC. L. REP. (CCH) ¶ 56,382, at 44,133. Also prohibited are certain specific advertising practices: testimonials; past specific recommendations that were profitable unless all recommendations made the preceding year are included; representing that any graph or chart alone can be used to determine when to buy or sell securities; and advertising any report, analysis, or service as free unless it actually is. Rule 206(4)-1(a)(1)-(4), 17 CFR § 275.206(4)-1(a)(1)-(4), 5 FED. SEC. L. REP. (CCH) ¶56,382, at 44,132-133.
69. Rule 206(4)-3 makes it unlawful for an adviser to pay a cash fee to one who solicits clients unless: (1) the adviser is registered; (2) the solicitor is not subject to court order or administrative sanction; and (3) the fee is paid pursuant to a written agreement that meets certain prescribed conditions. Rule 206(4)-3(a)(1)(i)-(iii), 17 CFR § 275.206(4)-3(a)(1)(i)-(iii), 5 FED. SEC. L. REP. (CCH) ¶ 56,383A, at 44,135.

funds and securities.[70]

To enforce the Advisers Act, the SEC has the authority to pursue administrative sanctions that include censure and revocation of registration,[71] injunctive relief,[72] and criminal prosecution for willful violations.[73] The SEC is also authorized to conduct periodic inspections of investment advisers.[74] Inspections are conducted on a routine basis, but are also undertaken in response to public complaints, rumors of violations, and anonymous tips.[75] Generally, following an inspection an adviser either will receive a "clean bill of health" or a deficiency letter informing the adviser of any violations or possible violations uncovered by the inspection.[76] A less common result is the institution of enforcement proceedings.[77]

The SEC considered the applicability of the Advisers Act to financial planners in a 1981 interpretive release known as Release 770.[78] Release 770 states that a planner is subject to the provisions of the Advisers Act if the services provided satisfy each element of the statutory definition of an investment adviser.[79] Therefore, a financial planner is an investment adviser if he: (1) provides advice, or issues reports or analyses, regarding securities; (2) is in the business of providing such services; and (3) receives compensation for such services.[80]

A financial planner who gives advice, makes recommendations, or issues reports or analyses with respect to specific securities, or securities in general, will satisfy the "providing advice" element of the definition.[81] The same is true of a planner who provides advice to clients concerning the relative advantages and disadvantages of investing in securities in

70. Rule 206(4)-2 pertains to advisers having custody or possession of the funds or securities of their clients. It requires that: (1) all client securities are segregated and marked to identify the particular client; (2) all funds of clients be deposited in bank accounts containing only client funds; (3) the adviser notify the client as to where securities and funds are held; (4) the adviser send each client, at least quarterly, an itemized report; and (5) all funds and securities must be verified each year by a surprise audit by an independent public accountant. Rule 206(4)-2(a)(1)-(5), 17 CFR § 275.206(4)-2(a)(1)-(5), 5 FED. SEC. L. REP. (CCH) ¶ 56,383, at 44,133-134. An estimated 2.5% of the total number of advisers have custody of clients' funds or securities.

71. Advisers Act, § 203(e)-(f), 15 U.S.C. §§ 80b-3(e)-(f). The SEC is given general enforcement powers in Advisers Act, § 209, 15 U.S.C. § 80b-9.

72. *Id.* § 209(e), 15 U.S.C. § 80b-9(e).

73. *Id.* § 217, 15 U.S.C. § 80b-17.

74. *Id.* § 204, 15 U.S.C. § 80b-4, and § 209, 15 U.S.C. § 80b-9(b).

75. *See* McGrath, *supra* note 47, at 157.

76. *Id.*

77. *Id.*

78. *Applicability of the Investment Advisers Act to Financial Planners, Pension Consultants, and Other Persons Who Provide Investment Advisory Services as an Integral Component of Other Financially Related Services*, Release No. IA-770, 46 Fed. Reg. 41771-01 (Aug. 18, 1981) (codified at 17 C.F.R. Part 276).

79. *Id.* at 41772.

80. *Id.*

81. *Id.*

general as compared to other investment media.[82] The "in the business" element will be satisfied by a planner providing financial services that include investment advice, unless the advice is solely incidental to a non-investment advisory business,[83] is nonspecific,[84] and is not paid for by special compensation.[85] The "compensation" element is satisfied if a planner receives any economic benefit in return for investment advice,[86] regardless of the source of the compensation.[87] Under the interpretation of Release 770, most financial planners are probably investment advisers subject to the requirements of the Advisers Act.[88]

The effectiveness of the Advisers Act is undermined by certain fundamental shortcomings in the regulatory structure. Many persons providing advisory services are not personally subject to the requirements of the Act because employees and agents of investment advisers are not required to register. As a result, information pertaining to individual employees and agents is not disseminated to the SEC or to the adviser's clients, and conflicts of interest can go undisclosed. This situation is especially troublesome where compensation of an employee or agent is tied to the financial products that he sells, as is the case with *commission-only*, *fee-plus-commission*, and *fee-based* financial planners. Financial advice may be less than disinterested and objective where an investment ad-

82. *Id.* "A person who, in the course of developing a financial program for a client, advises a client as to the desirability of investing in securities as opposed to, or in relation to, stamps, coins, direct ownership of commodities, or any other investment vehicle" . . . is "advising" within the meaning of the investment adviser definition. *Id.*

83. *Id.* at 41773. If a person holds himself out as an investment adviser, he is "in the business" of providing investment advice. *Id.*

84. A person whose principal business is providing financial services other than investment advice would not be "in the business" if "he merely discusses in general terms the advisability of investing in securities in the context of, for example, a discussion of economic matters or the role of investments in securities in a client's overall financial plan." *Id.* If a planner discusses investing in specific securities or specific categories of securities (bonds, mutual funds, etc.) on anything other than "rare and isolated instances," he would be "in the business" of providing investment advice. *Id.*

85. *Id.* A planner is "in the business" if he receives compensation for investment advice. A person would not receive special compensation if he makes no charge for the advisory portion of his services or if he charges a single fee for financial advisory services of which the investment advice is an incidental part." *Id.*

86. *Id.* The economic benefit may take the form of an advisory fee or other fee which relates to services rendered, commissions, or both. A separate fee need not be charged. This element is satisfied if a single fee is charged for a number of services which include investment advice. *Id.* Thus, an individual charging a single fee for advisory services will satisfy this element, but not the "in the business" element.

87. *Id.* The person receiving the advisory services need not be the one who provides the planner's compensation. If a planner provides advisory services to a client, but receives compensation through commissions upon the sale to the client of a financial product (e.g., a *commission-only* planner), he would have received "compensation" within the meaning of this element. *Id.*

88. Ferrara & Hirshland, *Federal Regulation of Financial Planners*, REV. OF FIN. SERV. REG., Jan. 29, 1986, 11, 12 ("It has been estimated that as many as ninety-five percent should register.").

viser/financial planner is aware that higher commissions may be earned by recommending certain products as opposed to others, and where he knows that the client is not in possession of this information.

A second problem is that the Advisers Act does not require applicants for registration to pass a qualification exam. Without such an exam, virtually anyone who can afford the application fee can become a registered investment adviser.[89] The problem of unqualified individuals holding themselves out as investment advisers is compounded by the fact that consumers may rely upon the "Registered Investment Adviser" moniker as an indication that an adviser is qualified.[90]

The third failing is a lack of active enforcement by the SEC. The Commission does not have the budget or personnel to enforce the Advisers Act effectively.[91] Individual registered investment advisers can anticipate being inspected by the SEC about once every nine years.[92] Inspections obviously will become less frequent as the number of financial planners registered under the Advisers Act increases. The Advisers Act also appears to be low on the SEC priority list because there are no qualification and entrance requirements.[93] In addition, the SEC recently has been devoting much of its effort to insider trading enforcement initiatives.

B. State Regulation

The majority of states regulate investment advisers through the investment adviser provisions of the Uniform Securities Act (Uniform Act).[94] These provisions are derived in large part from the concepts and

89. "Under present laws, . . . unless an applicant is disqualified for committing a crime, 'anyone with $150 and the ability to fill out the form can become a registered investment adviser' . . . ." Chambliss, *Regulation and Market Share*, FIN. PLANNING, Oct. 1986, at 65.

90. The SEC's regional administrator in Los Angeles recently described the Investment Advisers Act as a "charade." He explained, "[w]henever I see 'registered with the SEC' on an ad (for investment advisers), I want to laugh. People think it is equivalent to the *Good Housekeeping* seal of approval but it isn't." *See Statement of F. Daniel Bell*, *supra* note 35, at 9.

91. The SEC staff has decreased by 2% in the past five years. Ingersoll, *Inundated Agency: Busy SEC Must Let Many Cases, Filings Go Uninvestigated*, Wall St. J., Dec. 16, 1985, at 1, col. 1. In that same time period, the number of RIAs has tripled. Chambliss, *supra* note 89, at 65. In addition, investment adviser complaints received by the SEC also have tripled. *SEC Roundtable Background Materials*, *supra* note 30, at 1. *See* Stern, *Repainting Blue Skies*, FORBES, May 5, 1986, at 66 (noting that between 1975 and 1986, the SEC staff decreased slightly and the number of cases brought by the SEC also decreased, but that the number of RIAs and public complaints increased greatly).

92. Chambliss, *supra* note 89, at 65. One commentator states that the SEC is so far behind in its inspection program that "the backlog is practically an invitation for abuse." He adds that some financial planners "put the risk of not registering on par with that of being audited by the Internal Revenue Service, or maybe even a little less." J. Hallihan, *Cat-and-Mouse RIA's*, FIN. PLANNING, Nov. 1985, at 4.

93. *Statement of F. Daniel Bell*, *supra* note 35, at 9.

94. Uniform Securities Act (1956), 1 BLUE SKY L. REP. (CCH) ¶ 5501 *et seq.* All fifty

language of the Advisers Act, although the Uniform Act investment adviser provisions are only one part of the complete securities regulation scheme of the Uniform Securities Act.[95] The widespread adoption of the Uniform Act investment adviser provisions has contributed to uniformity among the states in the regulation of advisers, and has facilitated coordination of regulatory efforts between the federal and state governments.

The adviser provisions of the Uniform Act parallel those of the Advisers Act in several respects. The definition of "investment adviser," and the exclusions therefrom, are virtually identical to the Advisers Act definition and exclusions.[96] The Uniform Act contains a registration requirement with specified exemptions,[97] and a reporting and record keeping requirement.[98] It places restrictions on performance fees,[99] assignment of contracts,[100] custody of client's funds and securities,[101] and includes a general anti-fraud provision comparable to the Advisers Act.[102] The state securities administrator is granted enforcement authority.[103]

Conceptually the two acts are based upon similar principles and technically they share a number of corresponding provisions, but they differ significantly in some key aspects. Under the Uniform Act, for example, state administrators are authorized to require an examination and other qualification criteria of investment advisers, and of investment adviser representatives, as a condition of the adviser's registration.[104] The administrator also is given rulemaking power to impose minimum capital requirements for registered advisers,[105] and to require registered advisers

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states have adopted the Uniform Act. Of these, 39 jurisdictions have adopted the Uniform Act's investment adviser provisions. Wilkerson, *State Securities Laws and Regulations Concerning Investment Advisers and Financial Planners*, in *State and Federal Regulation of Financial Planners: Considerations for the Life Insurance Industry*, Sept. 2, 1986 (available from the Practicing Law Institute).

95. *See* Skillern, Jr., and Lubber, *State Regulation of Financial Planners*, REV. FIN. SERV. REG., Jan. 15, 1986, at 1.
96. The Uniform Act definition of investment adviser has been taken almost verbatim from the Advisers Act definition. *See* Official Code Comment, Uniform Securities Act § 401(f), 1 BLUE SKY L. REP. (CCH) ¶ 5541.01.
97. Uniform Securities Act, §§ 201(c)(2)-(3), 1 BLUE SKY L. REP. (CCH) ¶ 5521.
98. *Id.* § 203, 1 BLUE SKY L. REP. (CCH) ¶ 5523.
99. *Id.* § 102(b)(1), 1 BLUE SKY L. REP. (CCH) ¶ 5512.
100. *Id.* § 102(b)(2), 1 BLUE SKY L. REP. (CCH) ¶ 5512.
101. *Id.* § 102(c), 1 BLUE SKY L. REP. (CCH) ¶ 5512.
102. *Id.* § 102(a), 1 BLUE SKY L. REP. (CCH) ¶ 5512.
103. The enforcement provisions are contained in §§ 406-409 of the Uniform Act. 1 BLUE SKY L. REP. (CCH) ¶¶ 5547-49.
104. *Id.* § 204(a)(2)(I), 1 BLUE SKY L. REP. (CCH) ¶ 5524. The administrator is empowered to deny, suspend, or revoke any registration if the adviser "is not qualified on the basis of such factors as training, experience, and knowledge of the securities business. . . ." *Id.* The administrator also may condition an adviser's registration upon the qualification of "any other person who represents the investment adviser in doing any of the acts which make him an investment adviser." *Id.* § 204(b)(2)(B), 1 BLUE SKY L. REP. (CCH) ¶ 5524. This only includes those persons providing investment advisory services on behalf of the investment adviser.
105. *Id.* § 202(d), 1 BLUE SKY L. REP. (CCH) ¶ 5522.

to post surety bonds.[106] The SEC is not granted similar powers under the Advisers Act.

The Uniform Act has been the main impetus toward uniformity in investment adviser regulation on the state level, however, it has not been completely successful. Eleven states have not adopted the Uniform Act's investment adviser provisions. Eight of these states regulate investment advisers via statutes that are similar to the Uniform Act. Even the states that have adopted the investment adviser provisions have contributed to divergence from the uniform approach. State definitions of investment adviser do not always mirror the Uniform Act.[107] All of the states that have adopted the provisions require registration of investment advisers, however, some also require investment adviser representatives and agents to register,[108] and others require qualification of investment adviser representatives and agents as a condition of the investment adviser's registration.[109] Some states have minimum capital requirements for investment advisers, but the standards differ from state to state.[110] Coordination in federal and state regulation has been beset with similar problems.

The applicability of the Uniform Act adviser provisions to financial planners is unclear. Because the definition of investment adviser in the Uniform Act is derived directly from the Advisers Act, most planners probably can be characterized as investment advisers in Uniform Act states through an analysis that parallels Release 770.[111] Whether states will adopt the analysis of Release 770, however, depends upon the individual states.

The preceding discussion indicates that a framework is in place on the federal level, and on the state level in those states that have adopted the Uniform Act investment adviser provisions, that is adaptable to the

106. *Id.* § 202(e), 1 BLUE SKY L. REP. (CCH) ¶ 5522.

107. Only 14 states reproduce the Uniform Act definition verbatim. They are: Alaska, Arkansas, Kansas, Kentucky, Mississippi, Missouri, Nebraska, New Jersey, South Carolina, South Dakota, Tennessee, Utah, Washington, and West Virginia.

108. Connecticut, Delaware, Florida, Hawaii, Rhode Island, and Washington require registration of investment adviser agents.

109. California, Pennsylvania, and Wisconsin require qualification of the representatives and agents of the individual applying for registration.

110. *See, e.g.*, Conn. Agencies Reg. § 36-500-8(c), 1 BLUE SKY L. REP. (CCH) ¶ 14,408 (requiring $1,000 minimum capital); Fla. Admin. Code Rule 3E-600.016(3)(a), 2 BLUE SKY L. REP. (CCH) ¶ 17,406 (requiring $2,500 minimum capital); Wis. Admin. Code § SEC 5.02, 3 BLUE SKY L. REP. (CCH) ¶ 64,582 (requiring $5,000 minimum capital); Wash. Admin. Code R. 460-24A-170(1), 3 BLUE SKY L. REP. (CCH) ¶ 61,629 (imposing net capital requirements when an adviser has custody of a client's securities or takes power of attorney from a client); Cal. Admin. Code tit. 10, R. 260.237.1, 1 BLUE SKY L. REP. (CCH) ¶ 12,218 (applying a complex formula for determining minimum capital); Mo. Admin. Code § 30-51.070, 2 BLUE SKY L. REP. (CCH) ¶ 35,435 (applying the minimum capital requirements applicable to broker-dealers to all investment advisers).

111. California has expressly adopted Release 770 as an aid in interpretating the investment adviser provision of the Uniform Act. *See* 1 BLUE SKY L. REP. ¶ 12,571.

regulation of financial planners. Problems that diminish the effectiveness of each system of regulation have been identified. In addition to the shortcomings already noted, the two Acts share a common problem: neither the Advisers Act nor the Uniform Act applies specifically to financial planners. This raises the next issue that must be addressed — Is the current regulatory system adequate, or is new or additional regulation necessary to regulate financial planners?

III. IS NEW OR ADDITIONAL FINANCIAL PLANNER REGULATION NECESSARY?

Whether new or additional regulation is required to control financial planners is a question that has sparked considerable debate. The movement for regulation is based upon a belief that "abuses" are occurring through the negligent and intentional acts of some financial planners.[112] New or additional regulation of planners is seen as the means to eliminate abuse and to protect the public.[113] Those opposing this view argue that the evidence of abuse in the industry is not conclusive, and that present regulation is adequate to deal with any problem in the industry. The merits of these arguments are discussed below.

A. Types of Abuse By Financial Planners

Several types of abuse are prevalent in financial planning. The first is incompetence.[114] As discussed above, there are no minimum qualification, experience, or educational standards required of individuals who desire to become financial planners. As a consequence, anyone, including the unqualified and incompetent, may hold himself out as a financial planner. The client relies upon the ability of a planner to prepare a comprehensive plan, but is often advised by a planner who lacks all of the requisite skills necessary to prepare such a plan. The competency problem is complicated because the skills required of a planner cover such a broad range of financial expertise that it is very difficult for any one planner to keep current and well versed in all of the necessary areas.[115] Plan-

112. In the context of this comment, abuse refers to activity by a planner, either intentional or otherwise, which is not in the best interests of the client.

113. *See What Are They Really Selling?*, *supra* note 21, at 37; Roper, *supra* note 44; *Statement of F. Daniel Bell*, *supra* note 35, at 4-7; *Statement of Charles G. Hughes, Jr., before the Subcommittee on Telecommunications, Consumer Protection and Finance of the House Committee on Energy and Commerce*, June 11, 1986, at 16-20 (available from the ICFP) [hereinafter *Statement of Charles G. Hughes, Jr.*]; King, *The Regulatory Quagmire*, BEST'S REV., Mar. 1986, at 74; Damm, *supra* note 4, at 34; Hess, *supra* note 13, at 18; Kinkade, *supra* note 27, at 34.

114. Incompetence in this context refers not only to the planner who is completely unqualified or unskilled, but also to the planner who lacks only certain aspects of overall planner qualifications. In other words, there are varying degrees of incompetence. For instance, a planner may be highly qualified in many areas yet still be incompetent to give certain advice or recommendations in other areas.

115. Large firms that offer comprehensive financial plans probably possess the requisite financial expertise through their numerous employees who specialize in different

ners can alleviate this problem to some extent by enrolling in one of the educational programs offered by planner organizations.[116] Although enrollment has increased, only a small percentage of planners have completed such a program.[117] In addition, the successful completion of one or more of these programs does not ensure that a planner will pursue continuing education to keep current on developments, both legal and otherwise, that affect the variety of areas in which he must possess expertise.

The second type of abuse involves conflicts of interest that may affect a planner's recommendations when preparing a plan. Because his fiduciary responsibilities to his client are not well defined, the planner's advice may not always be objective. This occurs primarily when planners receive their compensation through commissions earned on the sale of financial products that are recommended in the plan.[118] In most cases, the commission structure is not revealed to the client. The client is promised, and expects, objective advice in the plan, but actually receives advice from a planner motivated to sell products in order to earn commissions. The plan therefore may be the product of the planner's self-interest, rather than a disinterested, objective determination of what steps are in the best interest of the client.[119]

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areas. However, this would not be true of smaller firms or sole practitioners. An IAFP Membership Survey indicates that one-half of all planners are in firms of seven or less employees, and one-third of all planners are in firms of three or less employees. If this is accurate for the entire industry, most planning firms would not have a staff that could supply wide-ranging financial expertise. *See Summary: 1985 Membership Survey, International Association for Financial Planning*, Aug. 1, 1985, at 3 (available from the IAFP).

116. *See supra* note 29.

117. *See* Roper, *supra* note 44, at 27. Based upon figures received from the Denver College for Financial Planning, which administers the CFP, and the American College, which adminsters the ChFC, the CFA report made the following findings. If 250,000 is accepted as the number of financial planners, then approximately 8.8% have completed one of the programs and another 13.2% are enrolled. These figures may be slightly lower because some planners have completed both programs. If 400,000 is accepted as the number of financial planners, then approximately 5.5% have completed one of the programs, and approximately 8.25% are enrolled. *Id.* at 27-28. The CFP and the ChFC are the two most widely held designations.

118. *See id.* at 14-15. The IAFP membership survey indicated that 64% of the average planner's gross revenue comes from commissions. Iowa State University faculty members surveyed planners with the CFP designation. Of those responding, 70% indicated that they earned 75% of their compensation through commissions. *Id.*

119. *See id.* at 23-36. *Consumer Reports* magazine recently published a study that it conducted of seven financial services companies that sell financial plans along with their traditional products. *Looking for Mr. Goodplan*, CONSUMER REP., Jan. 1986, at 39 (the seven companies are listed in footnote 39). *Consumer Reports* sent a husband and wife to the companies to determine what financial planning advice they would receive for $500 or less. The couple presented themselves as ordinary consumers, and provided each company with identical financial and personal data. The study found the plans "disappointing." Recommendations in the plans "almost always reflected the primary business of the company designing the plan." There were also wide variations in advice. One plan recommended nearly $1 million in insurance, and another recommended none. All but one of the plans ignored the

The final type of abuse consists of scams and fraudulent practices perpetrated by planners against clients. Misconduct of this type includes theft, misrepresentation, fraud, abusive tax shelters, securities violations, and ponzi schemes.[120] In these cases, the planning function frequently is used as a pretext to induce investment in some type of fraudulent scheme. Unfortunately, these types of abuses usually are uncovered only after the client's funds have disappeared.

The North American Securities Administrators Association (NASAA) and the Council of Better Business Bureaus conducted a survey of consumer complaints and state enforcement actions in twenty states to attempt to identify the pervasiveness of abuse.[121] The report found that hundreds of "con-artists" calling themselves financial plan-

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couple's stated objective of purchasing a home, and all of the plans failed to consider the couple's desire to keep their money easily accessible and to avoid risk. *Id.* at 39-43. *Consumer Reports* stated:

> Planning itself may be a service, but it almost inevitably leads to the purchase of financial products — stocks, bonds, certicates of deposit, insurance policies, and the like. Many planners turn out to have hidden agendas—to sell mutual funds, for example, or life insurance, or tax preparation services . . . .
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> . . . .
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> The hidden agendas become evident when planners frame their recommendations. That's when planners are likely to regress into stockbrokers, insurance or mutual fund sellers, or tax preparers — the roles that may have been their sole occupations before they became financial planners.

Financial Planners: What Are They Really Selling?, CONSUMER REP., Jan. 1986, at 37-38.

One commentator questions whether a planner's objective stature is compromised by incentives and contests tied to how much of a particular product a planner sells. Rose, *Incentives vs. Clients: Which One's Most Concern Financial Planners?*, Wall St. J., Nov. 24, 1986, at 33, col. 3. Incentives offered by one mutual fund group range from cordless telephones and ice cream makers, to a Blackglama mink or a Porsche. This commentator points out that such incentives can weigh heavily in a planner's mind when making recommendations to a client. Some planners state that if such incentives are accepted by a planner, they should be disclosed to clients. *Id.*

120. A ponzi scheme usually involves a promoter who offers a fake investment to clients and promises a large return on their money in a short period of time. The promoter pays early investors some return, using money invested by later investors. This enables the promoter to report that large returns have been paid and thereby draw in additional investors. Eventually, the promoter will pocket a substantial sum and disappear.

121. *NASAA State-by-State Summary: Recent Financial Planning Related Enforcement Developments*, in REGULATION OF FINANCIAL PLANNERS IN THE 1980'S 119-25 (1985) [hereinafter *NASAA State-by-State Summary*]. The survey took three years to complete. It states that alleged, but not proven, fraud and abuse during 1981-84 in the 20 states covered amounted to $90 million. The analysts preparing the survey estimated that the survey reflected about one-half of the cases in the country and that about one-half of the alleged abuses occurred in the last year of the study. *Shad Says Congress Should Await NASD Pilot before Acting on Advisers*, SEC. REG. & L. REP. (BNA), June 13, 1986, at 853 [hereinafter *Congress Should Await NASD Pilot*].

ners were responsible for millions of dollars in fraud and abuse.[122] Although the report did not canvas every state, it provides evidence that abuse is occurring in the planning industry. In most of the instances of abuse cited in this study, financial planning was used as a pretext by individuals who claimed to be financial planners. These persons used the title "financial planner" to gain access to and control over their clients' funds, thereafter converting the money to their own personal use.[123]

The Consumer Federation of America (CFA)[124] recently completed a study of financial planning, one part of which is an examination of common financial planning abuses.[125] The CFA study is a follow-up to the NASAA study and was intended to reveal the extent of abuse in the industry. The study indicates that fraud and other abuses are widespread.[126] In a survey of fourteen states, the CFA discovered that $125 million was lost as a result of alleged fraud and abuse by financial planners in 1985 and 1986.[127] When the fraud losses are combined with losses attributable to other abuses — incompetence and conflicts of interest — the CFA concludes that losses nationwide total billions of dollars.[128]

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122. *Investor Alert Newsletter: Fraud and Abuse in the Financial Planning Industry*, Aug. 1985 (available from the Better Business Bureau of New York) [hereinafter *Investor Alert Newsletter*].

123. An Arizona financial planner enlisted approximately forty investors in an investment club which was the vehicle for promotion of an abusive tax shelter known as "Rex Rabbit." The object of the investment was a supposed super rabbit with a mink-like pelt, and top grade meat which was to be freeze-dried and sold at $16 per pound to South Korean mercenary soldiers guarding Saudi Arabian oil fields. Super rabbit embryos were to be transferred to normal rabbits to increase production, and the slaughtering of the rabbits was to be done to take maximum advantage of the federal income tax credit. The planner collected over $1.1 million, but returned less than $50,000 to investors. *NASAA State-by-State Summary*, *supra* note 121, at 119.

    In Maryland, a two-man financial planning firm solicited investments for "certificates of investment," promising clients a thirty per cent return on their investment in ninety days. Over $2.6 million was invested, of which $600,000 was recovered when the firms assets were frozen by the state. *Id.* at 121.

    Finally, a Massachusetts insurance salesman used his client base to independently promote himself as a financial planner. He advised 143 clients to invest $717,000 in an abusive tax shelter involving twelve master album recordings. He promised tax writeoffs of the money which his clients invested. The planner did not have full rights to the recordings. He had promised clients that the albums would sell for approximately $13-14. The albums were discovered in the discount rack at Woolworth's for $1.99. *Id.* at 121-22.

124. The CFA is the nation's largest consumer membership organization composed of more than 200 national, state, and local groups. It has been ranked as one of the top ten lobbying organizations in Washington, D.C.

125. Roper, *supra* note 44, at 17-33.

126. *Id.* at 28-33.

127. *Id.* at 32. The CFA estimates that this figure represents one-half of the dollar amount of abuse in those 14 states, and that total losses in those states represent approximately one-third of the national total for the two-year period. *Id.*

128. *Id.* at 33. The CFA survey points out six separate instances in which a planner took custody of client funds and either lost the money through speculation or embezzlement. In one case, a financial planner took custody of almost $500,000 from a

A recent New York case illustrates the magnitude of deception and dishonesty possible in financial planning through conflicts of interest and fraud. In the largest financial planning fraud case ever to be filed in the United States, the Attorney General of New York brought suit against a financial planner, his firm, and five associates charging them with fraudulently inducing approximately 950 investors to invest over $55 million.[129] The charges allege that the First Meridian Planning Corporation was in business solely for the purpose of generating high sales commissions. First Meridian claimed that it tailored an individual investment plan for each client by suggesting a "balanced" portfolio, but instead it recommended investments that yielded the highest commissions.[130] Investors were not informed that in addition to fees paid to First Meridian for the plan, the firm also earned commissions on each financial product it sold. This case suggests that conflicts of interest, when carried to extremes, can amount to fraud.[131]

B. Opposition to New Regulation

Opposition to new regulation has arisen on several fronts. The SEC has questioned the actual extent of misconduct in financial planning, citing a lack of information that demonstrates that abuse is widespread.[132] Although recognizing that the NASAA survey provides evidence of abuse, SEC Chairman John Shad stated that the survey revealed abuses

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couple. After assuring the couple that the money was safely invested in government bonds and securities, the planner speculated with the money losing all but $12,000. In another case, a planner took custody of over $1 million from approximately 100 clients, promising to invest the money conservatively. Instead, he placed the money in his own account and spent all of it. *Id.*, at 19.

129. *See* Release, *News From Attorney General Robert Abrams, Largest Financial Planning Scam in Nation Charged*, Nov. 5, 1986 (available from The Department of Law, The State Capitol, Albany, NY 12224).

130. *Id.* Prospective investors were promised individual attention and objective financial advice. In fact, First Meridian sales representatives were urged to push certain investments, referred to as "power products," because they generated high commissions. Among these products were Florida condominiums, numismatic coins, and artwork. The condominiums were sold as "conservative, low-risk" investments that would yield 11-16% return. The condominiums eventually were sold by investors at a loss, but First Meridian earned 9% commission on each sale. The coins were rare, but not scarce, and clients paid such a high price for them that it would take a decade for them to break even. First Meridian made 15% commissions. Finally, the artwork purchasers were promised 33% profits per year for five years. One investor paid $12,000 for artwork later appraised at $1,200. First Meridian earned 16% commissions. *Id.*

131. *Id.* The Attorney General of New York stated that this case demonstrates the urgent need for planner regulation:

> First Meridian will be exhibit one when we make our case with federal and state authorities for regulation of financial planners. For years, the investment community, State Attorneys General and the securities regulators have called for regulation of this fast growing phenomenon. With this case, the need for new legislation has become demonstrably urgent.

Id.

132. *Congress Should Await NASD Pilot, supra* note 121, at 853.

amounting to only a small percentage of the total funds under financial management.[133] Moreover, the SEC has denied that it does not have the resources to enforce the Advisers Act effectively.[134] The SEC, however, has not taken an official position on whether new or additional regulation is needed.

The position taken by former SEC Chairman John Shad, that information on abuse was "lacking," was announced prior to the First Meridian case and the CFA study. Since that time, evidence has been mounting that suggests that the NASAA survey only scratched the surface of abuse in the industry.[135] Furthermore, the abuses which have taken place in financial planning often occur with respect to clients who have placed trust in a planner, and who have invested a substantial portion, if not all, of their assets.[136] This leads to the conclusion that, although only a small percentage of the total funds under investment management in this country may be involved, the nature of the financial planner/client relationship and the magnitude of harm that can be suffered by individual clients justifies the imposition of some form of new regulation. Finally, data regarding SEC personnel and budget, as compared to the number of investment advisers and financial planners, suggests that the SEC cannot effectively enforce the Advisers Act against investment advisers *and* financial planners without assistance.[137]

A large number of individuals providing financial planning services are engaged in business as insurance agents, investment advisers, brokers, bankers, and realtors. Many of these persons oppose new regulation because their professions already are regulated heavily.[138] Another layer of regulation is seen as redundant and overly restrictive. The solution offered by some of these professionals is to grant exemptions from any new regulation to individuals already subject to one form of regulation, thus

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133. Golob, *Mixed Blessings: After a great deal of fanfare, Congressional hearings into a financial planning self-regulatory organization may have caused more problems than they Solved*, FIN. PLANNING, Sept. 1986, at 31 (citing a survey by state securities regulators [the NASAA study], former Chairman John Shad of the SEC told a congressional panel that customer losses from alleged abuses totaled "only a tiny fraction of 1% of the funds under management" — about $90 million a year of the $1.2 trillion handled by investment advisers.).

134. Stern, *supra* note 91, at 66.

135. F. Daniel Bell, President of the NASAA, disputes Chairman Shad's conclusions, stating that Shad took the NASAA report out of context. Bell stated that:

> [T]he figure reported in the study was never presented as being complete. It is the tip of the iceberg. It represents only those cases reported to the states or discovered by state inspections in a scenario in which many of the abuses were not reported and many states have weak inspection programs.

Roper, *supra* note 44, at 31.

136. *Id.*

137. *See supra* note 91.

138. *See* Kapner, *Street Financial Planners: Go Ahead and Start an SRO, Just Don't Regulate Us*, INV. DEALER'S DIG., Aug. 5, 1985, at 8; King, *supra* note 113, at 74; Golob, *supra* note 133, at 31.

allowing them to continue to be regulated as they have in the past.[139] Others oppose any new or additional regulation, stating that current regulatory systems are adequate to handle financial planners.

The argument that an additional layer of regulation is not needed for those professions regulated under a separate set of rules is unconvincing. Regulation in these areas is accomplished through regulatory systems that apply to those specific professions. Financial planners, however, provide a wide variety of services encompassing many of the services offered by these different professions. The profession-specific regulatory systems cannot effectively protect the public and monitor the conduct of a planner who is engaging in practices that are beyond the scope of such regulation. In addition, any financial planner regulatory scheme would be severely undermined if broad exemptions are granted. Uniformity and professional standards would be unattainable if some planners were subject to regulation and others, performing the same services, were not.

The push for new regulation of financial planners is viewed by one commentator, Jonathan Macey, as an attempt by the industry, principally the International Association for Financial Planning (IAFP), to impede the growth of financial planning.[140] Macey suggests that the IAFP proposal, which proposes the creation of a self-regulatory organization to regulate financial planners, is "nothing but a thinly veiled plea for protectionism."[141] He charges that the IAFP's claim that government testing services are needed to insure the competency of planners is "completely untrue," pointing out that market forces have led to the creation of testing services that provide information about the qualifications of financial planners.[142] He also states that because the present situation places no impediments upon entry into the profession, increased competition caused by newcomers entering the field has driven fees down. By establishing the self-regulatory organization with its licensing test, the number of planners entering the profession would be curtailed, thereby reducing competition and eventually leading to an increase in fees.[143] Macey also notes that licensing tests will provide little benefit to the public as they are not effective in detecting "potential swindlers." He reaches the conclusion that the IAFP is not motivated by a desire to protect the public, but instead, the IAFP "is playing the age-old game of using political

139. *See* Kapner, *supra* note 138, at 8.

140. Macey, *Financial Planners: A New Professional Cartel?*, Wall St. J., Oct. 30, 1985, at 28, col. 4. The IAFP proposal for new regulation calls for the creation of a self-regulatory organization for financial planners. It is discussed in greater detail in the following section.

141. *Id.*

142. *Id.* The commentator is referring to the College of Financial Planning's CFP designation, and the Institute of Chartered Financial Analyst's "Chartered Financial Analyst" designation. *See supra* note 29.

143. Macy, *supra* note, 140.

pressure to stifle competition through regulation."[144]

Self-interest should not be considered the only reason underlying the IAFP's proposal. The organization represents a large segment of the industry. It is concerned not only with protecting itself through regulation, but also with building financial planning into a legitimate and respected profession. Recognizing that problems do exist in current regulation and that the IAFP has offered a possible solution, the proposal should not be discredited on such narrow grounds.

The movement for new or additional regulation of the financial planning industry is gaining strength as the issues receive increasing public attention. Many states have taken steps in their respective legislatures by introducing bills and passing specific financial planner regulation.[145] The NASAA has proposed amendments to the Uniform Act that would include financial planners,[146] and other organizations have suggested new ways in which planners might be regulated. The federal government also has become involved. In June 1986, Congress held hearings to inquire into the matter of regulating financial planners.[147] Testimony was heard from many of the major participants in the planning industry.[148] Following the hearings, Congress requested that the SEC coordinate and supervise a comprehensive study to examine the status of the planning industry and the degree of abuse.[149] The scope of the study includes customer demographics,[150] financial planner characteristics,[151] compensation of planners,[152] registration,[153] and inspection.[154] As of March, 1987, the SEC had been making progress towards completion of the

144. *Id.* "The academic literature on the economics of regulation asserts that because legislation is a commodity supplied and demanded like any other, those politically powerful groups most willing to pay for protectionist legislation will very likely receive it. The current efforts by financial planners to push through self-regulation is entirely consistent with this theory." *Id.*

145. *See infra* notes 212-35 and accompanying text.

146. *See infra* notes 191-202 and accompanying text.

147. The hearings were conducted by the United States House of Representatives Subcommittee on Telecommunications, Consumer Protection and Finance of the Committee on Energy and Commerce.

148. Securities and Exchange Commission Chairman John Shad testified, as did representatives from the NASD, the IAFP, the ICFP, the NASAA and others. Golob, *supra* note 133, at 31-34.

149. Letter from Congressman Wirth and Congressman Rinaldo to John S. R. Shad, Chairman, Securities and Exchange Commission (July 9, 1986) (requesting the SEC to begin the financial planner study).

150. The SEC will examine demographic characteristics of institutional and individual customers. For individuals, the study will examine income level, educational background, previous financial experience, and reasons for seeking out financial advice.

151. Characteristics include the size of the planner (number of employees, clients, and offices), educational background, qualifications, other business activities (broker/dealer, insurance agent, etc.), and whether the planner has custody or discretionary authority over clients' funds.

152. The SEC will survey the manner in which planners are compensated, and if compensated by commission, the number and types of products which the planner sells, and the amount of disclosure they provide.

153. The study is intended to reveal the federal and state regulatory authorities or self-

study,[155] however, final conclusions and results are not expected until late in 1987.

This section began by asking the question "Is new or additional financial planner regulation necessary?" The information available on abuse, and the lack of a compelling argument against regulation, indicates that some regulatory steps should be taken to deal with financial planners. The remainder of this comment examines what form such regulation should take, and what entity should be responsible for its enforcement.

IV. PROPOSALS FOR NEW REGULATION

New financial planner regulation has been proposed in a variety of forms, all of which are intended to address the perceived abuses and other problems discussed in the preceding section. Proposals have been advanced by certain financial planner organizations, as well as by the NASAA, the NASD, and some individual states. This section presents and critiques the new regulatory initiatives.

A. Self-Regulatory Organization — The IAFP Approach

The creation of a self-regulatory organization (SRO) to regulate financial planners was proposed by the International Association for Financial Planning.[156] According to the IAFP, the SRO would provide a mechanism which would make it possible for the financial planning industry to regulate itself.[157] The SRO proposal is intended to enhance the professionalism of the industry, provide greater protection for clients, promote fair and equitable business practices, and prevent fraudulent and manipulative acts and practices.[158] The SRO would be modeled after the National Association of Securities Dealers (NASD), and would be sub-

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regulatory agencies with which planners are registered, and whether they file reports and submit to inspections.

154. The study seeks to determine the number and type of inspections to which planners are subjected.

155. In an update on the study, the SEC outlined the background, tasks, and progress that had taken place since July, 1986. *SEC Financial Planner/Investment Adviser Study*, (March 3, 1987) (available from the SEC). The SEC reports that additional funding has been allocated for the study, and that seven headquarters staff and 45 field staff are working on the study. The SEC has begun inspections upon a random sample of 100 planners, and has begun collecting and reviewing literature on financial planning and reviewing Form ADV filings to describe planner characteristics. The SEC also is collecting and categorizing information on previous SEC enforcement actions against planners, and has requested NASAA to provide information of this type from the states in order to uncover any evidence of abuse by planners.

156. Piontek, *NASD-Type Organization to Regulate Planners Proposed by IAFP Board*, NAT'L UNDERWRITER (LIFE/HEALTH INS. EDITION), June 15, 1985, at 1.

157. *IAFP Spells Out Its Self-Regulatory Plan*, NAT'L UNDERWRITER (LIFE & HEALTH INS. EDITION), Sept. 21, 1985, at 25 (This article is a reprint of a memorandum published by the IAFP which summarizes the significant features of the SRO proposal.) [hereinafter *IAFP Spells Out Its Self-Regulatory Plan*].

158. *Id.*

ject to oversight by the SEC.[159]

Authorization for the establishment of an SRO would be accomplished through Congressional amendments to the Advisers Act. The amendments would provide for the creation of one or more "registered financial planner associations," or SROs.[160] An SRO would be created by filing an application for registration with the SEC, and would not be approved for registration unless the SEC made certain determinations regarding the qualifications of the association.[161] The SEC would be required to find that the rules of the association are designed to prevent fraudulent and manipulative practices, to ensure that planners meet professional and ethical standards, to promote fair and equitable business practices, and to protect the public interest and the clients of financial planners.[162] The rules of the SRO also would be required to provide a fair procedure for disciplining member planners.[163]

Every financial planner would be required to become a member in an SRO.[164] The SRO could deny membership to a planner who has been expelled or suspended from any other SRO.[165] The SRO also could deny the membership to a planner who did not meet the association's standards of training, experience, or competence, or if the planner had engaged in acts which were inconsistent with just and equitable business practices.[166]

The SEC would be authorized to delegate any function pertaining to financial planners that it performs under the Advisers Act to an SRO.[167] An SRO would be empowered to set professional qualification standards as a condition of initial and continuing registration.[168] It would develop

159. *Id.* An SRO would be required to file any rule changes with the SEC for its approval, and the SEC could abrogate, alter, or supplement any of the SRO's existing rules. The SEC would be empowered to suspend an SRO for up to one year, and suspend or revoke the registration of a member of an SRO.

160. *Id. See also* Financial Planner Self-Regulation Act, (1986) (available from the IAFP).

161. *IAFP Spells Out Its Self-Regulatory Plan*, *supra* note 157, at 25.

162. *Id.* The SEC also would have to find that the SRO is capable of carrying out the purposes of the act, and that the rules of the association permit any planner to become a member, assure fair representation of members in selecting directors and assure that one or more directors represent clients of members, and provide for equitable allocation of dues and fees. *Id.*

163. *Id.*

164. *Id.*

165. *See* Financial Planner Self-Regulation Act, *supra* note 160. Other bases for denial are: if sections 203(e) or (f) (relating to actions which the SEC may take against an investment adviser) of the Advisers Act are applicable; if the person fails to meet the SROs standards of operational capability; or if the person is not engaged in the type of business in which the SRO requires its members to be engaged. *Id.*

166. *Id.*

167. *IAFP Spells Out Its Self-Regulatory Plan*, *supra* note 157, at 29.

168. *Id.* at 25. As part of the professional qualifications standard, an SRO would set education and experience standards and administer tests covering knowledge of the law and financial planning principles and techniques. An SRO also would impose continuing education requirements that would have to be met as a condition of con-

ethical standards, as well as standards concerning the conduct of a planner with respect to the services he provides. An SRO would have the authority to take disciplinary actions and impose sanctions in the event that a member violated the provisions of the Advisers Act or the rules of the association.[169]

The Advisers Act also would be amended by adding definitions for the terms "financial planner,"[170] "financial planning,"[171] "financial planning professional,"[172] and "person associated with a financial planner."[173] These definitions would include a person in business exclusively as a financial planner, as well as a person whose business does not exclusively involve financial planning.[174] Persons who provide financial planning services as an incidental service of another occupation also would come within these definitions. Not covered would be persons who provide financial advice occasionally but who do not provide financial planning services.[175]

Each SRO would be a nonprofit corporation funded through "user fees," income producing activities relating to financial planners, and annual membership dues.[176] A field examination of each financial planner would be performed at least once every three years to determine compliance with Advisers Act requirements and the rules and regulations promulgated by the SEC and the SRO. State regulation of financial plan-

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tinuing registration. Standards also would be developed to identify the matters that should be addressed in a comprehensive financial plan. *See* Financial Planner Self-Regulation Act, *supra* note 160.

169. *IAFP Spells Out Its Self-Regulatory Plan*, *supra* note 157, at 29. Any disciplinary action taken by an SRO would be subject to review by the SEC, either upon its own motion or upon application by an aggrieved party. An SRO also would have the power to impose dues, fees, and other charges upon its members, persons associated with members, and user of services provided by the association. *See* Financial Planner Self-Regulation Act, *supra* note 160.

170. *Id.* at 25. A "financial planner" is any person that is engaged in the business of providing financial planning or provides financial planning to more than fifteen persons during any twelve-month period. Exceptions from the definition similar to those in § 202(a)(11) of the Advisers Act also are provided in this amendment. *Id.*

171. *Id.* "Financial planning" means providing to a natural person, for compensation, a written plan recommending strategies and actions designed to help achieve the overall financial goals of that person on the basis of an evaluation of the personal and financial condition and capabilities of that person. *Id.*

172. *Id.* A "financial planning professional" means any person associated with a financial planner, except for an employee whose functions are solely clerical or ministerial. *Id.*

173. *Id.* A "person associated with a financial planner" means any partner, officer, or director of such financial planner (or any person performing similar functions), or any person directly or indirectly controlling or controlled by such financial planner, including any employee of such financial planner. *Id.*

174. *Id.*

175. *Id.* The proposal would prohibit a person who is not a financial planner or financial planning professional from holding himself out as such or using a similar term to describe his business, and would deem any person who is a financial planner to be an investment adviser. *Id.*

176. *Id.* at 28. "User fees" would be paid to an association by persons who benefit from services provided by the SRO. *Id.*

ners would not be affected by the amendments.[177]

The IAFP proposal is an ambitious and extensive undertaking that would introduce revolutionary changes into the present scheme of regulation. The proposal has several positive aspects. Defining financial planner and financial planning, and establishing professional and ethical standards, would aid consumers in intelligently selecting a planner and would provide the industry with professionalism and credibility. These additions would benefit consumers by helping to ensure consistency among individuals and institutions holding themselves out as financial planners, and by ensuring that consumers receive legitimate financial planning rather than incompetent services rendered by individuals who do not have the clients' best interests in mind. Establishing a central authority to register, test, inspect, and keep track of financial planners would relieve the SEC of a considerable burden, improve enforcement, and provide a method to insure that only qualified planners enter the profession. The proposal, however, is not without its shortcomings.

The IAFP is cognizant of its position of power in the industry, and its SRO proposal would be a substantial step toward protecting that position. The IAFP, as the largest financial planner organization and as the initiator of the SRO proposal, probably will seek to form an SRO if its proposal is accepted by Congress. As noted earlier, one of the major problems with the IAFP proposal is its self-serving nature.[178] Given the extensive regulatory powers that would be placed into the hands of an SRO, the self-serving image would be enhanced in the eyes of the media and the public, especially if the IAFP formed the only SRO.[179] Connected to this inherent self-serving image is the likelihood that regulation from within the industry would not be as vigorous as it would be if the regulation were performed by outside authorities.[180]

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177. *Id.* Where a state imposes substantive regulation such as professional qualification standards, compliance with SRO standards would be considered as a substitute. The SRO's would coordinate with the states in the areas of examination, testing, discipline, and registration.

178. *See supra* notes 137-41 and accompanying text.

179. Although the proposal makes allowance for the existence of "one or more SROs," such a situation is unlikely. Two or more SROs would necessarily have to work together, operating with idential rules, procedures, and standards. Given this premise, there would be little regulatory purpose served in allowing two or more SROs to operate. The existence of multiple SROs would lead to competition for members and cause disunity within the industry. Furthermore, it would be highly inefficient to establish several competiting SROs, along with their substantial operating and administrative costs, to enforce identical regulation. The most sensible arrangement would be to have one central SRO to govern the entire financial planning industry.

180. A recent note discussing the IAFP proposal lists several other criticisms pertaining to self-regulatory organizations in general. Note, *Financial Planning: Is It Time For a Self-Regulatory Organization*, BROOKLYN L. REV. 143, 176 n.191 (1987). The necessity of SEC supervision creates a two-tier bureaucracy that can lead to duplication of effort and conflicts in jurisdiction. An SRO may overregulate due to a sensitivity to criticism, or it may prevent necessary changes from taking place because it is the entity which organizes the industry. Finally, the SRO may abuse its power. *Id.*

The SRO proposal poses additional problems for the industry. A financial planner would be defined as one who is in the business of financial planning. Each SRO would have authority to develop standards denoting what constitutes a comprehensive financial plan.[181] Read broadly, each SRO is given the authority to define "financial planning"; read narrowly, each SRO may prescribe to individual planners, regardless of a particular client's circumstances, the plan which must be drawn in order to receive SRO approval. In either case, financial planners should be concerned about the impact of such provisions upon their professional judgment in developing a plan, and upon their planner/client relationships. Moreover, planners choosing to employ a plan which varies from the SRO proposal possibly could be prevented from holding themselves out as financial planners.

The radical departure from present regulation that would result from the enactment of the SRO proposal is perhaps the most effective argument against its adoption. Although the NASAA study and the CFA survey reveal many abuses, neither was intended nor conducted as a comprehensive study of the planning industry. A more thorough examination possibly could reveal that the extent of the problems in the industry, although serious and in need of some attention, are not of sufficient magnitude to warrant the creation of an entirely new system of regulation.[182] Therefore, until such time as a complete analysis of the financial planning industry yields conclusive evidence that the SRO proposal is the best way to proceed, it is more sensible to take less drastic and costly steps to regulate the industry. It would seem that the future of the SRO proposal depends a great deal upon the results of the current SEC study. If the study provides evidence of extensive abuse throughout the industry, then perhaps the SRO proposal can be recognized as a proper response.

B. Self-Regulatory Organization - The NASD Approach

In the summer of 1986, the National Association of Securities Dealers (NASD)[183] began a pilot program to study the impact on the NASD

181. *See* Financial Planner Self-Regulation Act, *supra* note 160, ("A registered financial planner association may develop, administer, and enforce standards concerning the conduct of a [financial planner] . . . with regard to the financial planning services provided by such person."); *see also IAFP Spells Out Its Self-Regulatory Plan*, *supra* note 157, at 29 ("The SRO would develop standards concerning the matters that should be addressed in a comprehensive financial plan. These standards would be subject to ongoing review by the SRO. Financial planners would not be required to address all of these matters in every plan, but the plan must address them if the financial planner wants to present the plan as meeting SRO standards.").

182. In fact, the results of the NASAA study are questionable in their application to financial planning. Most of the abuses discovered were perpetrated by con-artists calling themselves financial planners, and not by actual financial planners. *See Investor Alert Newsletter*, *supra* note 122.

183. The NASD was formed in the 1930's to aid the SEC in regulating over-the-counter securities markets. The NASD is a quasi-independent, self-regulatory organization

if it were to assume responsibility from the SEC for regulating registered investment advisers (RIA) and financial planners.[184] The pilot program was intended to assess the NASD's capability to enforce the Advisers Act's existing rules and provide additional assistance to the SEC in monitoring the industry.[185] Objectives of the six-month study included developing methods and procedures for regulating RIAs, evaluating the costs of regulation, and exploring how the NASD would absorb the RIA's into its own regulatory structure.[186] The NASD, in its regulation of financial planners would not be accountable to the states.[187]

The NASD proposal calls for a lesser role on the part of the states in the regulation of financial planners, and in fact would be a substitute for state regulation. The proposal comes at a time when state securities administrators, through NASAA, have proposed amendments to the investment adviser provisions of the Uniform Act to include financial planners,[188] and when many individual states are pursuing specific financial planner legislation.[189] There is a clearly articulated interest on the state level to have an active role in supervising financial planners, however the NASD proposal ignores these concerns. Insensitivity towards legitimate state interests, along with a history of not cooperating with state securities administrators, renders the NASD proposal an undesireable alternative.[190]

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which is supervised by the SEC. It currently regulates 6,400 member firms, which represent about 240,000 brokers and a total of 360,000 individuals. *See* Chambliss, *supra* note 89, at 66. It performs its self-regulatory functions over broker-dealer firms which are members of the NASD, and over persons associated with members, through the administration of qualification examinations, by conducting compliance inspections, and by taking disciplinary actions in appropriate situations.

184. Golob, *supra* note 133, at 31. The pilot program is limited to twenty-five NASD member firms or associated member firms. It is estimated that approximately sixty per cent of the RIA's are also NASD members or associated with NASD members. *NASD to Launch Pilot SRO Program to Oversee Some Financial Planners*, WASH. FIN. REP. (BNA) No. 46,848 (May 19, 1986).

185. The NASD cannot enforce provisions of the Advisers Act without Congressional legislation because the NASD charter does not extend its authorityto non-NASD members.

186. Chambliss, *supra* note 89, at 66.

187. *Statement of F. Daniel Bell*, *supra* note 35, at 22-23.

188. *See infra* notes 191-202 and accompanying text.

189. *See infra* notes 212-35 and accompanying text. The SEC has also recognized the legitimate state role in investment adviser and financial planner regulation. *See Statement of F. Daniel Bell*, *supra* note 35, at 11-13.

190. NASAA surveyed state securities administrators to determine the working relationship between state regulators and the NASD. The survey revealed an absence of cooperation and shared information from the NASD. Complaints stated that the NASD did not report violations of state law uncovered in inspections or disciplinary actions to the states, and that there was a general lack of communication. State regulators often were forced to issue a subpoena to get information from the NASD. *See Statement of F. Daniel Bell*, *supra* note 35, at 24-25, 38, 40. Appendix D to Mr. Bell's statement reports that 81% of the states responding to the survey claim that the NASD does not share routinely information concerning consumer complaints, scheduled inspections and results of such inspections, disciplinary actions, and vio-

C. *Uniform State Regulation - The NASAA Approach*

The North American Securities Administrators Association established a Regulation of Financial Planners Study Committee to examine the need for state regulation of financial planners and to suggest possible regulatory approaches.[191] The committee surveyed the states and discovered that reported abuses by financial planners were increasing.[192] After studying the regulatory issues pertinent to the planning industry, NASAA members concluded that state regulation of financial planners should be accomplished through state investment adviser laws.[193] The NASAA membership directed the Regulation of Financial Planners Study Committee and the Investment Adviser Committee to propose uniform state investment advisers laws that would provide that financial planners are subject to regulation under state investment advisory laws, and that would apply uniform examination and/or qualification procedures, licensing requirements, and centralized multi-state registration of investment advisers and their agents, including persons engaged in financial planning.[194]

The finalized committee recommendations proposing amendments to the investment advisor provisions of the Uniform Securities Act were adopted by the NASAA membership.[195] One of the most important changes is the inclusion of financial planner within the definition of investment adviser.[196] Another requires the registration of investment ad-

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lations of state law. *Id.* at 38. Appendix F gives examples of NASD efforts to undermine state securities regulation. *Id.* at 40.

191. *Id.* at 1. The Committee was created in 1984 to address concerns that the rapidly expanding financial planning industry was operating without effective regulation at the state and federal levels. *Id.*

192. *Id.* The survey, completed in 1985, was of financial planning-related enforcement actions taken by state securities agencies. For a reprint of the survey, see *NASAA State-by-State Summary*, *supra* note 121, at 119. Mr. Bell stated in his testimony before the House subcommittee, "[o]ur canvass of state enforcement actions turned up over $90 million of fraud and abusive practices on the part of the underside of the financial planning industry. And indications are that this is just the tip of the iceberg." *Statement of F. Daniel Bell*, *supra* note 35, at 7.

193. *Statement of F. Daniel Bell*, *supra* note 35, at 14. NASAA also took a separate step towards uniform state regulation. On September 29, 1985, it adopted Form ADV as amended by the SEC for use as a uniform registration form for investment advisers in all jurisdictions.

194. *Id.* at 14-15.

195. In late 1986, the NASAA membership adopted the amendments at its annual meeting. 1 NASAA REP. ¶¶ 4851-4900.

196. *Id.* at ¶4881.10. The amendment provides:

> Investment adviser also includes financial planners and other persons who, as an integral component of other financially related services, provide the foregoing investment advisory services to others for compensation and as part of a business or who hold themselves out as providing the foregoing investment advisory services to others for compensation.

Id. The comment to the amendment states that the definition was patterned after Release 770. *Id.* at ¶4881.15. The drafters believe that most financial planners are investment advisers, however, planners who render advice solely in non-securities areas such as insurance or budget management would not come within the defini-

viser representatives[197] as well as investment advisers.[198] Centralized registration would be accomplished by permitting state securities administrators to designate a person to receive applications on their behalf.[199] Licensing and uniform examination qualification requirements are not addressed in the amendments.[200] The amendments authorize the administrator to establish special minimum financial requirements for certain investment advisers.[201] Finally, a statutory cause of action at law or in equity would be created to allow redress for clients.[202]

The amendments proposed by NASAA are a sensible approach to the administration of rules and regulations in the planning industry. The NASAA recognizes that states have a legitimate interest in regulating the conduct of financial planners and investment advisers. These amendments would relieve the SEC of a burden which at the present time it does not have the resources to bear, and would negate the necessity for an entirely new level of regulation and the associated costs.

To have legal significance, however, the amendments must be adopted as law in the individual states. Once adopted, their effectiveness will be diminished if the approach is not made uniform by the adoption of the Uniform Act investment adviser provisions in the eleven states that have not yet done so. Finally, the amendments do not go far enough to include all planners within the scope of regulation. Only those planners who provide investment advice must register, creating a situation in

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tion. Simply holding oneself out as a financial planner, without rendering investment advice, would not bring a person within the definition. *Id.*

197. The amendments define "investment adviser representative" as:

> any partner, officer, director of (or a person occupying a similar status or performing similar functions) or other individual employed by or associated with an investment adviser, except clerical or ministerial personnel, who (1) makes any recommendations or otherwise renders advice regarding securities, (2) manages accounts or portfolios of clients, (3) determines which recommendation or advice regarding securities should be given, (4) solicits, offers or negotiates for the sale of or sells investment advisory services, or (5) supervises employees who perform any of the foregoing.

Id. at ¶ 4881.10.

198. *Id.* at ¶ 4861.20.

199. *Id.* at ¶ 4862.05. In March 1986, NASAA members adopted a resolution endorsing a centralized registration system for investment advisers. *Statement of F. Daniel Bell, supra* note 35, at 13. The official NASAA comment suggests that the administrator could designate the Central Registration Depository (CRD) to receive applications on his behalf. 1 NASSA REP., ¶ 4862.25. The NASAA and the NASD co-own the CRD.

200. NASAA is in the process of developing a uniform investment adviser examination. *Statement of F. Daniel Bell, supra* note 35, at 13-14.

201. 1 NASAA REP., ¶ 4862.20. The administrator may set different minimum financial requirements for those investment advisers who have custody of or discretionary authority over their client's funds, and those who do not. *Id.*

202. *Id.* at ¶ 4890.10. A person who is the victim of an investment adviser's fraud or other misconduct may sue at law or in equity to recover the compensation paid for the investment advice and any loss due to such advice, plus interest, costs and reasonable attorney fees. The amount recoverable may be offset by any income derived from the advice. *Id.*

which some planners are regulated and others, those not providing investment advice, are not. Therefore, although the NASAA proposal is desireable, it is not likely to come to fruition in the near future.

D. The ICFP Approach

The Institute of Certified Financial Planners (ICFP) is the other major financial planner organization to come forward with a regulatory proposal.[203] The ICFP's position is that an adequate regulatory structure is in place under existing federal and state law to monitor financial planners effectively, but that stronger enforcement is necessary.[204] On the state level, the ICFP endorses the NASAA uniform state investment adviser amendments discussed in the preceding section, and encourages states that have not adopted the investment adviser provisions to do so.[205] The ICFP also urges that a definition of "financial planner" be placed in the Uniform Act to require compliance by those holding themselves out as financial planners,[206] and that full disclosure through mandatory registration should be pursued with rigorous enforcement and strong penalties for noncompliance.[207] On the federal level, the ICFP calls for a clearer statement from the SEC as to the applicability of the Advisers Act to all planners,[208] and more effective enforcement of the Advisers Act by increasing the frequency of inspections.[209] The ICFP also emphasizes the need for consumer education and awareness,[210] and the preservation and enforcement of the fiduciary relationship between planner and client.[211]

The ICFP approach mirrors the NASAA approach in many respects. It improves upon the NASAA amendments by recommending that a definition of "financial planner" become a part of the Uniform Act, and that all financial planners be required to register. However, the

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203. The ICFP and the IAFP are the two largest financial planner organizations.
204. *Statement of Charles G. Hughes, Jr.*, *supra* note 113, at 1.
205. *Id.*
206. *Id.* at 8.
207. *Id.* at 6.
208. *See ICFP Proposed Solutions for Effective Financial Planner Regulation*, (Oct. 1986) (available from the ICFP).
209. *Statement of Charles G. Hughes, Jr.*, *supra* note 113, at 13. The ICFP recommends an amendment to § 204 of the Advisers Act, 15 U.S.C. 80b-4, which would permit the SEC to delegate the inspection power to third parties who would report results to the SEC. After a period of three years, the power would revert to the SEC. *Id.*
210. *Id.* at 14-16. Consumers would be made aware of their right to demand and receive an accurate and current disclosure document from a planner. Consumer awareness programs would: (1) enlist the cooperation of consumer groups to mount an aggressive awareness and educational campaign; (2) inform planners that consumers will be made aware of their rights to demand and receive full disclosure; (3) work with the SEC to develop a clearer statement of the applicability of the Adviser Act to financial planners; and (4) assist educational and professional organizations in educating and training new financial planners/advisers in legal, ethical, and other professional responsibilities. *Id.* at 15.
211. *Id.* at 6.

ICFP approach shares the same problems with uniformity and lack of adoption in the states that hinder the effectiveness of the NASAA amendments to the Uniform Act.

E. Special State Financial Planner Regulation

An increasing number of states are considering legislation to regulate financial planners and investment advisers, or have appointed committees to study the regulatory issues.[212] Several of the state initiatives propose legislation that would be addressed specifically at regulating financial planners. This trend reflects the concerns of some state officials that the absence of effective regulation of financial planners is related to the recent proliferation of abuses associated with the financial planning industry. Some of the more significant state initiatives are discussed below.

Several states are considering bills that would provide for the licensing of financial planners. A bill introduced in California would apply to any person holding himself out as a financial planner or providing financial planning services.[213] Persons who provide planning services that are incidental to a governmentally regulated profession and who do not use the title financial planner are excluded from the requirements of the bill. Financial planners would be subject to licensure under existing California requirements relating to investment advisers. The bill would impose disclosure requirements upon planners[214] and would require written agreements between planner and client,[215] and financial plans,[216] to meet

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212. *Statement of Daniel F. Bell, supra* note 35, at 9-11; *see also* Wilkerson, *Recent Proposals to Regulate Financial Planners in the States: Divergent Trends*, in *State and Federal Regulation of Financial Planners: Consideration for the Life Insurance Industry*, Sept. 1986 (available from the Practicing Law Institute); *IAFP State Legislation/Regulation Report*, Dec. 31, 1986, and Feb. 20, 1987. These three sources combined indicate that a total of 25 states have considered financial planning issues in some form: Alabama, Arkansas, California, Connecticut, Florida, Georgia, Hawaii, Illinois, Maine, Maryland, Massachusetts, Minnesota, Mississippi, Montana, Nebraska, Nevada, New Hampshire, New Jersey, New York, North Carolina, Ohio, Tennessee, Texas, Virginia and Wisconsin. This section is not intended to provide information regarding the current status of the proposed bills in their respective state legislatures. These bills are offered only to illustrate the different types of legislation under consideration, and to demonstrate the extreme diversity in the states in the area of financial planner regulation.

213. California Senate Bill No. 315.

214. A planner would be required to disclose the identity of the entity providing the planning services, information on the persons actually preparing the plan, methods used to develop the plan, whether the entity sells financial products, and whether the entity or any affiliates will receive commissions on the sale of such products.

215. A planner would not be permitted to provide planning services for compensation unless the planner and client enter into a written agreement which includes all material terms of the agreement, the basis upon which fees will be determined, a description of the services to be provided, and the identity of the persons who will be primarily responsible for the content of the plan.

216. The bill would require a plan to include a statement of the client's goals and objectives as stated by the client, the identity of each person responsible for the content of

specified standards. A consumer-oriented pamphlet would be prepared describing the duties and responsibilities of planners to their clients and the rights of those clients.[217]

A bill introduced in New Jersey[218] would establish a state financial planners examining board to review applicants, issue licenses, conduct and set standards for examinations, establish rules and regulations with respect to continuing education, and maintain records of every financial planner licensed in the state. A person would not be permitted to practice financial planning without a valid license. To be licensed in New Jersey, an applicant would have to be eighteen years of age, have completed a board approved program of study in financial planning, have satisfied experience requirements in financial planning as established by the board, and have passed a competency examination administered or approved by the board.[219] A grandfather clause is included for certain planners practicing in New Jersey on the effective date of the bill.[220] Bills similar to the New Jersey licensing act have been introduced in New York[221] and Maryland.[222]

In Maryland and New York, other legislation has been introduced

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the plan, a description of all recommendations, whether those persons identified in the plan sell financial products recommended in the plan, and whether they will receive compensation or commissions if the financial planning client purchases those products.

217. These pamphlets must be made available to all financial planners. Each planner must deliver the pamphlet to clients and prospective clients 48 hours prior to entering the written agreement.

218. New Jersey Assembly Bill No. 3097 (1987). "Financial planner" would be defined as a person licensed to practice financial planning. The bill would define "financial planning" as the business of advising others, for compensation, as to how to manage their financial affairs including, but not limited to, offering advice on money management, insurance, taxation, planning for retirement, and estate planning. *Id.*

219. The examination would test the applicant's knowledge of financial planning theory and procedures, plus other areas the board deems important. *Id.*

220. A person practicing financial planning on the effective date of the bill would not be required to sit for the examination if the person has completed a course of study in financial planning approved by the board and had been a planner for at least three of the ten years preceding the effective date of the bill. *Id.*

221. Senate Bill 8790. The bill would establish a State Board for Financial Planning and would define the "practice of financial planning" as holding one's self out as having expertise in, or performing services for compensation that involve providing advice or making recommendations relating to securities, estate planning, investments, tax minimization strategies, or the management of monies or properties. An applicant for licensure would be required to meet education requirements, be of good moral character, and pass an examination. The agreement between planner and client would have to be in writing, and the planner would have to make certain disclosures to the client. The bill also contains a bonding requirement.

222. Maryland House of Delegates Bill No. 618 (1987). The bill would create a State Board of Financial Planners with powers to license, regulate, and enforce the provisions of the bill. It contains a broad definition of financial planner that would include virtually anyone providing financial planning and investment advisory services, and the bill describes a wide range of improper conduct, including fraud, deceit, false and misleading statements, and failure to disclose compensation and commissions received.

that would not require planners to be licensed, thereby creating a less restrictive method of regulation. The Maryland bill[223] proposes amendments to the provisions of the Maryland Securities Act. It would require investment advisers to register under the securities act.[224] The definition of "investment adviser" would be amended to include those providing financial planning services, and those holding themselves out as financial planners.[225] The bill also includes performance fee prohibitions, and disclosure requirements.[226] The New York bill would amend the investment adviser provisions of the New York general business law to include a person who provides investment advice with respect to the management or commitment of a client's financial resources within the definition of investment adviser.[227] It would require all investment advisers to furnish each client or prospective client with a written disclosure statement, and would require the attorney general to develop a consumer pamphlet.[228]

The Minnesota Department of Commerce adopted provisions which regulate the "Business of Financial Planning." [229] The regulations prohibit a person from representing that he is in the business of financial planning unless he provides a disclosure document to the client.[230] A planner must disclose the basis of fees or commissions he will receive, the

223. Maryland House of Delegates Bill No. 767 (1987).

224. At the present time, Maryland does not have investment adviser provisions. These amendments would require investment advisers to meet the requirements that must now be met by broker/dealers. Although these amendments add investment adviser provisions to the Maryland Uniform Securities Act, they parallel neither the Uniform Act provisions nor the recent NASAA amendments.

225. The definition of investment adviser adopted in Maryland is the Uniform Act definition. These amendments add to that definition. The investment adviser definition would be amended to include a person who:

(i) provides, or offers to provide, financial planning services or comprehensive financial counseling or advice, on a group or individual basis, for compensation;

(ii) on advertisements, cards, signs, circulars, letterheads, or in any other manner, indicates the person is a "financial planner," "financial counselor," "financial adviser," "investment counselor," "investment adviser," "financial consultant," or any other similar designation of title or combination thereof. . . .

226. Maryland House of Delegates Bill No. 767 (1987). Before entering an investment advisory contract, an adviser would be required to disclose information about the business, the educational background and business affiliations of all partners, directors, and officers, the scope of the adviser's authority with respect to a client's funds, and the bases for compensation. *Id.*

227. Senate Bill 119.

228. The pamphlet would be made available to each investment adviser for distribution to each client. The pamphlet would describe the duties and responsibilities of the investment adviser to his clients.

229. 1A BLUE SKY L. REP. (CCH), ¶ 33,441A. "Business of financial planning" means providing, or offering to provide, financial planning services or financial counseling or advice, or a group or individual basis. *Id.*

230. *Id.* It is a manipulative, deceptive, or fraudulent device or contrivance within the meaning of Minnesota law to practice financial planning without providing disclosure documents to clients. *Id.*

name of any company that supplies the products or services which the planner sells, the licenses held by the person,[231] and the identity of any financial products or services the planner is authorized to sell.[232]

In Arkansas, a bill was introduced based upon the NASAA's proposed amendments to the Uniform Act.[233] A Connecticut bill would require certification of planners similar to that required of CPA's.[234] A bill introduced in Mississippi would require investment advisers to post a surety bond in an amount up to $30,000.[235] Other states, such as Georgia, Tennessee, and Wisconsin, have established study committees to examine the regulation of financial planners.

The fact that approximately one half of the states have considered regulating financial planners in some form indicates a perception among the states that such matters should be addressed at the state level. It also indicates that some states detect a serious course for concern associated with financial planning. If the practice of financial planning were limited or restricted by state boundaries, and if states existed in a vacuum independent of each other, individual state regulation of financial planners would be the only viable form of regulation. However, financial planning is a nationwide industry, and state boundaries have little significance in the financial services market. Under these conditions, regulation on an individual basis by the states would be ineffective and inefficient, both from the point of view of financial planners and of the states. Planner regulation inevitably would vary from state to state and in some states there would be no regulation at all. Planners would have to meet different standards and qualifications in each state in which they practiced. Most important from an enforcement perspective, lack of uniform standards and state cooperation would make it possible for a planner who is barred from practicing in one state to set up shop in another. For these reasons, special state regulation is not the most advisable approach to regulating the planning industry.

V. A SUGGESTED APPROACH TO FINANCIAL PLANNER REGULATION

A comprehensive system for regulating financial planners needs to be developed. The effectiveness of such a system will depend upon its ability to protect the public from financial planner abuse, to provide a means for vigorous and strict enforcement of its provisions, and to educate the public regarding the benefits, detriments, and potential hazards of financial planning. Each of the proposals described in the preceeding

231. *Id.* The licenses referred to are insurance agent, securities agent or broker/dealer, real estate broker or sales person, and investment adviser. *Id.*

232. *Id.* Financial products include mutual funds, stocks, or limited partnerships.

233. Arkansas House Bill No. 1606 (1987).

234. Connecticut House Bill No. 5624 (1987).

235. Mississippi House Bill No. 160 (1987).

section attempts to achieve these goals; however, each is flawed in some way that will prevent it from effectively regulating financial planners.

The two existing regulatory systems—the Advisers Act and the investment adviser provisions of the Uniform Securities Act—also are intended to address these issues and, to a large degree, they contain most of the provisions and rules necessary to regulate the financial planning industry. Although state regulation has unique advantages that make it ideal for financial planner regulation, it is highly unlikely that uniform state regulation will materialize within the next few years. Thirty years have passed since the Uniform Securities Act was drafted and there are still eleven states that have not adopted the adviser provisions. Moreover, NASAA amendments to the Uniform Act, which include financial planner within the definition of "investment adviser,"[236] must be adopted in all fifty states for regulation to have its full effect. Finally, because the NASAA amendments do not include all financial planners within the definition of investment adviser,[237] it may prove necessary to further amend the Uniform Act to ensure that all financial planners are subject to regulation. For these reasons, it is unrealistic to rely upon the states to regulate financial planners in a uniform manner within the next few years.

This leaves the SEC, through the Advisers Act, as the entity best suited at this time to regulate financial planners. The Advisers Act, like the Uniform Act, can be adapted easily to include financial planners, and possibly even more so because the SEC has an existing regulatory infrastructure. Modifications to the Advisers Act, as well as alterations in the way in which the SEC monitors investment advisers, will be necessary, however, to make financial planner regulation effective through the Advisers Act. The Advisers Act should be amended to include both a definition of financial planner and a clear statement that the Act applies to all planners without exclusions for certain institutions or individuals.[238] It also should be amended to require investment adviser/financial planner representatives to register under the Act. Finally, the SEC should be given rulemaking authority to require a qualification exam and/or other minimum qualification requirements as a condition of registration,[239] and to require that each planner provide a consumer awareness pamphlet to each client prior to the signing of any agreement.[240]

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236. *See supra* note 196.

237. *Id.*

238. "Financial planner" should be defined to include all persons holding themselves out as financial planners or providing financial planning services. This definition should not be tied to the definition of investment adviser, and should allow only extremely limited exclusions. This would guaranty that all planners are subject to regulation.

239. A planner could be excused from a testing requirement by demonstrating the successful completion of one or more of the courses of study offered by planner organizations. *See supra* note 29.

240. This pamphlet should be prepared by the SEC. It should contain information regarding the nature of financial planning services, the type of person who can most benefit from the services, and the potential conflicts of interest problems that can

A financial planner is susceptible to conflicts of interest when recommending financial products in a plan. To prevent this, disclosure should be increased by amending Part II of form ADV to require dissemination of information specifically applicable to financial planners.[241] Such an amendment would not need to be extensive, and would not result in any greater burden on a planner completing the form. Disclosure of a planner's compensation and commission structure, and of a planner's affiliation with any entity selling financial products recommended by the planner, should be sufficient to put a client on notice that the advice being given may not be objective. Finally, a planner should be required to disclose to every client any commissions that will be received for products recommended in the client's plan.[242]

The SEC is presently incapable of taking on the added burden of full financial planner regulation, especially with respect to conducting inspections. Although the disclosure system is essentially self-executing, thorough inspections conducted on a regular basis require a considerable commitment of financial and personnel resources by the SEC. The revenue to meet this commitment could be raised by a sizable appropriation of funds by Congress. A more realistic alternative, however, is for the SEC to increase filing fees required at registration. Costs also might be reduced by requiring planners to bear a portion of the financial burden of the inspection system. The SEC could conserve personnel resources through increased coordination with the states in inspection and enforcement functions. This type of cooperation also would provide some of the benefits of uniform state regulation without having to wait for legislative actions in each of the states.

The goal of financial planner regulation must be to develop a system that makes it possible to monitor the activities of planners, to inform potential clients of the benefits and pitfalls of utilizing the services of a planner, and to provide a means of effective enforcement that deters misconduct and protects the public. The modifications to the Advisers Act suggested here would achieve these goals by requiring all financial planners to register with the SEC, demonstrate certain minimum qualifications, and fully disclose to clients all actual and potential conflicts of interest. All planners also would be subject to the anti-fraud provisions and rules of the Advisers Act. The Advisers Act, as modified, would be sufficient to protect the public, and would pose a minimal compliance burden on planners. By screening out the incompetent, educating the consumer, and severely punishing those who violate their fiduciary du-

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arise. This will enable prospective clients to make an informed decision when choosing a planner.

241. Form ADV requires only limited disclosure of financial planning information. *See supra* note 58.

242. This disclosure should be made on an individual basis to each client. The disclosure should not be made in Form ADV, but instead should be made directly by the planner to the client prior to the signing of any agreement.

ties, this approach would be an efficient and effective system of financial planner regulation.

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