State Securities Regulators Report on Regulatory Effectiveness and Resources with Respect to Broker-Dealers and Investment Advisers

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NASAA

State Securities Regulators Report on Regulatory Effectiveness and Resources with Respect to Broker-Dealers and Investment Advisers

State securities regulators, through the North American Securities Administrators Association ("NASAA"), present this report to assist the United States Securities and Exchange Commission (the "Commission") in the preparation of the study called for by Section 913 of the ***Dodd-Frank*** Wall Street ***Reform*** and Consumer Protection ***Act (the "Dodd-Frank Act"), and in particular that portion of the study*** that examines regulatory resources and effectiveness with respect to Broker-Dealers, Investment Advisers, and persons associated with them in providing services to investors (the "Study").

NASAA, through the considerable efforts of its Dodd-Frank Studies Working Group, has assembled a data set detailing the means and methodologies of the states regarding Broker-Dealer and Investment Adviser regulation. Through questionnaires and interviews prepared and conducted from August 30 to September 7, 2010, the relevant information from all 51 jurisdictions (fifty states and the District of Columbia) was compiled, structured, and set forward into the format of report presented here. This report provides a detailed analysis of state activity as regards Broker-Dealer and Investment Adviser regulation, specifically focusing on pre-licensure review of those seeking entry into the industry and the post-registration examinations and audits conducted to gauge registrant compliance.

I. Introduction to State Securities Regulators Effectiveness and Resources

Like the Commission, the states direct significant resources to regulating, examining, and enforcing the applicable laws. The states also devote considerable attention and resources to detecting unregistered activity occurring in their states and bringing enforcement actions against both registered and non-registered persons; this Report, however, focuses on the proactive components of the states' comprehensive securities regulatory programs.

In the Investment Adviser arena, the states are the sole regulator of smaller firms and Investment Adviser representatives and are exceptionally effective in that role. In 2009 alone, the states conducted just less than 2,400 Investment Adviser examinations, and will surpass that number in 2010. In recognition of the states' exemplary record of accomplishment in this area, Section 410 of the Dodd-Frank Act recently expanded the states' authority to include a larger percentage of the Investment Adviser population. In less than a year, the states will assume responsibility for regulating most Investment Advisers with up to $100 million in investor assets under management, an estimated 19,000 firms or approximately 75 percent of all Investment Adviser registrants.

NASAA actively supported Section 410 of the Dodd-Frank Act based on the states' firm belief that the new distribution of firms will significantly enhance the effectiveness of Investment Adviser regulation at both the state and federal level. Approximately 4,000 additional Investment Adviser firms will now fall in place with other smaller firms already regulated by the states. The Commission will now be free to focus its resources on the larger, more complex firms. Investors and industry will be better served and investors across the nation will be better protected as the result of this single change.

In the Broker-Dealer arena, the states collaborate with the Commission and the Financial Industry Regulatory Authority ("FINRA") to ensure that registrants are carefully and regularly examined for both basic compliance and anti-fraud purposes. The states have conformed their Broker-Dealer regulations and record keeping requirements to federal law as required by the National Securities Markets Improvement Act of 1996 ("NSMIA"), and devote significant resources to examining and monitoring the activities of the Broker-Dealers, particularly their branch and remote offices. There is no request regarding a state-registered Investment Adviser or Broker-Dealer to which the states will not promptly and capably respond.

With respect to both Investment Adviser and Broker-Dealer regulation, states use extensive and uniform examination tools, a number of which, particularly those related to dishonest and unethical practices rules, are specifically targeted to test compliance with the fiduciary duty standard. State securities regulators also develop and participate in training at many levels and have the resources and support of their sister states and NASAA. These methodologies, along with those highlighted below, make the states highly effective in determining compliance with all applicable securities laws and regulations.

Further, states are well positioned to ensure investor protection proactively because of their all-important background checks of Investment Adviser representatives. Such background checks serve a dual function: to provide investors with assurances that their Investment Adviser representatives are free from violations of the law and that potential problems with bad actors do not have the opportunity to reach fruition. Neither the Commission nor FINRA can perform this vital function. This is because neither the Commission nor FINRA register Investment Adviser representatives.

The critical role with which state regulators are charged, and which they so effectively fulfill, is best explored in four categories: Performance, Resources, Presence and Accountability.

Performance. The examination process at the state level typically begins before an entity ever becomes a registrant. State securities regulators, using standardized processes supported by sophisticated technology, review information submitted by applicants to determine whether the applicant satisfies the state's registration requirements. This examination includes an evaluation of the applicant's history as disclosed on the Forms BD and ADV and the applicant's performance on competency exams written by the states. The states continually review and monitor registrant activity to assess whether registrants remain qualified to do business in their state.

States monitor ongoing compliance in a variety of ways including, but not limited to, post-registration reviews, annual questionnaires, and both on- and off-site examinations. Thousands of on-site examinations employing sophisticated examination modules are performed on routine and for-cause bases each year in virtually every state. For Investment Advisers, routine exams commonly occur within a three-to-five year examination cycle. Broker-Dealer exams are similarly frequent, but given complementary exam programs at the Commission and FINRA, state examinations in this area are often "for-cause" or address special circumstances.

State registration and examination efforts are supplemented by comprehensive data collection and analysis techniques that identify trends and allow the states to stay on the cutting edge of regulation while encouraging collaboration. The registration and examination programs prevent unqualified or unfit applicants from entering the industry while also exposing thousands of deficiencies in industry operations each year. These proactive state regulatory efforts lead not only to needed withdrawals from the industry, enforcement referrals and actions, and monetary recoveries, but also the development of regulatory-licensee relationships and the identification of best practices.

Resources. The states devote significant resources in terms of registration, licensing, and examination staff to Broker-Dealer and Investment Adviser regulation. They, like the Commission, believe their employees are their most vital strategic resource, and the states deploy over four hundred experienced and well-credentialed staff members nationwide to meet their proactive regulatory duties. While a number of states are seeking to increase their staffing and resources in response to the additional responsibilities bestowed upon them by the Dodd-Frank Act, all fifty states and the District of Columbia have agreed through a formal memorandum of understanding to work together and share resources as needed to regulate the state Investment Adviser population. Through NASAA, the states have the benefit of sophisticated training programs and technological tools to assist their licensing and examination staffs in fulfilling their examination responsibilities.

The states deploy over four hundred experienced and well-credentialed staff members nationwide to meet their proactive regulatory duties.

Presence. State regulators have an inherent physical presence in every state, which gives them unparalleled geographic distribution and proximity to the industries and constituents they serve. As compared to both the Commission and FINRA whose national scopes necessitate limited office placement, the state securities regulator's immediate physical proximity ensures accessibility in every community. Further, this proximity results in a significant benefit as regards savings to taxpayers and mitigates the problem of underserved locations and victims. From preregistration screenings to formal outreach initiatives to registrants, state regulators go far beyond the onsite examination in interacting with their registrants.

Accountability. As residents of the states they serve, state securities regulators are aware of regional demographics, income levels, local economy and trends, education levels, and local affinity groups in their communities. States also perform extensive outreach and education directly to investors, often one-on-one in person meetings and events that may not be feasible for a regulator with national responsibility. Combined, the states' intimate familiarity with investors and outreach efforts create a unique level of trust between the state regulator and Main Street investors. This trust is key, and investor expectations that arise from it create the sense of urgency and ownership that serves investors well. State securities agencies often fall under the jurisdiction of elected officials. There is little barrier, whether geographic or bureaucratic, between the agency and the grass-roots investor or registrants. This heightened level of accountability results in the greatest degree of responsiveness, attentiveness, and commitment on the part of the local regulator to even the smallest Investment Adviser, Broker-Dealer, or individual customer. As a result, state regulators are regarded as the "local cop on the beat" who promptly respond to all calls.

The states view the Commission as an essential partner in promoting the states' core mission, protecting investors. State securities officials are confident that this partnership, in its current form, including the continuous enhancements that are one of its hallmarks, is generous enough to provide the comprehensive regulation necessary to advance that core mission. The states are particularly pleased by and laud the advances and reforms that the Commission has made over the past two years to augment Main Street investor protection. One of the most important steps the Commission has taken to date has been to restructure and increase its staffing in order to respond to the challenges it faces. The states are encouraged by the Commission's recruiting efforts and creation of new specialized units that will enhance the overall effectiveness of its Broker-Dealer and Investment Adviser examination program. There is no question that working together, the states and the Commission operating under Chairman Schapiro's leadership will effectively partner to regulate Broker-Dealers and Investment Advisers in the future.

NASAA appreciates this opportunity to contribute to the Study, and looks forward to continuing its collaborative work with the Commission.

II. Overview of State Broker-Dealer, Broker-Dealer Agent, Investment Adviser, and Investment Adviser Representative Registration and Examination Programs.

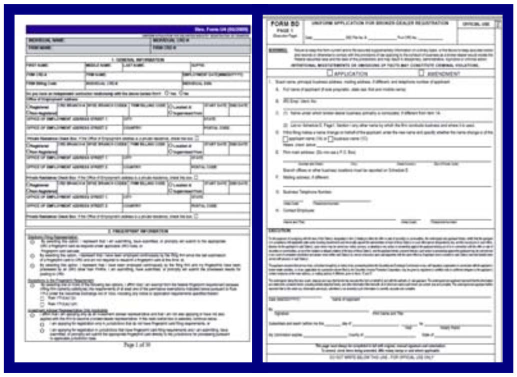
Oversight of the Broker-Dealer and Investment Adviser industries is a cornerstone of state securities regulation. In furtherance of their investor protection mission, state regulators maintain an orderly and honest industry by serving an important gatekeeper function. This serves to prevent undesirable or unqualified individuals from entering the industry. Further, states continue beyond the initial gatekeeper function by employing a comprehensive post-registration examination program to ensure that registrants are both trustworthy and in compliance with all applicable rules and regulations.

The execution of both the gatekeeper functions and the post-registration examination programs are essential to the protection of Main Street investors. Implementation begins with the registration process.

A. Licensing and Registration of Broker-Dealers, Investment Advisers, Broker-Dealer Agents and Investment-Adviser Representatives

State securities regulators use two different database systems to monitor who is acting as a securities professional in their states: the Central Registration Depository (CRD) and the Investment Adviser Registration Depository (IARD). These two databases—accessible by all subscribing states and jurisdictions—centralize a Broker-Dealer or Investment Adviser's regulatory record, thus affording states an important enhancement to their investor protection arsenal.

As part of their investor protection mandate, all states, Puerto Rico, the U.S. Virgin Islands, and the District of Columbia require Broker-Dealers and their agents to apply for registration/licensing before doing business in their jurisdictions. State regulators use the CRD to process the registrations/licenses of Broker-Dealers and their agents as well as Investment Adviser representatives. Consequently, the CRD system is a central component of the states' Broker-Dealer and Broker-Dealer agent registration and licensing programs.



Forms U4 and BD

States register their Broker-Dealers and agents, in part, by requiring the use of the same forms required by FINRA and the Commission. Broker-Dealers must submit the Form BD while their agents use the Form U4. Under state statutes and regulations, Broker-Dealers and their agents must submit their filings through the CRD, which is operated by FINRA under policies contractually established by both FINRA and NASAA.

But, in the interest of investor protection, state registration/licensing procedures are not restricted to simply processing forms. States frequently require Broker-Dealers and their agents to provide additional information not contained within the parameters of the forms. States do this to ensure, ex ante, that the securities professionals in their states meet the highest standards of conduct. For instance, states may require additional submissions including, but not limited to, the following:

- Financial Statements
- Statement of Prior Sales Activities
- U4 for at Least One Principal/Agent to be Registered
- Form BR for Branch Offices

As noted above, the CRD equivalent for Investment Advisers is IARD. IARD is operated by FINRA, as is CRD, through a contract with the Commission and undertakings with NASAA. Both the Commission and state securities regulators use the IARD to process Investment Advisers' registration/licenses. Together, CRD and IARD facilitate the registration of both firms and individuals with state and federal regulators.

With one exception, all states, Puerto Rico, the U.S. Virgin Islands, and the District of Columbia, require Investment Advisers to be registered or licensed to do business in their jurisdictions. An Investment Adviser applies for such registration/licensing by filing a Form ADV—as also required by the Commission—through the IARD system, indicating the state(s) in which the adviser is seeking registration. States also require Investment Advisers to file Part 1B of the ADV which requires additional information regarding the Adviser's business and conduct.

As is the case with Broker-Dealer filing requirements, the states go further than the completion of the required forms. To enhance investor protection, some states require Investment Advisers to register their branch offices and provide a bond or otherwise demonstrate that the Adviser has sufficient net capital requirements.

As noted above, states require the registration/licensing of Broker-Dealers and their agents. Similarly, but unlike the Commission or FINRA, virtually all states require that Investment Adviser *Representatives* also register or be licensed to do business in their jurisdiction.

To register, an Investment Adviser representative will submit a Form U4 to the state(s) in which they wish to register through the CRD. These individuals must have successfully completed required professional competency exams (the Series 65 or the Series 7 and 66) or currently hold one of five recognized professional designations: Certified Financial Planner; Chartered Investment Counselor; Chartered Financial Consultant; Personal Financial Specialist; or Chartered Financial Analyst. An outline of the core competencies tested by the Series 65 and Series 66 exams is attached as **Exhibit 1**.

Before a Broker-Dealer, its agents, an Investment Adviser, or its representatives can do business in a state, their registration/licensing is subjected to a thorough examination. State securities regulators review *all* registration forms for Broker-Dealer, agent, Investment Adviser, and representative applicants. In reviewing these applications, state examiners evaluate the comprehensive information contained within the forms. Some of the more pertinent items subject to review include individual and firm disclosure history, the applicant's financial status, the firms' business practices (especially provisions in adviser client contracts), and potential conflicts of interest.

This process is not merely ministerial. If there are concerns or questions about the applicant's information, or unexplained gaps in the information, state examiners will address those directly with the applicant. In order to ensure the protection of investors, that applicant will not pass registration/licensure until all issues are resolved to the state securities regulator's satisfaction.

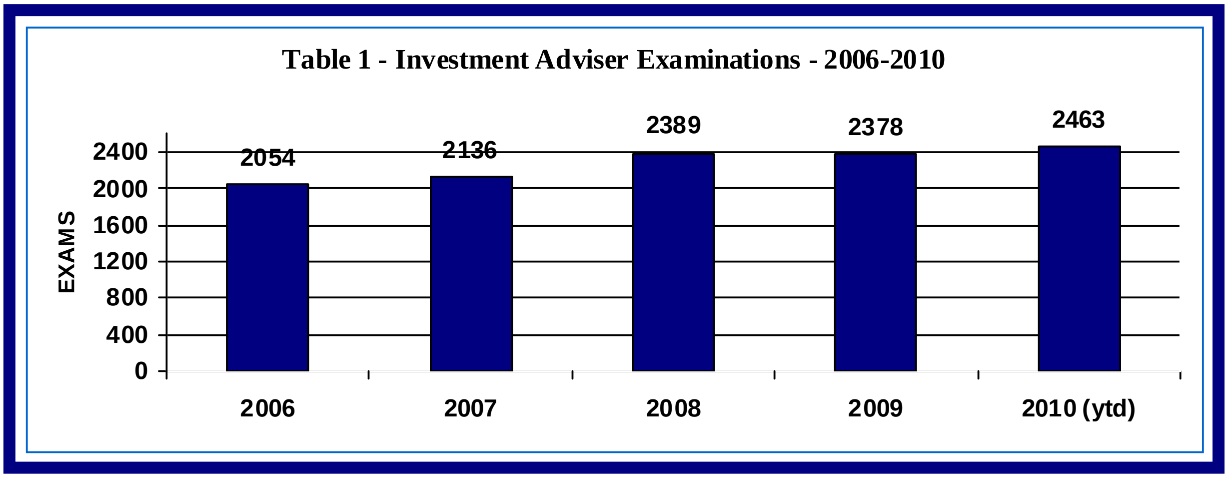
The ongoing effort to ensure the protection of investors frequently does not end with the filing of a single form. States may also require annual questionnaires, both to supplement the information collected on the ADV and as a means to monitor adviser activity. The average time spent on these reviews varies greatly due in large part to the length of time a registrant must take in order to provide the requested materials.

Once registered, Broker-Dealers and Investment Advisers are then "handed-off" to the state examiners and auditors. The examiners and auditors then conduct thorough and regular on-site examinations of the firms, which include examination of their books, interviews with the registrant's staff, examination of the registrant's client files, and any and all other records that would assist the examiner in their determination of the registrants' compliance with state laws. These examination programs are one of the many on-the-ground, frequent and proactive investor protection efforts that the states are uniquely positioned to perform. Such examinations are imperative in regard to state-registered Investment Advisers. This is due to both the local nature of such firms and the lack of complementary oversight from any other regulator.

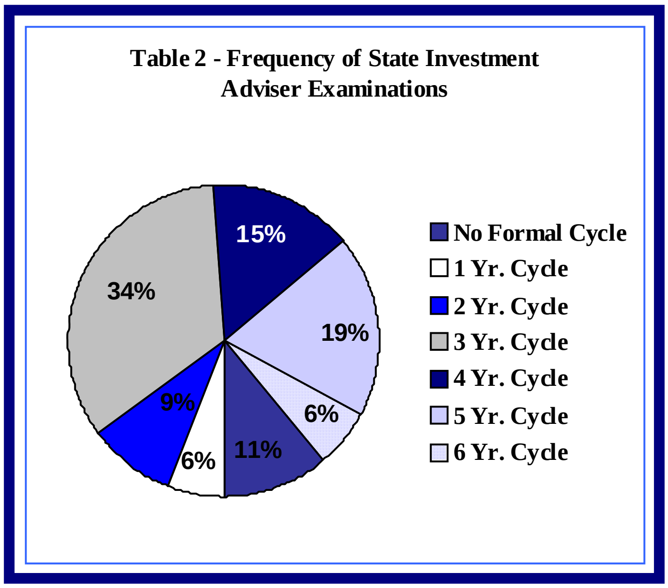
B. Investment Adviser Examinations Conducted by State Securities Regulators

Comprehensive compliance exams are at the core of state Investment Adviser regulation. While the methods utilized by the states range from standard annual questionnaires to formal court-petitioned inspections, at least 47 states monitor compliance through examinations or audits of their registered Investment Advisers.

Virtually all states (94%) conduct Investment Adviser examinations on-site at the Investment Adviser's principal place of business on a "routine" or non-cause basis. These examinations are often initiated within the first two years of a firm's registration. This proactive approach allows the states to identify and correct problem areas early on. Follow-up examinations are conducted thereafter on a frequent basis to reinforce strong compliance practices and are designed to prevent, rather than react to, investor fraud and abuse.



The vast majority (89%) of state routine examinations are completed on a formal cyclical basis, while a minority (11%) are performed on a random or ad hoc basis. All states that adhere to a formal cycle audit their entire Investment Adviser registrant populations in six years or less. As the chart in Table 2 reflects, approximately one-half of the states complete examinations in recurring 1-3 year cycles while the remaining half report cycles falling within the 3-6 year range. On a comparative basis, states conduct routine examinations of their Investment Adviser registrant populations with much greater frequency than the Commission has historically examined its pool of Investment Adviser registrants.



Investment Adviser examinations at the state level are not only frequent, they are comprehensive and consistent. Using information collected as part of the registration review as well as current data from other sources, the states thoroughly review all relevant material to assure compliance. Using standardized Investment Adviser examination modules developed by the states, the electronic examination performance and tracking tool "NEMO," and other common tools like NASAA performance calculators, the states are remarkably united in their compliance efforts. Intensive training programs also developed jointly by the states through NASAA are widely attended and reinforce the states' uniform approach.

Because the volume of data analyzed by state examiners during an examination is significant, the overall process is time-intensive. While the exact time it takes to complete an examination depends upon the size and complexity of the firm being examined, an average examination will normally take two weeks. However, it is commonplace for state examiners to spend up to fifty hours preparing for a single examination. Once on-site at the Investment Adviser's place of business, state examiners generally expect to spend one to two full days at the firm and typically issue an audit report several weeks later that documents their findings.

ITEMS OFTEN REVIEWED IN INVESTMENT ADVISER EXAMINATIONS:

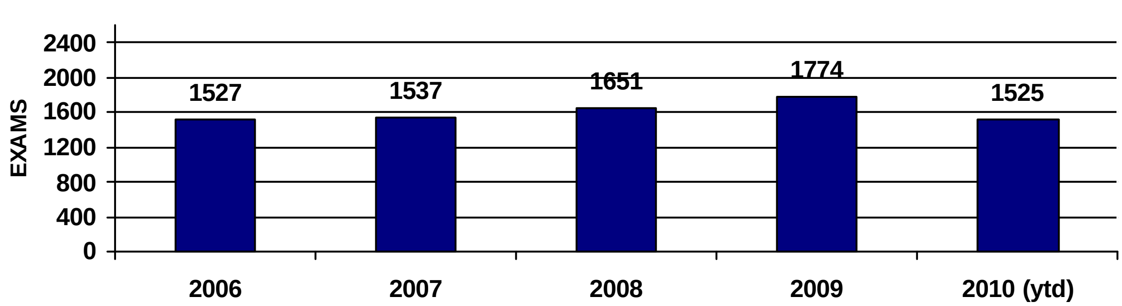
- Form ADV, Parts 1 and 2
- CRD/IARD and other disciplinary and employment history records
- Form U-4s for employees and associated individuals
- firm advertising, business cards, brochures and website
- firm operating and compliance manuals and code of ethics
- company formation documents and financial statements
- client account files (contracts, correspondence, payments)
- information from peer regulators, including the Commission, FINRA, insurance and banking agencies
- Private Placement Memoranda
- Limited Partnerships agreements for hedge funds, performance materials
- management fees
- solicitor agreements and cash referrals
- internet and social media research
- Pacer to search court/litigation activity]

While the states' focus in examining Investment Advisers is clearly prophylactic in nature, there are occasions when state examinations are initiated by or reveal indications of fraud and abuse. An examination that is precipitated by an investor complaint, an industry tip, peer regulator referral, or other method is most commonly referred to by the states as a "for-cause" examination. Regardless of whether the examination is labeled routine or for-cause, any examination that produces findings of fraud, abuse or other violations of the securities laws is quickly referred to state enforcement staff for further investigation and/or prosecution.

C. Broker-Dealer Examinations Conducted by State Securities Regulators

Similar to their comprehensive oversight of Investment Advisers, state regulators implement a long standing and uniform Broker-Dealer examination program encompassing the fifty states via routine examinations as well as risk-based selection methodologies. These examinations, like those for Investment Advisers, are generally on-site, routine examinations, conducted periodically and on a "non-cause" basis. Firms subject to these examinations are given advance notice to give the firm time to prepare so that the examination is as minimally invasive as

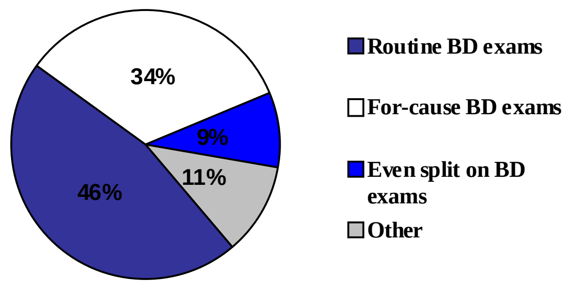
Table 3 - Broker-Dealer Examinations - 2006-2010



possible. On the whole, ninety-four percent of the states conduct Broker-Dealer examinations and all of those states report conducting on-site exams. In 2009, the states reported a total of 1,774 Broker-Dealer examinations.

While many of these examinations are conducted within a state's routine audit cycle, the states' Broker-Dealer examination program includes a robust "for-cause" component. Because states are generally examining Broker-Dealer firms concurrent with FINRA and Commission examinations, state resources are often best spent on these risk-based exams. States also endeavor to reach small, remotely located offices where violations of the securities laws frequently occur. In thirty-four percent of the states that conduct Broker-Dealer examinations, either most or all of such audits are "for cause." Forty-six percent of the states conduct most or all of their Broker-Dealer examinations on a routine basis. An additional nine percent of states report that their Broker-Dealer examinations are split evenly between routine and for-cause circumstances. Regardless of the initial examination approach, any Broker-Dealer examination that uncovers dishonest or unethical behavior, or fraud, is referred to enforcement staff for investigation and/or prosecution.

For-Cause v. Routine Exams for Broker-Dealers



Generally, state Broker-Dealer examiners employ a uniform examination module, similar to the Investment Adviser form, that is regularly reviewed by the NASAA Broker-Dealer Section and modified to address new and emerging key risks. Eighty-three percent of the states report that they use the NASAA examination module in their examinations of Broker-Dealers. The module allows for flexibility in the field as well as general uniformity across the states.

Further to uniformity and coordination, the states employ sweep examinations, a powerful hybrid compliance and enforcement tool whereby NASAA will periodically coordinate Broker-Dealer examination programs across the states. For instance, in 2006, NASAA conducted sweep examinations focusing on firms' compliance with the new books and records rules which were adopted in 2003 as part of the revisions to the Uniform Securities Act. The 2006 NASAA's Broker-Dealer sweep report found that 80% of violations that it uncovered during the sweep were committed in remote, small branch offices. Such branch offices compose twenty percent of the Broker-Dealer offices open to investors. The 2006 Sweep Report is attached as **Exhibit 2**. NASAA conducted a similar sweep in the first of 2010 and a report on the same is expected by the end of the year.

The 2006 NASAA's Broker-Dealer sweep report found that 80% of violations that it uncovered during the sweep were committed in remote, small branch offices.

State coordination in Broker-Dealer examination sweeps is not limited to comprehensive, nationwide efforts. States also have a long tradition of collaborating and sharing resources to address particular concerns at a single firm. Twenty-eight states indicate that they have been involved in joint examinations with other states, outside of the sweep context, within the past five years. Only four states, however, indicate that they have participated in joint examinations with the Commission or FINRA within the past five years.

The paucity of state-FINRA joint Broker-Dealer examinations is a key issue in terms of exam effectiveness, but also in relation to overall regulatory performance vis-à-vis the Broker-Dealer industry. FINRA has traditionally rejected joint examination overtures from the states, citing concern over the "state actor" issue. State regulators have long sought to work jointly with FINRA on complex or multi-state exam matters, both from a resource conservation standpoint and to avoid redundancies and promote industry convenience. But, FINRA has taken the position that it will not join the states in any substantive way to work on immediate or ongoing matters.

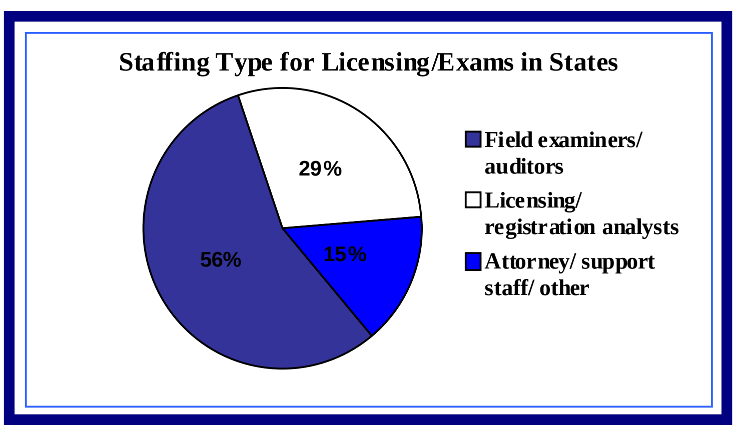
FINRA's refusal to accommodate the states and industry through joint examinations and regulatory coordination is an issue ripe for resolution satisfactory to all parties concerned when considering both the effectiveness and resources that are fundamental to the regulation of the financial services industry.

III. The Resources of State Securities Regulators

As with other regulators, consistent and efficient employment of staff and resources is crucial to effective state securities oversight. While every regulatory office would welcome a budget increase, technology upgrades, or an increase in full-time employees, state securities regulators have developed robust, comprehensive regulatory programs through the optimal use of all available resources. The approximate 25% increase in state-covered Investment Advisers resulting from the Congressionally mandated increase in the assets under management threshold for state registration from $25 million to $100 million ("the Switch") will present a unique opportunity for the states to meet a worthwhile challenge. The states are prepared to meet this challenge through effective stewardship and reliance upon their most vital strategic resource, their employees.

A. Licensing and Exam Staffing by the Numbers

In addition to enforcement, securities registration, and investor education units, state securities regulators have efficient and thorough licensing and examination units. Nationwide, state securities regulators employ a total licensing and examination staff of over 400 professionals, including examiners, auditors, accountants, attorneys and support staff.



While approximately twenty-five percent of states have staff members who are cross-trained to perform both pre-licensing reviews and post-registration examinations, the states report 120 staff members assigned primarily to application and pre-license review and analysis. In addition to staff members devoted to licensing, the states employ an additional 230 field examiners and auditors dedicated to the assessment of compliance at Investment Adviser and Broker-Dealer firms, and report another 60 administrative assistants, support staff, financial analysts, staff economists and attorneys who support both the registration and examination functions.

This host of registration and examination professionals working for state regulators produces a ratio of one full-time licensing/exam staff member for approximately every 37 state-registered Investment Advisers.

1. State Licensing and Registration Staff

The importance of application reviews and other pre-licensing work should not be understated. Pre-licensing examinations offer state regulators an important opportunity to determine whether a Broker-Dealer agent or Investment Adviser representative is both qualified and suitable for registration in a state, and allows the 100-plus nationwide state licensing analysts and examiners to serve as gatekeepers, preventing unqualified applicants from entering the local financial services community.

This critical function is performed by state licensing teams composed of analysts, specialists, accountants, paralegals, and others. The size of state licensing and registration units varies. In states where emphasis is placed upon the state's rigorous pre-licensure review, dedicated registration/licensing staffs can be 10 to 12 staff members strong. In less-populated states with a relatively small number of registered Investment Advisers and/or home office Broker-Dealers, technology and coordination with other states allow a modicum of experienced staff members to conduct a state's licensure program.

2. State Field Examination Staff

Once licensed, firms continue to be subject to consistent and regular oversight. As noted elsewhere, state securities regulators conduct thorough post-registration examination programs to ensure a professional, honest and compliant industry within their jurisdictions. Experienced and skilled field examiners are the key to success in these programs.

Forty states have field examiner units with multiple full-time staff members dedicated to performing routine examinations. Many of these units are supported by additional investigators, attorneys and other staff resources to conduct for-cause or special examinations. Still other states cross-train several employees who leverage their familiarity with a firm gained through pre-licensure work in conducting post-registration compliance examinations of the same.

States report that their preparedness, flexibility and cross-training would allow as many as four hundred staff members nationwide to be available to perform examinations of state-covered Investment Advisers.

While the nationwide average is five fulltime field examiners or auditors on a state regulator's staff, states with large Broker-Dealer and/or Investment Adviser populations employ a much higher number. Exam units boasting twenty, twenty-five or even almost 50 field examiners can be found in the largest states.

3. State Support Staff

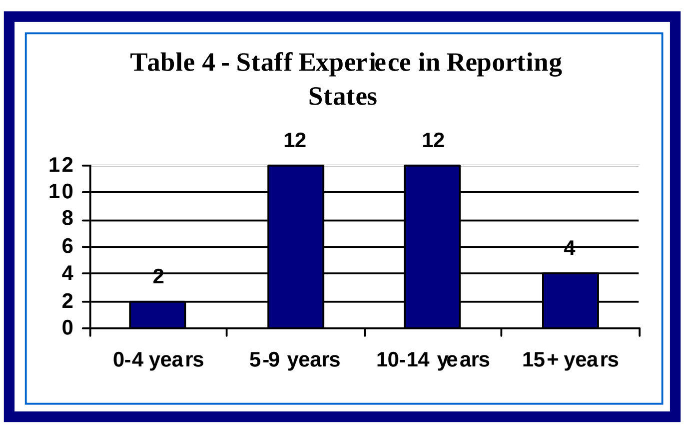
As noted above, “licensing analysts” and “field examiners” do not comprise the entirety of licensing and examination staffs in a state securities regulator’s office. Lawyers, special examiners, special investigators, staff economists, accountants and even appointed administrators or commissioners are often called to perform licensing and examination work. The role of these other staff members should not be underestimated, as these individuals are often asked to assist in for-cause or special audits, or in the comprehensive examinations of large Broker-Dealers with multiple business lines headquartered in a state. The states are keenly aware of the need to be both flexible and agile in meeting challenges head-on, whether in the form of an urgent for-cause examination or the additional twenty-five percent of Investment Advisers that will soon fall under their jurisdiction. If needed, the states report that their preparedness, flexibility and cross-training would allow as many as four hundred staff members nationwide to be available to perform examinations of state-covered Investment Advisers.

B. State Regulatory Staff Experience, Training and Credentials

The statistics unequivocally demonstrate that state licensing and examination programs are strong. However, the creation, maintenance, and continued evolution of such strong programs flows directly from the talented, experienced staff members who perform the work that make these state programs successful.

1. Experience and Longevity of State Staff

State licensing examiners and field auditors rely on their experience and familiarity with their community to ensure thorough, consistent regulation. Thirty states specifically track and recently reported the regulatory work experience of their licensing and/or examination staff members. Among these thirty states, the average experience ranges from three and half years to twenty years. Sixteen states have an average staff experience of over ten years; seven of those states have an average staff experience of fourteen years or greater.



These statistics on staff longevity contain some notable success stories in the areas of loyalty and employee retention. Reporting states are proud of their individual employees with 20, 25 or even 30 years of regulatory experience. In one Western state, the field examiners average thirty years of experience; in another, the field exam unit has an average of 20 years of *industry* experience. In one Southern state, the registration and exam staff averages seventeen years experience, and the for-cause exam supervisor has thirty years experience. In a different state, the registration and compliance managers each have over 20 years of regulatory experience, and field examiners have average experience of 14 years.

Attracting and keeping experienced, knowledgeable registration and examination staff is a serious challenge that the states have mastered. In the thirty states that specifically track and reported average longevity, the overall average regulatory experience for staff members is 10 years. This level of experience pays off handsomely in terms of familiarity with licensees, issue spotting and problem-solving.

2. Background and Credentials of State Staff

In addition to impressive experience in terms of years on the job, state licensing and field examiners also boast impressive credentials. State licensing and exam staffs include attorneys, Certified Public Accountants ("CPAs"), and other professionals, including individuals who hold Master's Degrees in Business Administration ("MBAs").

INDIVIDUAL STATE REGULATOR CREDENTIALS INCLUDE:

- Juris Doctor (J.D.)
- Master of Business Administration (MBA)
- Certified Public Accountant (CPA)
- Certified Fraud Examiners (CFE)
- FINRA certificate
- NWC3 certificate

Twelve states specifically count attorneys among their licensing and exam staff members, while thirteen states have staff members who have earned a Certified Fraud Examiner ("CFE") designation, an MBA, a CPA license, a FINRA professional designation or a National White Collar Crime Center certificate. One mid-sized state reports that its field examination staff includes an attorney, two CFEs, and three staff members who have earned a FINRA certified regulatory compliance examiner certificate. In another state, all field examiners are CPAs or CFEs.

3. State-Sponsored Staff Training

In addition to outside training, certifications, and study programs, the states find another valuable resource in the comprehensive training conferences provided by NASAA. NASAA presents annual training conferences with subject matter focused around the day-to-day operations and duties of registration and examination units.

NASAA's annual three-day, multi-track Broker-Dealer training conference features in-depth panels and break-out sessions conducted by experienced state regulators covering books and records issues, unauthorized trading and examination protocols, as well as detailed reviews of the NASAA examination modules and case studies on a variety of Broker-Dealer violations. In 2010, staff members from 42 states participated in this training.

NASAA's annual Investment Adviser training conference offers multiple tracks to accommodate regulators of varying experience levels. The hands-on Investment Adviser training allows participants to engage in a mock field examination with instruction from experienced auditors and examiners who cover issues ranging from adviser conflicts of interest and client contracts to interview techniques and tips for reviewing financial documents. Examiners from thirty-nine states attended this training in August 2010.

In addition to the Broker-Dealer and Investment Adviser training conferences, NASAA also traditionally presents a multi-day training conference focused on the CRD and IARD systems. This training familiarizes state registration staff members with the complex systems and improves participants' ability to work with data to both streamline the licensing process and identify problem or high-risk applications.

As a complement to these trainings, and to promote cohesion and interaction, NASAA also establishes ready and accessible forums for practical discussion of trends and pressing issues. The NASAA Investment Adviser Section sponsors Zone Project Groups which divides the membership into eight regional zones that meet regularly to address items of immediate or particular concerns to Investment Adviser licensing and examination staff members. This manner of practical and issue-specific collaboration provides unmatched on-the-job training.

4. Industry Experience on State Staffs

In addition to their regulatory experience, education and training, the ranks of state examiners are also bolstered by those with securities and financial industry experience. Thirteen state regulators recently reported that current staff members have experience in securities and financial industries or have held Series 7, 63, 65 or 66 licenses. Those thirteen states reported a total of 36 current staff members with prior industry experience, or almost three per reporting state. In one Western state, each member of the field examination staff has passed the same Series 7 and Series 63 examinations required of state licensees. In one Southern state, the licensing staff and field examiners combine traditional regulatory training (all registration and field examiners are CFEs) with extensive industry experience; all full-time field examiners in that state have eight more years of securities industry experience.

In total, over fifty percent of the states expressly report that their securities division has staff members with industry, legal or professional regulatory experience.

C. Effective and Collaborative Regulatory Tools

State regulators provide their experienced and talented staffs with the proven tools that are necessary to conduct innovative and consistent regulatory programs. As noted above, states use the CRD and IARD systems, complemented by well-developed competency examinations, background reviews, and financial analysis methodologies in their licensing duties. In post-registration activity, the states employ a set of effective tools to measure compliance and assist Broker-Dealers and Investment Advisers in avoiding deficiencies.

1. NASAA Examination Modules

Forty-three states affirmatively report utilizing special examination modules designed, developed and regularly updated by NASAA for Broker-Dealer and Investment Adviser examinations. The comprehensive NASAA examination modules promote uniformity and consistency among the states and enable firms to prepare for examinations and gauge their own compliance with state regulations. The NASAA examination modules were developed by a group of state securities regulators working under the auspices of NASAA Broker-


REGISTRATION/LICENSURE DOCUMENT REVIEW

NASAA Exam Module

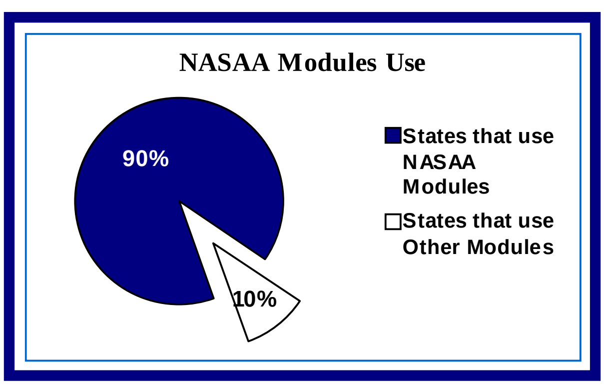
Dealer and Investment Adviser Project Groups. These modules are continually updated and revised for precision and to reflect changes in the industry. The modules cover nearly every scenario an examiner may encounter when examining an Investment Adviser or Broker-Dealer.

Investment Adviser modules include items and a battery of questions to be posed to firms including, but not limited to, the following:

- required books and records maintenance;
- form ADV issues;
- registration of firm and associates;
- financial viability, including net worth requirements and bonding (where statutorily required);
- custody of client funds or securities;
- client billing and invoicing;
- fee and compensation schemes;
- client account performance and activity;
- customer complaints and their resolutions;
- advertising and marketing;
- privacy policies;
- supervisory policies;
- solicitor activity;
- suitability;
- conflicts of interest;
- disclosures;
- dishonest and unethical business practices; and
- hedge fund-specific matters.

Broker-Dealer modules are similar in scope and breadth to Investment Adviser modules, but also delve into issues particular to Broker-Dealer business. Broker-Dealer examination modules expand on the Investment Adviser modules to include business-line or operation-specific items such as:

- private securities offering modules;
- market making examination modules;
- municipal securities modules;
- mutual funds modules; and
- options examination modules.



NASAA examination modules allow examiners to conduct thorough and comprehensive reviews, with sub-modules triggered on the identification of certain issues. The effectiveness of the NASAA examination modules is evidenced by the fact that nearly 90% of state regulators use them. Further, several of those states that do not self-report as employing those modules utilize novel module systems that they designed and/or implemented based on the NASAA examination modules.

2. NASAA Electronic Examination Modules ("NEMO") System

The NASAA examination modules also allow state regulators to maintain data, share knowledge and identify trends with their sister states. NASAA has developed and now maintains a proprietary electronic coordination system that streamlines the examination process and collects and manages information and data from the states' comprehensive exam efforts: the NASAA Electronic Examination Modules, or "NEMO" system. The NEMO system includes:

- Customizable modules that allow a state to pick and choose from a master template to develop a state-specific template;
- The ability to assign a particular state's statutes and rules to any module item or question;
- The ability to flag questions or items as a potential deficiency during an examination, creating a working deficiency list;
- Built-in intelligence features that activate certain questions or sections depending on the answer to a related question;
- Automatic identification of conflicts in answers or incomplete modules;
- Reporting features that allow states to review their examination findings and statistics and contribute the same to a national database; and
- Regional and national statistical reports.

As states continue to expand their use of NEMO, their uploaded field examination data will allow further enhancements to the NASAA examination modules and make them more responsive to emerging trends in the industry. NEMO will prove particularly effective in managing the 2011 Investment Adviser switch, in determining its success, as well as identifying areas for enhancement.

3. Risk Assessment and other Tools

To identify high-risk Broker-Dealer or Investment Advisers and to ensure that valuable staff and financial resources are marshaled in the most effective manner, state examination units employ risk assessment tools.

Twenty-seven states have created and use their own risk assessment tools for choosing examination targets and enhancing their routine examination processes. By leveraging this risk assessment experience and technology, NASAA has developed a new NASAA Risk Assessment Tool that is currently used by at least ten states, and several states report plans to supplement their own exam target processes by putting the tool into service in the near future. In five other states, the Star Examination Program is utilized, a proprietary software program designed to enhance examination processes and reporting.

NASAA's Risk Assessment Tool is a prototype and was developed to provide states a mechanism to rapidly view their IA registrants and the individual risk factors associated with each registrant. The tool will evolve as time goes on. The tool identifies risk factors and assigns each a numeric value. The risk factors are gathered from each state-regulated Investment Advisor's form ADV, and include the following:

- Whether a firm has custody of client funds or securities;
- Number of clients;
- Wealth of clients;
- Type of client – individual, pension fund, trust, pooled investment vehicle, etc.;
- Compensation arrangements;
- Solicitor agreements;
- Number of Investment Adviser representatives employed;
- Type of services provided;
- Other business involvement (ie. insurance agency, real estate broker, etc.); and
- Past regulatory action or customer complaints.

Although many states rely upon a sequential examination cycle to ensure that they visit firms on a routine basis, many have indicated an intention to increase their reliance on risk assessment tools to filter the larger number of firms that will result from the AUM increase and ensure that those most in need of examination are visited.

D. Presence and Proximity as a Resource

The states expend considerable resources to attract knowledgeable and talented professionals, to train and maintain those staffs, and to keep pace with the industry and other regulators in terms of technology and regulatory tools. The states also benefit by leveraging an inherent resource: their offices' very presence in the heart of every state. This physical presence gives state regulators unparalleled geographic distribution and proximity to the industries and constituents they serve. As compared to both the Commission and FINRA whose national scopes necessitate limited office placement, the state securities regulator's immediate physical proximity ensures accessibility in every community.

Their inherent proximity gives state regulators heightened awareness of regional demographics, income levels, local economy and trends, and local affinity groups.

Further, this proximity results in a significant benefit as regards savings to taxpayers, eliminating the necessity for travel to geographically-disbursed locations, while providing much needed coverage of areas that would otherwise be underserved. These locations, where both registrants and victims are often located, are often in suburban or rural areas and located far from a headquarters or branch or regional offices. As a result, these locations and victims are underserved by national regulators. State securities regulators provide full coverage of these areas at no cost to federal taxpayers. From preregistration screenings to formal outreach initiatives to registrants, state regulators go far beyond the onsite examination in interacting with their registrants.

Proximity is of enormous value because, as residents of the states they serve, state securities regulators have a heightened awareness of regional demographics, income levels, local economy and trends, education levels, and local affinity groups in their communities.

E. Acquiring and Conserving State Resources

A search for expanded resources follows as a natural consequence of the assumption of increasing charges and responsibilities. The recent financial crisis has resulted in an increase in calls and complaints to state securities regulators' offices, and heightened investor expectations of proactive, practical front-end regulation of the financial services industry. Combining these developments with the upcoming state-registered Investment Adviser switch, state securities regulators have put into action several strategies for solidifying their resources and tools.

The expansion of the state-registered Investment Adviser category has been a primary motivator in the search for new resources. All fifty states have agreed through a formal MOU (attached as **Exhibit 3**) to work together and share resources as needed to regulate the expanded state Investment Adviser population. Pursuant to the MOU, all states will work to ensure that examination resources are augmented and that schedules are coordinated to allow for maximum coverage and consistent audits. The MOU also provides for the possibility of joint exams funded by NASAA. The MOU will bridge the gap while and until state regulators acquire any necessary additional resources.

The states stand ready and able to take on these new duties, and securities administrators have been proactive in their preparation. Coordinating through NASAA, a group of state administrators and the NASAA Investment Adviser Section has formed a team to develop a strategy for regulating additional advisers with $100 million in assets under management. The NASAA Investment Adviser Section's Zones Project Group, working closely with the team, together form a group of subject matter experts from across NASAA who are focusing on the issues that must be addressed in order to facilitate a smooth transition for both advisers and state regulators.

As the Adviser Switch Team, the NASAA IA Zones Project Group, and the NASAA Investment Adviser Section work toward developing a uniform plan for an enhanced examination process, state administrators expect to communicate regularly with industry, associations, the Commission and investors to increase an understanding and awareness of the new regulatory landscape.

Preparation for the AUM increase and other growing expectations and accountability further expands the opportunities for both internal and external training. At least twenty states are expanding their training programs for staff members, many through participation in NASAA's new distance education and training program, which will feature specific lessons on Investment Adviser regulation, licensing and examinations.

Other states are reaching out to the Investment Adviser community – workshops or town hall meetings for Investment Adviser firms anticipating a switch are already scheduled in five states. Other states are implementing or considering a variety of other programmatic tweaks to avoid disruption during the switch, including:

- New/improved training on examining hedge fund
- Escalated reliance on more frequent multi-state cooperative exams
- New or increased use of risk assessment tools
- Improved coordination of state regulations with other states and/or the Commission
- Extended exam cycles
- Engaging contract auditors

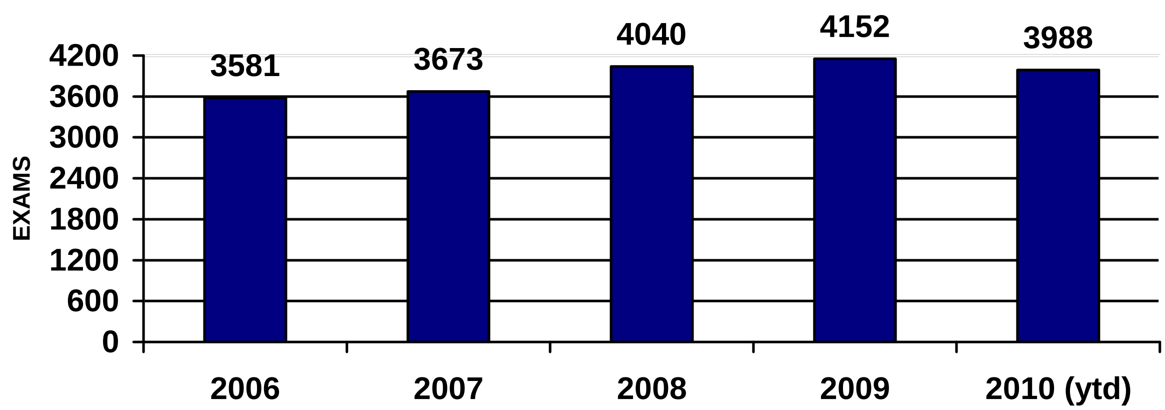
IV. Results and Outcomes of Thorough Registration and Exam Programs

The process and application of state registration and examination programs lead to robust, comprehensive regulation of the industry and proactive protection of investors that is borne out by impressive statistical results chronicled below.

A. Overall Examination and Audit Statistics

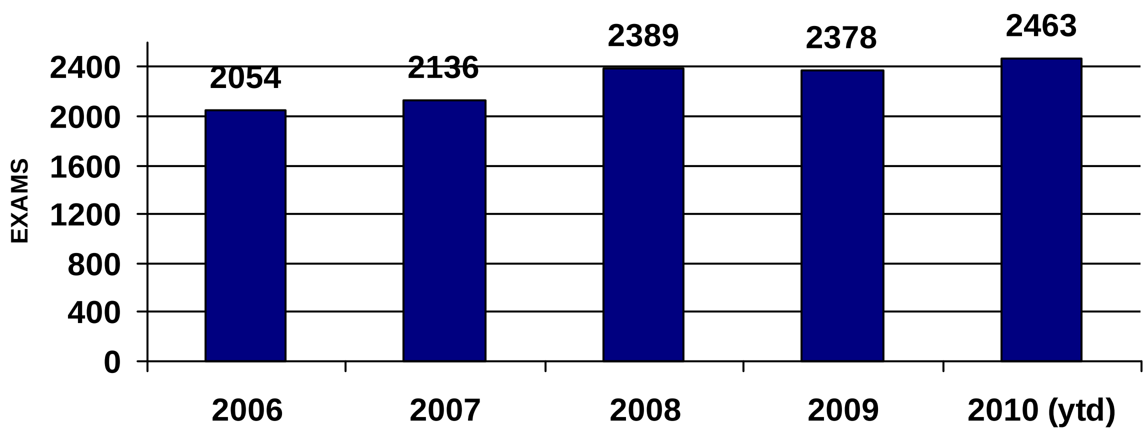
States utilize their examination programs and strategic resources to perform a remarkable number of examinations. The states' robust track record is evidenced by their performance of 4,152 audits of Broker-Dealers and Investment Advisers nationwide in 2009 alone.

Table 5 - Combined Broker-Dealer and Investment Adviser Examinations - 2006-2010



In 2009, state regulators performed 2,378 on-site examinations of Investment Advisers, which does not include the countless number of regular desk, registration, or other abbreviated examinations that states perform every day. This number is similar to examinations of Investment Advisers performed nationwide in most recent years, though over the previous three year period, the states' examination numbers in this area steadily increased. In 2006, states reported of 2,054 examinations of Investment Advisers, while in 2007 and 2008 that number increased to 2,136 and 2,389 examinations respectively.

Table 6 - Investment Adviser Examinations - 2006-2010



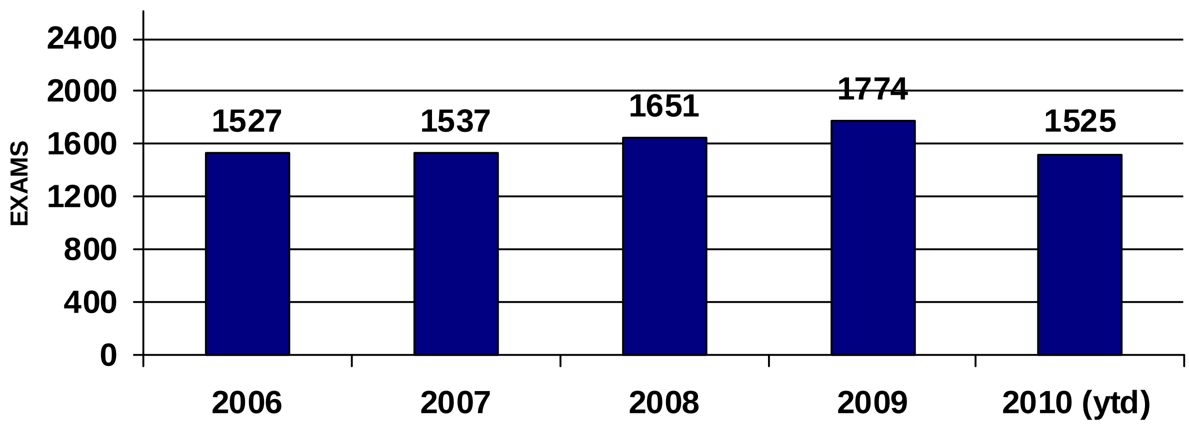
The 2010 numbers to-date represent a notable and significant increase in on-site examinations of Investment Advisers. As of August 2010, states have already performed 2,463 Investment Adviser audits. This number represents a material increase over the previous year, and the year's reporting period is not yet complete. At the current rate, a complete 2010 reporting year will easily result in a significant increase over 2009, setting a high-water mark for the past several years.

This 2010 increase is significant for two reasons. First, it is likely attributable to the enhancements and additions that states are developing and using in anticipation of the increase in state-covered Investment Advisers. With the assets under management increase and resulting expansion of state-registered Investment Advisers upon the horizon, states are demonstrating that not only can they adequately and effectively regulate their current registrants, but also that they are increasing their efforts to apply the same consistent, efficient regulation to a larger population of registrants. Second, the states' efforts are especially noteworthy given recent, erratic state budgets and accompanying constraints during the current economic crisis. The states' exemplary record marks a resilience and commitment to their mission in the face of the challenging issues that accompany today's economic conditions, and demonstrates that the states' will continue to deliver superior results regardless of economic conditions.

The annual Investment Adviser examination numbers reported herein are consistent with the states' average exam cycle of three to five years. As with every average, there is a range. In some of the most populous states, states demonstrate a relatively high number of examinations. One state reported 257 examinations of Investment Advisers in 2009, representing forty-one percent of that state's registered investment adviser firms. This same state reported examinations of nearly fifty percent of all state-registered investment adviser firms every year from 2006 to 2008. Another state reported 1,014 examinations in five years, an average of 203 examinations every year.

With respect to other side of licensed supervision, the states performed 1,774 examinations of Broker-Dealers nationwide in 2009. In furtherance of their heightened level of responsiveness in acute investor protection situations and in recognition of the complementary Broker-Dealer programs at FINRA, many states focus their Broker-Dealer audits on "for-cause" matters. Nationwide, states categorized eighteen percent of their Broker-Dealer examinations as special or for-cause. As noted above, thirty-four percent of states report that all or a majority of their Broker-Dealer examinations are special or for-cause.

Table 7 - Broker-Dealer Examinations - 2006-2010



Additionally, the states seek to collaborate closely with the Commission and FINRA to provide comprehensive examination of Broker-Dealers. As the "local cops on the beat," states lend the unparalleled benefit of their geographic presence to each other and could provide the same to regulators with a national scope, to wit, the Commission and FINRA. This collaboration would allow for the joining of forces and the sharing of resources and talent when pursuing the same entity and/or the same egregious conduct. The resulting streamlined process would provide effective and efficient regulation.


PROTECTING SENIOR INVESTORS:
REPORT OF EXAMINATIONS OF SECURITIES FIRMS
PROVIDING "FREE LUNCH" SALES SEMINARS

BY THE

OFFICE OF COMPLIANCE INSPECTIONS AND EXAMINATIONS
SECURITIES AND EXCHANGE COMMISSION

NORTH AMERICAN SECURITIES ADMINISTRATORS ASSOCIATION

FINANCIAL INDUSTRY REGULATORY AUTHORITY

SEPTEMBER 2007

2007 NASAA/SEC/FINRA
Free Lunch Report

28 states report participation in a joint examination with other state regulators in recent years, and an additional 4 states have performed joint examinations with the Commission or FINRA in the same span. The states teamed with the Commission and FINRA to produce the 2006 comprehensive examination sweep and report on the use of "free lunch" seminars to market to seniors (attached as **Exhibit 4**). In 2008, six states combined to conduct an on-site for-cause examination at a national Broker-Dealer's headquarters concerning auction rate securities issues.

B. *Identification of Industry Deficiencies and Investor Protection Measures Resulting from State Registration and Examination Programs*

The securities regulators' examination and audit programs reveal that states are thoroughly scrutinizing their jurisdictions' licensed firms. As part of that process, the states' programs frequently uncover regulatory shortcomings and violations in licensees' operations.

1. Deficiency Letters

The deficiency letter is an oft-used tool to notify an Investment Adviser or Broker-Dealer of the states' requirements and the firm's failure to comply with the same. Virtually every state confirms using deficiency letters, and in the last reporting period, for instance, the states sent 5,176 deficiency letters as a result of their examinations. Often, examinations will trigger several deficiency letters, generally if minor violations are sequentially discovered. A few states even report that 100% of their exams lead to a deficiency letter. Sixteen states reported issuing dozens of deficiency letters in the past reporting period, while seven reported issuing hundreds.

Typically, the deficiencies these examinations uncover include:

- out-of-date ADV Part II, which impairs disclosure to an Investment Adviser's clients;
- books and records deficiencies;
- suitability violations;
- misleading or noncompliant advertising;
- problems with fees, whether billing the client for the proper service or in the manner contracted for; or
- inappropriate procedures for maintaining client funds.

These deficiency letters are crucial not only to preemptively identify problems but also to ensure regulatory compliance and thus investor protection. A deficiency letter provides a roadmap to Investment Advisers and Broker-Dealers as to how to come into compliance with the securities laws. In fact, most reporting states indicate that 100 percent of their deficiency letters resulted in satisfactory cures and compliance. This typically means that the licensed firm has corrected the problem by, for example, installing certain internal procedures; amending documents provided to clients; or putting an individual under a supervisor's heightened supervision.

RESULTS OF THE REGISTRATION AND EXAM PROGRAMS

- States issued **5,176** deficiency letters as a result of their examinations.
- Most reporting states indicate that **100 %** of their deficiency letters resulted in satisfactory cures and compliance.
- In 2009, state preregistration analysis or examination deficiency letters and resulting discussions with applicants or registrants led to **1,557** withdrawals.
- In the most recent reporting period, twenty-five jurisdictions issued a total of **219** denials, suspensions, or revocations.
- Examinations in thirty-two states led to **195** cease and desist orders.
- In 2009, more than half the states combined to collect fines or other penalties or recoveries in excess of **$1 million**.

2. Licensure Actions and Enforcement Orders

Of course, some exams or audits reveal situations requiring a response more severe than a deficiency letter. In such situations, state regulators have a number of ways to respond. In the case of a preregistration examination, a state can request that a particularly troubling Broker-Dealer or Investment Adviser, or individual attempting to affiliate with the same, withdraw its registration before turning to other options. Where a field examination generates similar concerns, regulators can seek a similar licensure surrender and withdrawal from the jurisdiction. States frequently use this option: twenty-six states indicated that, in 2009, their preregistration analysis or examination deficiency letters and resulting discussions with applicants or registrants led to 1,557 withdrawals.

Alternatively, if a registrant's exam or audit uncovers more troubling deficiencies, states can deny, suspend, or revoke a registration. In the most recent reporting period, twenty-five jurisdictions issued a total of 219 denials, suspensions, or revocations. These actions over the past year served to proactively shield thousands of investors who were exposed to potential losses and other harm by firms with poor track records and severe compliance problems.

When deficiencies amount to violations of the law, examinations may lead to an enforcement action. For instance, in the last reporting period, examinations in thirty-two states led to 195 cease and desist orders. (A few states reported routinely issuing a cease and desist order with every deficiency letter, but most reported issuing the orders only when the circumstances were sufficiently grave.)

Although not all, many states have the authority to collect fines as a result of deficiencies uncovered by examination programs. Accordingly, in 2009, more than half the states combined to collect fines or other penalties or recoveries in excess of one million dollars.

By virtue of their locality and proximity, state securities regulators also have a uniquely close relationship with local and regional law enforcement. State securities regulators necessarily make connections with others who enforce the securities laws, whether it is the county prosecutor, federal postal inspectors, or the United States Department of Justice. These numerous connections enhance the state regulators' ability to respond to serious violations; such connections not only help leverage state resources, but state regulators can also work with these other authorities in large operations or, as necessary, refer cases to the more appropriate agency. Where a routine audit reveals criminal activity, state regulators have developed the relationships necessary to eliminate investor exposure to future harm and to hold the criminals accountable.

C. State Regulator Interaction and Cooperation with Industry Actors

The effectiveness of state registration and exam programs should not be measured by enforcement actions and deficiency letters alone. State regulators recognize that building relationships with licensees, and being available and accountable to the same, is just as essential as producing the above enforcement metrics. A number of state regulators keep their licensing and exam functions intentionally separate from enforcement


PROTECTING SENIOR INVESTORS:
COMPLIANCE, SUPERVISORY AND OTHER PRACTICES
USED BY FINANCIAL SERVICES FIRMS IN SERVING
SENIOR INVESTORS

2008 Protecting Senior Investors

activities, and all state regulators view examinations as a sensible method for helping licensed firms avoid future problems and cure deficiencies. To sustain a workable regulatory environment that encourages growth and creation of business, the states work to relate best practices, help licensees avoid deficiencies, and promote open communication.

State regulators are proactive in developing relationships with the industry and providing useful information, tips and best practices in a non-confrontational setting. Twenty-seven state regulatory offices currently conduct industry training or industry outreach programs in the form of training seminars, town halls, roundtables or other special events. An additional five states are currently implementing or planning similar programs. Multiple states partner with FINRA or the Commission in reaching out to and meeting with the industry, and all states, through NASAA and in conjunction with FINRA and the Commission, have produced and updated a best practices guide for brokers and Investment Advisers who serve senior citizen investors (***Protecting Senior Investors:*** **Compliance, Supervisory and Other Practices Used by Financial Services Firms in Serving Senior Investors**, first produced September 22, 2008, and updated August 12, 2010, are attached as **Exhibits 5** and **6**).

Other states utilize their websites or other technology to discuss regulatory developments, industry trends or other news with their licensees. Six states maintain special webpages or newsletters devoted to sharing these trends and best practices, while others use special advisory councils that include industry members. In addition, several states focus a component of their outreach efforts on new licensees. Multiple states conduct immediate exams or visits with new licensees, and others require special meetings or interviews with firms that have a history or high-risk of disciplinary problems or concerns. All of these efforts solidify a state securities division's role as an effective, familiar and local regulator.

V. State Regulators are Effective and Resourceful

As this Report amply demonstrates, state securities regulators perform a crucial service in an unmatched fashion at the highest levels for investors nationwide. Comprehensive licensing programs executed by every state regulator prevent unqualified applicants from entering the industry while also streamlining the process for the vast majority of licensees who provide valuable services through honest operations. The coordinated and precise examination programs are on-the-ground, proactive systems that leverage the experienced and skilled staffs of state regulators and their unparalleled geographic saturation to ensure a compliant industry. Statistical analysis, an understanding of the states' marshalling of resources, and appreciation for states' coordination with each other and their peer regulators combine to create the ideal foundation for reaching a conclusion on the performance of state regulators. Any objective appraisal of the states' regulatory performance, current preparedness to meet coming challenges, and expert positioning for continued high-levels of production recommends the states as a preeminent and irreplaceable force in investor protection.

EXHIBIT 1

NASAA Investment Adviser Competency Exam
(Series 65)
Exam Specifications and Outline
(Effective 1/1/2010)

CONTENT AREA	**# of Items**
1. Economic Factors and Business Information	**19 (14%)**
A. Basic economic concepts	6
1. business cycles	
2. monetary and fiscal policy	
3. US dollar valuation	
4. inflation/deflation	
5. interest rates and yield curves	
6. economic indicators	
a. GDP	
b. employment indicators	
c. trade deficit	
d. balance of payments	
e. CPI	
B. Financial reporting	5
1. financial statements	
a. income statement	
b. balance sheet	
c. statement of cash flow	
2. financial ratios	
a. current ratio	
b. quick ratio	
c. debt-to-equity ratio	
3. corporate SEC filings	
4. annual reports and prospectuses	
C. Quantitative methods	3
1. time value of money concepts	
a. internal rate of return (IRR)	
b. net present value (NPV)	
2. descriptive statistics	
a. measures of central tendency (mean, median, mode)	
b. range	
c. standard deviation	
d. Beta and its derivatives	
3. valuation ratios	
a. price/earnings	
b. price-to-book	
D. Types of risk	5
1. systematic risk	
a. market	
b. interest rate	
c. inflation	
2. unsystematic risk	
a. business	
b. regulatory	

c. political
d. liquidity
3. opportunity cost
4. capital structure including liquidation priority

2. Investment Vehicle Characteristics **31 (24%)**

A. Types and characteristics of cash and cash equivalents 3

1. insured deposits
   a. demand deposits
   b. CD's
2. money market instruments
   a. commercial paper
   b. Treasury bills

B. Types and characteristics of fixed income securities 5

1. U.S. government and agency securities
   a. Treasury securities
   b. FNMA
   c. TIPS
2. corporate bonds
   a. coupon bonds
   b. convertible bonds
   c. tax implications
   d. bond rating
3. municipal bonds
   a. general obligation
   b. revenue
   c. tax implications
4. foreign bonds
   a. risks and advantages
   b. government debt
   c. corporate debt
   d. Brady bonds

C. Methods used to determine the value of fixed income securities 3

1. fixed income valuation factors
   a. premium
   b. discount
   c. duration
   d. maturity
   e. yield to call
   f. yield to maturity
   g. coupon
   h. conversion valuation
   i. bond ratings
2. discounted cash flow

D. Types and characteristics of equity securities 5

1. equity interests
   a. common stock
   b. preferred stock
   c. convertible preferred stocks
   d. warrants
   e. ADRs

2. restricted stock
3. foreign stocks
4. employee stock options
    a. incentive
    b. non-qualified
5. shareholder rights
    a. voting rights
    b. dividends
    c. liquidity preferences
    d. antidilution

E. Methods used to determine the value of equity securities 2
1. fundamental analysis

F. Types and characteristics of pooled investments 4
1. open-end investment companies (mutual funds)
2. closed-end investment companies
3. unit investment trusts
4. exchange traded funds
5. real estate investment trusts (REITs)

G. Methods used to determine the value of pooled investments 2
1. net asset value
2. discount/premium

H. Types and characteristics of derivative securities 1
1. types
    a. options (definition only)
    b. futures (definition only)
    c. forward contracts (definition only)

I. Alternative Investments 2
1. hedge funds (definition only)
2. limited partnerships (definitions only)

J. Insurance-based products 4
1. variable annuities
2. fixed annuities
3. equity indexed annuities
4. life insurance (e.g., whole, term, universal, variable)

3. Client Investment Recommendations and Strategies 40 (31%)

A. Type of client 4
1. individual, sole proprietorship
2. business entities
    a. general partnership
    b. limited partnership
    c. limited liability company
    d. C-corporation
    e. S-corporation
3. trusts & estates

B. Client profile 4
1. financial goals and strategies
    a. current income
    b. retirement
    c. death
    d. disability

    e. time horizon
  2. current financial status
    a. cash flow
    b. balance sheet
    c. existing investments
    d. tax situation
  3. risk tolerance
  4. non-financial investment considerations
    a. values
    b. attitudes
    c. experience
    d. demographics

C. Capital Market Theory 3
  1. Capital Asset Pricing Model (CAPM)
  2. Modern Portfolio Theory
  3. Efficient Market Hypothesis
    a. semi-strong
    b. strong
    c. weak

D. Portfolio management styles and strategies 5
  1. strategic asset allocation
    a. style
    b. asset class
    c. rebalancing
    d. buy/hold
  2. tactical asset allocation (e.g., market timing)
  3. active vs. passive
  4. growth vs. value
  5. income vs. capital appreciation

E. Portfolio management techniques 3
  1. diversification
  2. sector rotating
  3. averaging
    a. dollar-cost
    b. capital goal within specified time period

F. Tax Considerations 4
  1. individual income tax fundamentals
    a. capital gains
    b. tax basis
  2. alternative minimum tax
  3. corporate, trust, and estate income tax fundamentals
  4. estate and gift tax fundamentals

G. Retirement plans 3
  1. Individual Retirement Accounts (traditional and Roth)
    a. traditional
    b. Roth
  2. qualified retirement plans
    a. pension and profit sharing
    b. 401(k)
    c. 403(b)
    d. 457

3. nonqualified retirement plans

H. ERISA issues — 3

1. fiduciary issues
   a. investment choices
   b. 404(c)
2. investment policy statement
3. prohibited transactions

I. Special types of accounts — 3

1. education-related
   a. 529s
   b. Coverdell
2. UTMA/UGMA
3. account ownership options
   a. joint
   b. pay-on-death
   c. tenancy in common

J. Trading securities

1. terminology — 5
   a. bids
   b. offers
   c. quotes
   d. market, limit, or stop order
   e. short sale
   f. cash accounts, margin accounts
   g. principal or agency trades
2. role of broker-dealers, specialists, market-makers
3. exchanges and markets
   a. NYSE, AMEX, CBOE, regional, international
   b. OTC, Nasdaq
4. costs of trading securities
   a. commissions
   b. markups
   c. spread

K. Performance measures — 3

1. returns
   a. risk-adjusted
   b. time-weighted
   c. dollar-weighted
   d. annualized
   e. total
   f. holding period
   g. internal rate of return
   h. expected
   i. inflation-adjusted
   j. after tax
2. yield
   a. yield-to-maturity
   b. current yield
3. benchmark portfolios

4. Laws, Regulations, and Guidelines, including Prohibition on Unethical Business Practices **40 (31%)**

A. State and Federal Securities Acts and related rules and regulations (19%)

1. Regulation of Investment Advisers, including state-registered and federal covered advisers 4
   a. definitions
   b. registration/notice-filing requirements
   c. post-registration requirements
2. Regulation of Investment Adviser Representatives 4
   a. definition
   b. registration
3. Regulation of Broker-dealers 4
   a. definition
   b. registration
   c. post-registration requirements
4. Regulation of Agents of Broker-dealers 4
   a. definition
   b. registration
5. Regulations of Securities and Issuers 4
   a. definitions
   b. registration
   c. post-registration requirements
   d. exemptions
   e. state authority over federal covered securities
6. Remedies and Administrative Provisions 4
   a. authority of administrator
   b. administrative actions
   c. other penalties and liabilities

B. Ethical practices and fiduciary obligations (12%)

1. communications with clients and prospects 4
   a. disclosure
   b. unlawful representations concerning registrations
   c. performance guarantees
   d. client contracts
2. compensation 4
   a. fees
   b. commissions
   c. performance-based fees
   d. soft dollars
   e. disclosure of compensation
3. client funds and securities 4
   a. custody
   b. discretion
   c. trading authorization
   d. prudent investor standards
   e. suitability
4. conflicts of interest and other fiduciary issues 4
   a. excessive trading
   b. loans to and from clients
   c. sharing in profits and losses in a customer account
   d. client confidentiality

e. insider trading
f. selling away
g. market manipulation

Uniform Combined State Law Examination
(Series 66)
Exam Specifications and Outline
(Effective 1/1/2010)

CONTENT AREA	# of Items
1. Economic Factors and Business Information	**5 (5%)**
A. Financial Reporting	1
1. Financial ratios	
a. Current ratio	
b. Quick ratio	
c. Debt-to-equity ratio	
2. Corporate SEC filings	
3. Annual reports and prospectuses	
B. Quantitative Methods	1
1. Time value of money concepts	
a. Internal rate of return (IRR)	
b. Net present value (NPV)	
C. Types of Risk	3
1. Systematic risk	
a. Market	
b. Interest rate	
c. Inflation	
2. Unsystematic risk	
a. Business	
b. Regulatory	
c. Political	
d. Liquidity	
3. Opportunity cost	
4. Capital structure including liquidation priority	
2. Investment Vehicle Characteristics	**15 (15%)**
A. Methods Used to Determine the Value of Fixed Income Securities	3
1. Discounted cash flow	
B. Types and Characteristics of Derivative Securities	3
1. Types	
a. Options	
b. Futures	
c. Forward contracts	
d. Costs, benefits, and risks of derivative securities	
C. Alternative Investments	4
1. Hedge funds	
2. Limited partnerships	
D. Insurance-Based Products	5
1. Variable annuities	
2. Fixed annuities	
3. Equity indexed annuities	
4. Life insurance (e.g., whole, term, universal, variable)	
a. Whole	

b. Term
c. Universal
d. Variable

3. **Client Investment Recommendations and Strategies** **30 (30%)**

A. Type of Client 5
1. Individual, sole proprietorship
2. Business entities
a. General partnership
b. Limited partnership
c. Limited liability company
d. C-corporation
e. S-corporation
3. Trusts & estates

B. Client Profile 5
1. Financial goals and strategies
a. Current income
b. Retirement
c. Death
d. Disability
e. Time horizon
2. Current financial status
a. Cash flow
b. Balance sheet
c. Existing investments
d. Tax situation
3. Risk tolerance
4. Non-financial investment considerations
a. Value
b. Attitude
c. Experience
d. Demographics

C. Capital Market Theory 2
1. Capital Asset Pricing Model (CAPM)
2. Modern Portfolio Theory
3. Efficient Market Hypothesis
a. Semi-strong
b. Strong
c. Weak

D. Portfolio Management Styles and Strategies 5
1. Strategic asset allocation
a. Style
b. Asset class
c. Rebalancing
d. Buy/hold
2. Tactical asset allocation (e.g., market timing)
3. Active vs. Passive
4. Growth vs. Value
5. Income vs. Capital appreciation

E. Portfolio Management Techniques 5
1. Diversification

2. Sector rotating
3. Averaging
    a. Dollar-cost
    b. Capital goal within specified time period
4. Risk modification techniques
    a. Puts
    b. Calls
    c. Leveraging

F. Tax Considerations 1
1. Individual income tax fundamentals
    a. Capital gains
    b. Tax basis
2. Alternative minimum tax
3. Corporate, trust, and estate income tax fundamentals
4. Estate and gift tax fundamentals

G. Retirement Plans 2
1. Individual Retirement Accounts
    a. Traditional
    b. Roth
2. Qualified retirement plans
    a. Pension and profit sharing
    b. 401(k)
    c. 403(b)
    d. 457
3. Nonqualified retirement plans

H. ERISA Issues 1
1. Fiduciary issues
    a. Investment choices
    b. 404(c)
2. Investment policy statement
3. Prohibited transactions

I. Special Types Of Accounts 2
1. Education-related
    a. 529s
    b. Coverdell
2. UTMA/UGMA
3. Account ownership options
    a. Joint
    b. Pay-on-death
    c. Tenancy in common

J. Trading Securities 1
1. Terminology (e.g., bids; offers; quotes; market, limit, or stop order; short sale; cash accounts, margin accounts; principal or agency trades)
2. Role of broker-dealers, specialists, market-makers
3. Exchanges and markets (e.g., NYSE, AMEX, CBOE, regional, international; OTC, Nasdaq)
4. Costs of trading securities (e.g., commissions, markups, spread)

K. Performance Measures 1
1. Returns

a. Risk-adjusted
b. Time-weighted
c. Dollar-weighted
d. Annualized
e. Total
f. Holding period
g. Internal rate of return
h. Expected
i. Inflation-adjusted
j. After tax

2. Yield
   a. Yield-to-maturity
   b. Current yield
3. Benchmark Portfolios

4. Laws, Regulations, and Guidelines, including Prohibition on Unethical Business Practices **50 (50%)**

A. State and Federal Securities Acts and Related Rules and Regulations 30

1. Regulation of Investment Advisers, including state-registered and federal covered advisers
   a. Definitions
   b. Registration/notice-filing requirements
   c. Post-registration requirements
2. Regulation of Investment Adviser Representatives
   a. Definition
   b. Registration
3. Regulation of Broker-dealers
   a. Definition
   b. Registration
   c. Post-registration requirements
4. Regulation of Agents of Broker-dealers
   a. Definition
   b. Registration
5. Regulations of Securities and Issuers
   a. Definitions
   b. Registration
   c. Post-registration requirements
   d. Exemptions
   e. State authority over federal covered securities
6. Remedies and Administrative Provisions
   a. Authority of administrator
   b. Administrative actions
   c. Other penalties and liabilities

B. Ethical Practices and Fiduciary Obligations 20

1. Communications with clients and prospects
   a. Disclosure
   b. Unlawful representations concerning registrations
   c. Performance guarantees
   d. Client contracts

2. Compensation
    a. Fees
    b. Commissions
    c. Performance-based fees
    d. Soft dollars
    e. Disclosure of compensation
3. Client funds and securities
    a. Custody
    b. Discretion
    c. Trading authorization
    d. Prudent investor standards
    e. Suitability
4. Conflicts of interest and other fiduciary issues
    a. Excessive trading
    b. Loans to and from clients
    c. Sharing in profits and losses in a customer account
    d. Client confidentiality
    e. Insider trading
    f. Selling away
    g. Market manipulation

EXHIBIT 2

2006
BROKER DEALER COORDINATED EXAMS

North American Securities Administrators Association

Who Was Examined? 228 Broker Dealers…

- 35 were home office exams (15%)
- 193 were branch office exams (85%)

Who Conducted the Exams?

Securities examiners from 28 states, the District of Columbia, and the U.S. Virgin Islands

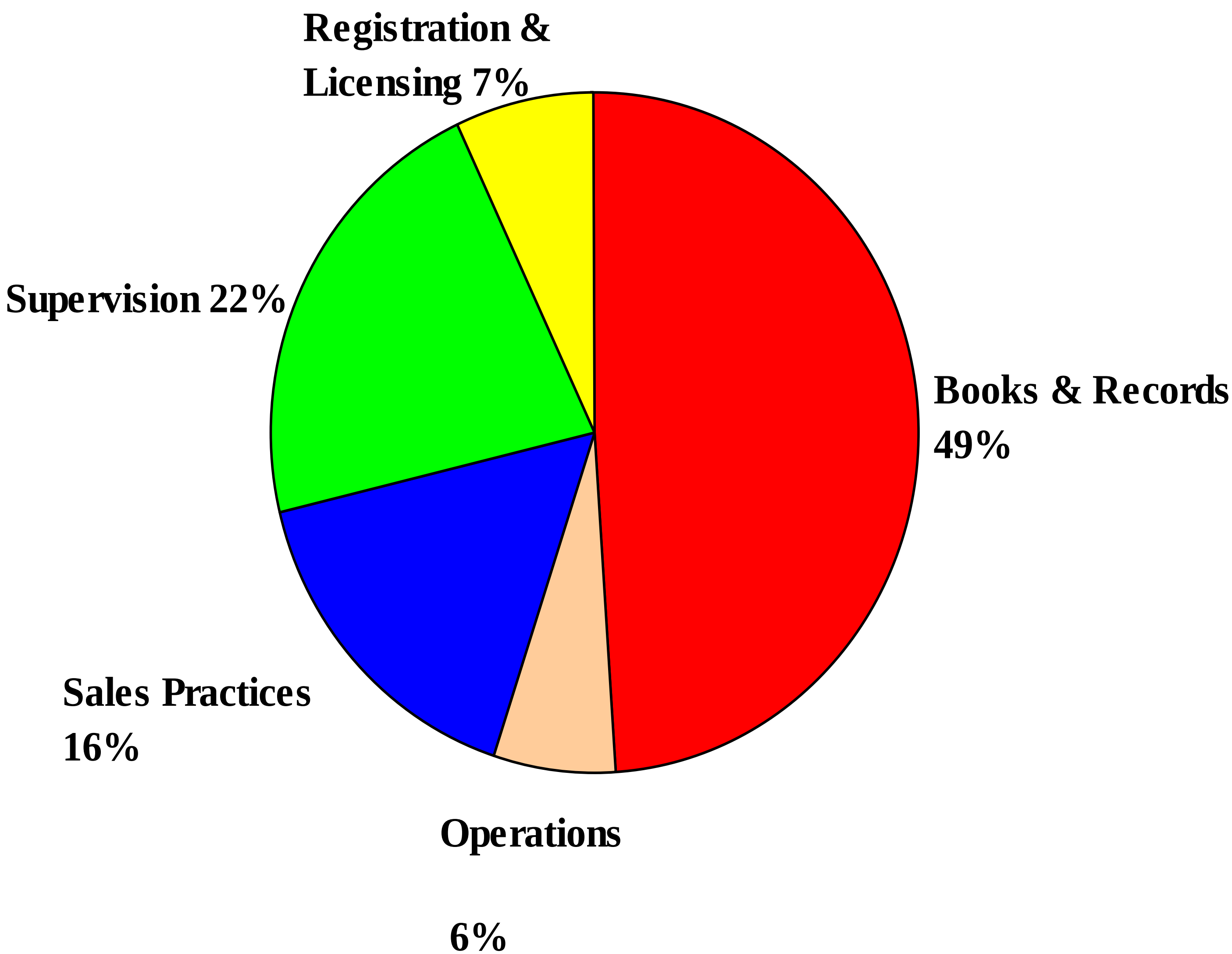
When Were They Conducted?

Between May 1 and June 30, 2006

Are any exams for the period still ongoing?

Yes, a substantial number of examinations are still ongoing. The majority of these are complex cases relating to Sales Practice reviews.

654 TOTAL DEFICIENCIES FOUND



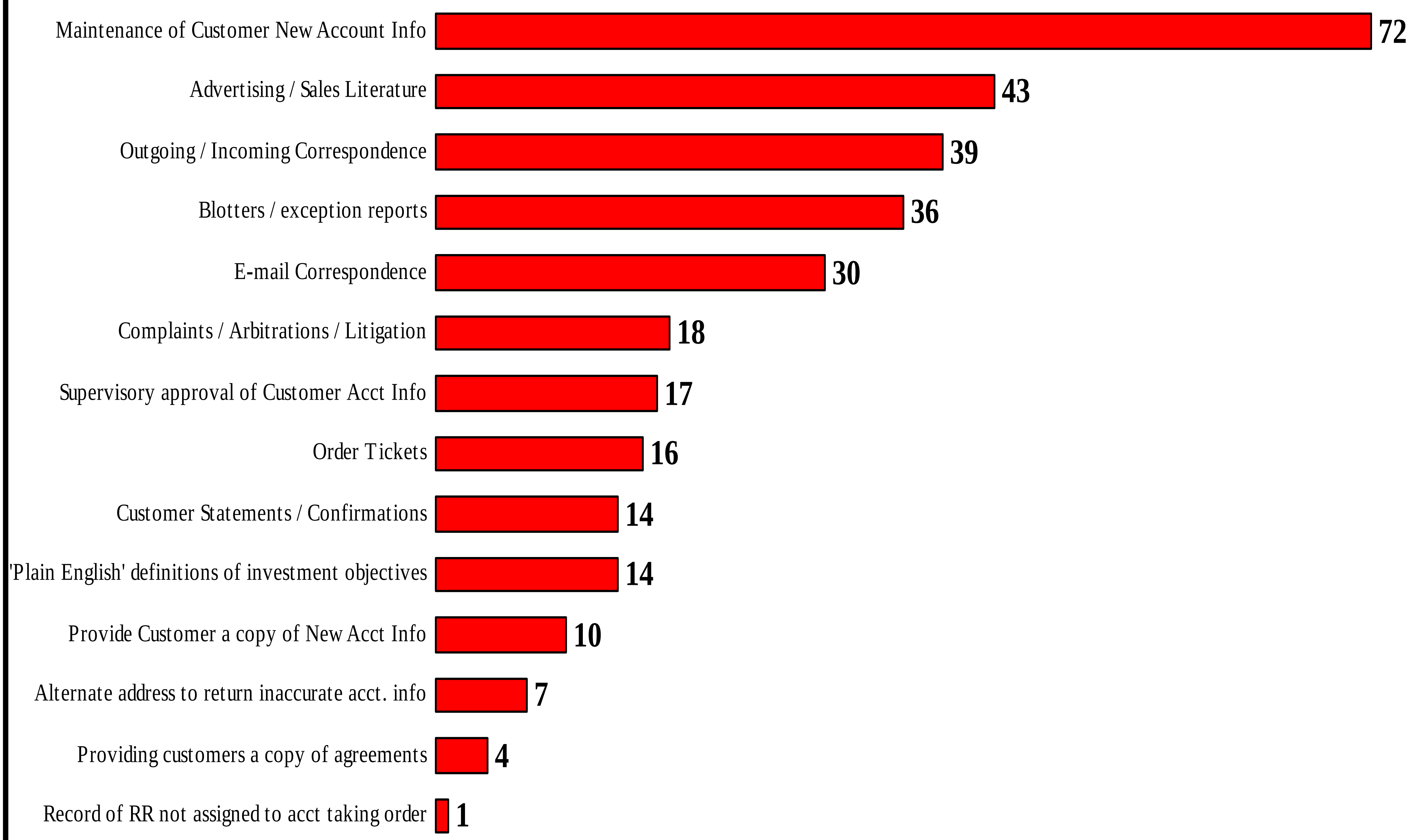
FACTS & FIGURES

Largest number of deficiencies found in one exam 23

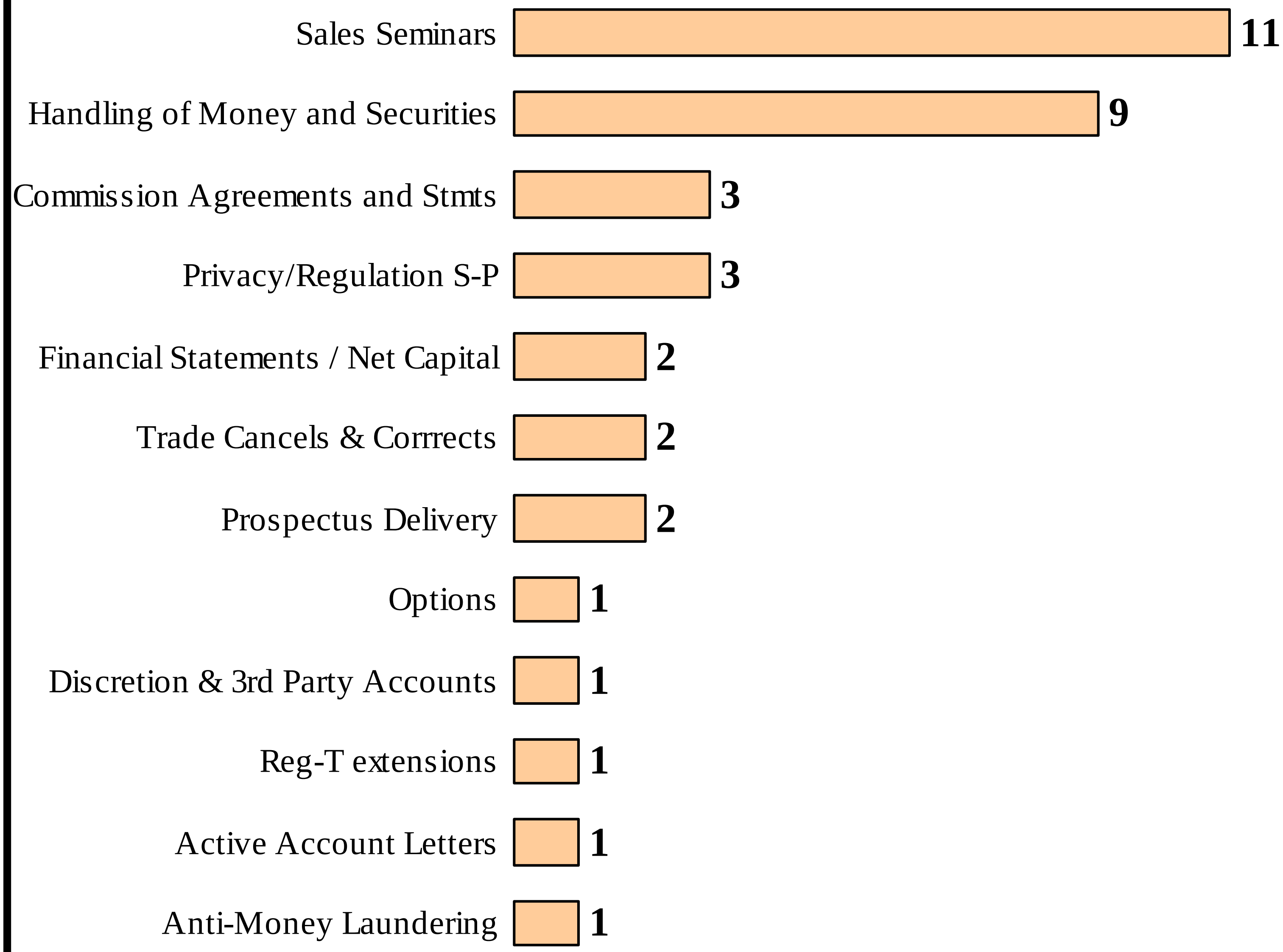
Exams with 10 or more deficiencies found 10

Offices with 1,000 or more accounts 20 %

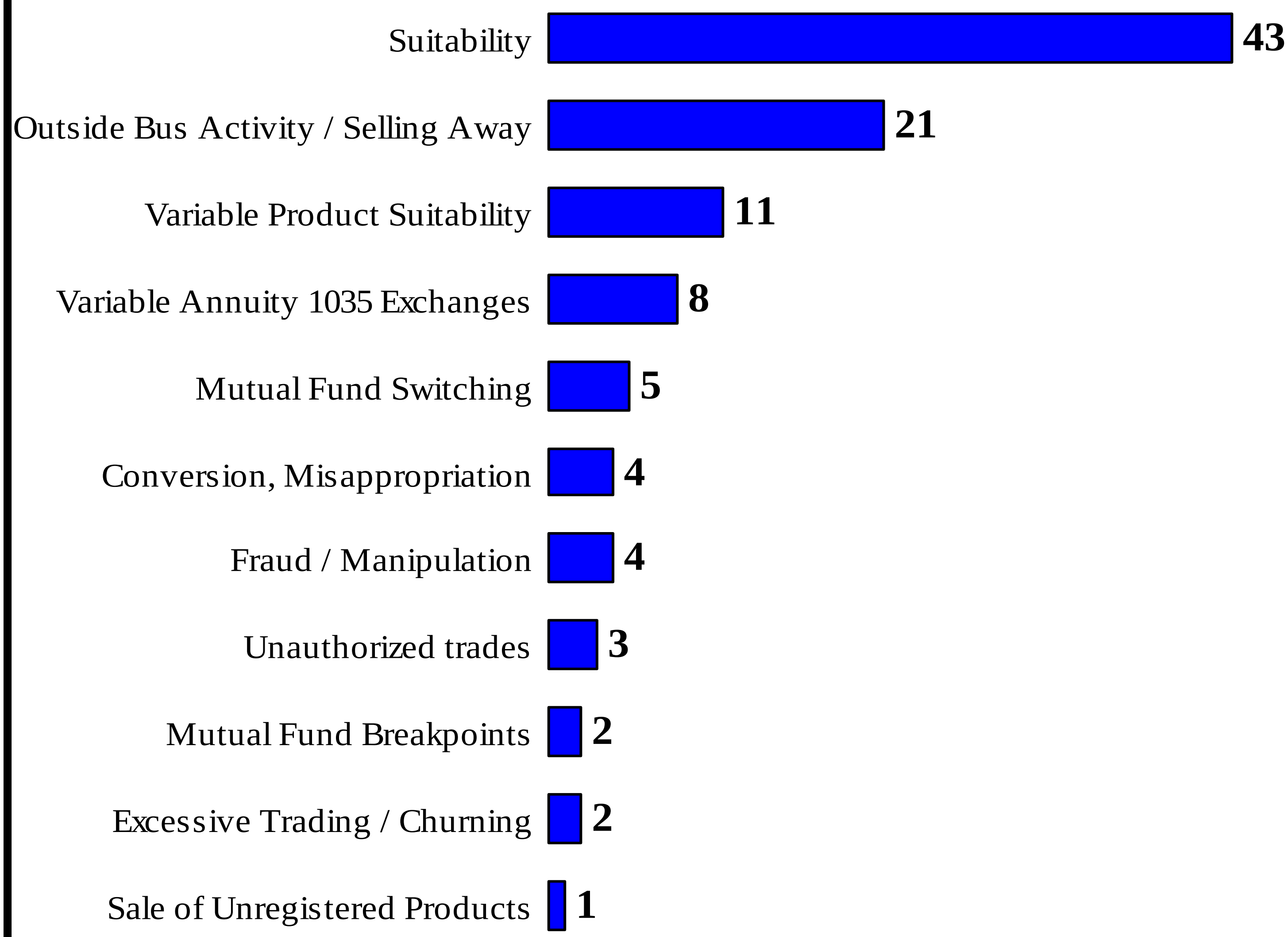
BOOKS & RECORDS REVIEW - 321 deficiencies

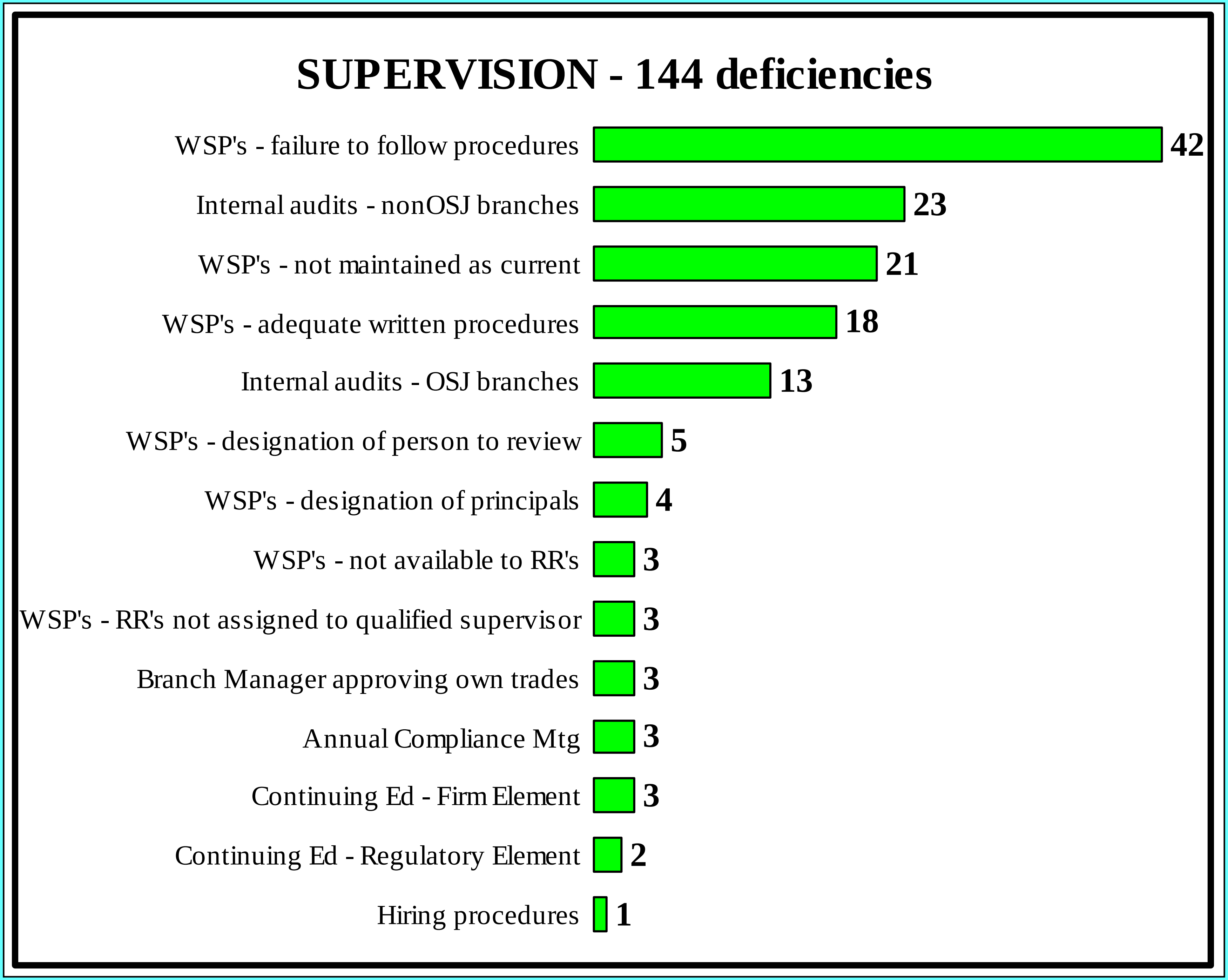


OPERATIONS REVIEW - 37 deficiencies

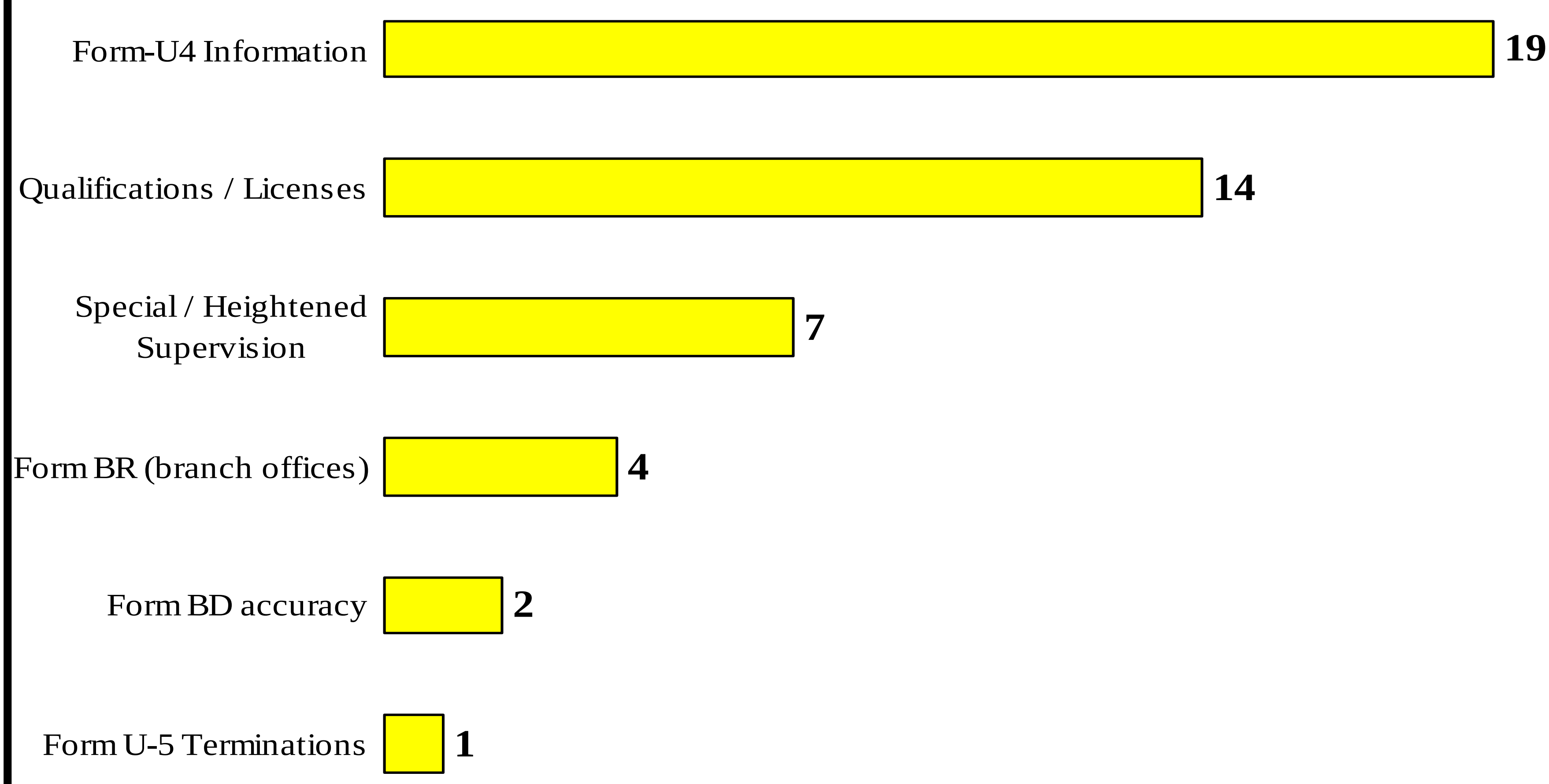


SALES PRACTICES - 105 deficiencies

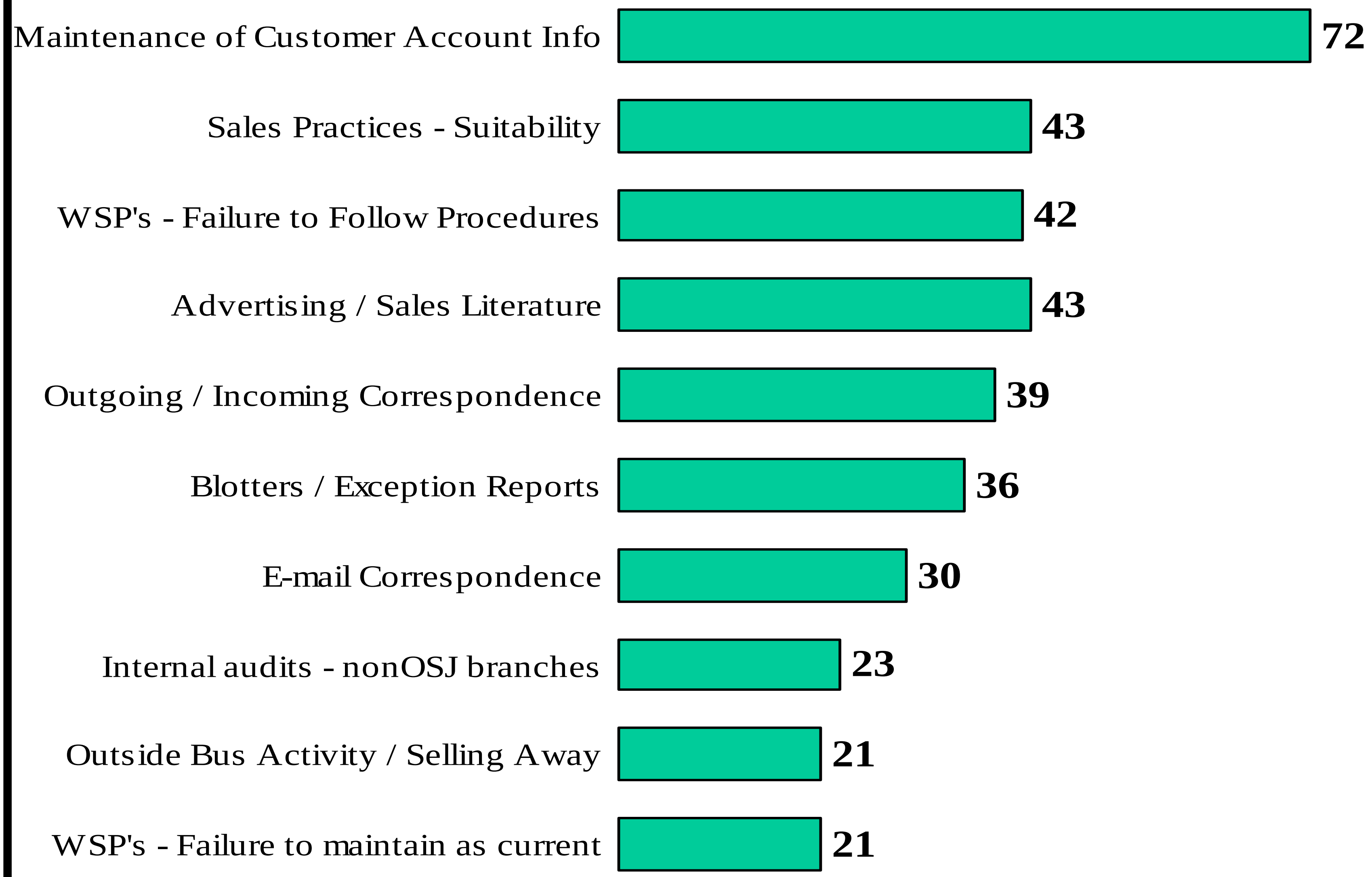


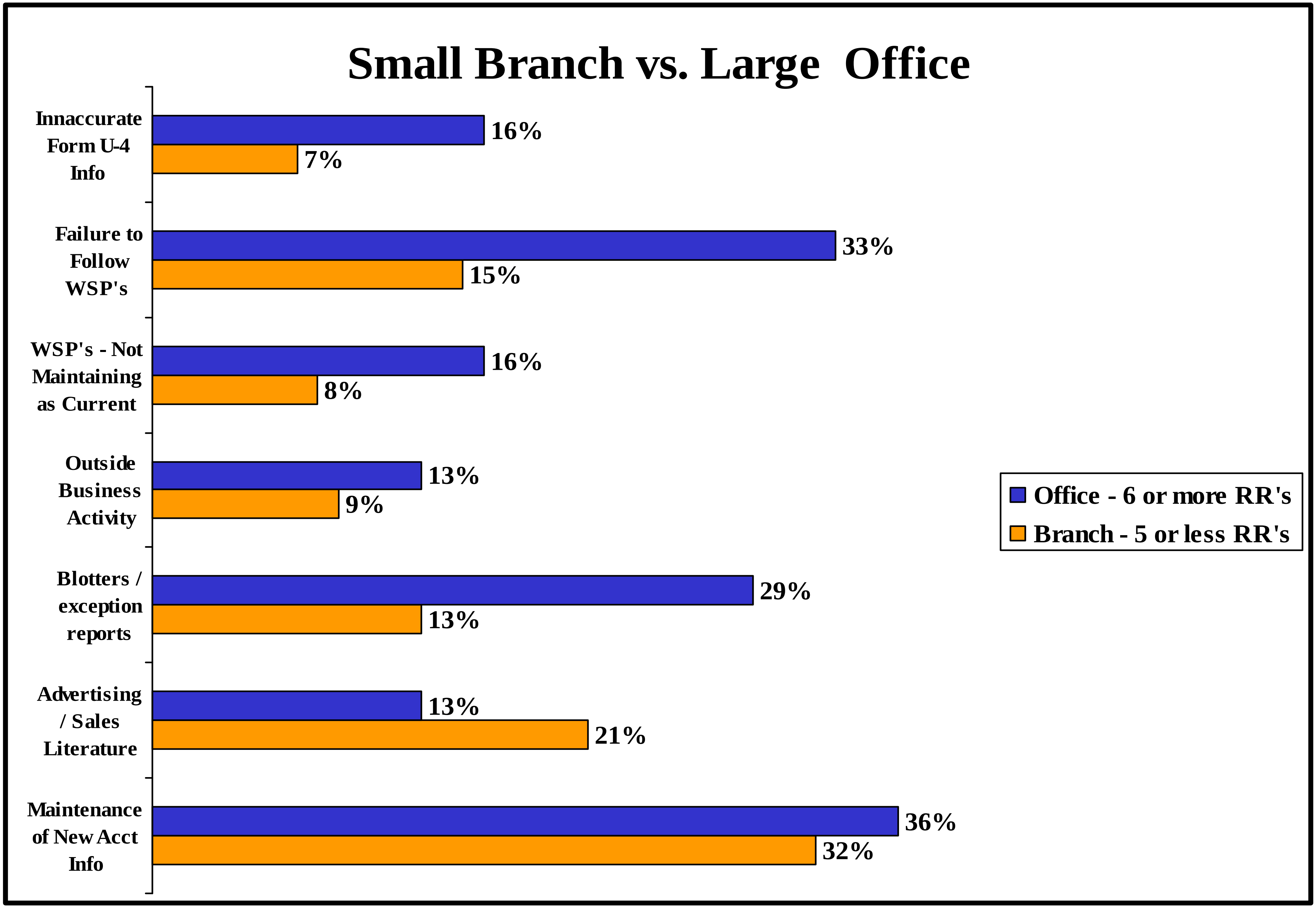

SUPERVISION - 144 deficiencies
WSP's - failure to follow procedures
42
Internal audits - nonOSJ branches
23
WSP's - not maintained as current
21
WSP's - adequate written procedures
18
Internal audits - OSJ branches
13
WSP's - designation of person to review
5
WSP's - designation of principals
4
WSP's - not available to RR's
3
WSP's - RR's not assigned to qualified supervisor
3
Branch Manager approving own trades
3
Annual Compliance Mtg
3
Continuing Ed - Firm Element
3
Continuing Ed - Regulatory Element
2
Hiring procedures
1

REGISTRATION & LICENSING - 47 deficiencies



TOP 10 DEFICIENCIES




Small Branch vs. Large Office
Innaccurate Form U-4 Info
16%
7%
Failure to Follow WSP's
33%
15%
WSP's - Not Maintaining as Current
16%
8%
Outside Business Activity
13%
9%
Blotters / exception reports
29%
13%
Advertising / Sales Literature
13%
21%
Maintenance of New Acct Info
36%
32%
Office - 6 or more RR's
Branch - 5 or less RR's

NOTABLE EXCEPTIONS

80 % of the examinations were conducted at small branches with 5 or less RR's

Deficiencies occurred in the same 80% to 20% ratio when comparing small branches to large offices except in the following categories:

- **Exception Reports –** 42% of deficiencies were in large branches or home offices
- **Inaccurate U-4's -** 37% of deficiencies were in large branches or home offices
- **Failure to Follow Supervisory Procedures -** 36% of deficiencies occurred in large branches or home offices

HOT TOPICS AND BEST PRACTICES FOR BROKER DEALERS

1) Develop, Update, and Enforce Written Supervisory Procedures. BD's should also ensure that staffing and expertise are commensurate with the size of the BD and type(s) of business engaged in by the firm.

2) Ensure that the firm provides each customer within 30 days of account opening, upon updating, or on a rolling 36-month period each of the following:

    - Copies of the new account information(card)
    - Copies of all customer agreements
    - "Plain English" definition of the BD's investment objectives

3) Customers must be provided with name(s) and address(es) for returning inaccurate account information and also where to direct customer complaints and questions. Responses should be directed to the firm rather than the RR.

HOT TOPICS AND BEST PRACTICES (cont.)

4) Develop effective standards and criteria for determining suitability.

5) Ensure that exception reports are generated, when necessary, and that “red flags” are documented and resolved in a timely manner. If the BD elects to electronically recreate an exception report the BD must not only be able to recreate the report but also document how the exception was resolved.

6) Develop a branch audit program which includes an effective audit plan, unannounced visits, a means to convey audit results, and a follow-up plan for requesting that the branch take corrective action.

7) Ensure that outside business activity and requests to sell securities not yet approved by the BD are disclosed by each RR and adequately investigated by the firm.

HOT TOPICS AND BEST PRACTICES (cont.)

8) Advertisements and sales literature MUST make full and fair disclosure and be approved prior to use.

9) Seminars and handout materials utilized MUST be approved by the BD prior to the seminar being held. Additionally, any guest speakers and their materials must also be reviewed prior to the seminar.

10) Correspondence, both electronic and hard copy, MUST be effectively monitored by the BD including a system of capturing and maintaining E-mails sent by RR’s from websites and ISP’s outside the firm.

EXHIBIT 3

MEMORANDUM OF UNDERSTANDING CONCERNING THE EXAMINATION OF INVESTMENT ADVISERS

This Memorandum of Understanding (MOU) addresses the regulation and examination of investment advisers by the members of the North American Securities Administrators Association, Inc. ("NASAA") and for purposes of this MOU being the securities regulators of the fifty states, the District of Columbia, Puerto Rico, and the U.S. Virgin Islands.

1. RECITALS

1.1 NASAA members are currently responsible for the regulation of investment advisers with assets under management of less than $25 million. NASAA members are the only regulators that qualify and license investment adviser representatives. The Securities and Exchange Commission ("SEC") is currently responsible for the regulation of investment advisers with assets under management of not less than $25 million. The statutory cap for determining state and federal regulation of investment advisers was established in 1996 by Congress. NASAA (which as used herein also refers to the state securities regulators that are members of NASAA) conducts its examinations of investment advisers and investment adviser representatives on a regular and consistent basis.

1.2 The SEC has stated that its current workload has made regular and frequent examinations of investment advisers exceedingly difficult. Therefore, without state assistance, it is unlikely that there will be sufficient resources to provide for a meaningful increase in the frequency of examinations of larger investment advisers by the SEC. Additionally, because of SEC's proper focus on larger investment advisers, it is also probable that, absent assistance from the states, smaller investment advisers with assets under management between $25 million and $100 million will go unexamined thereby creating an "examination gap" of investment advisers with assets under management of more than $25 million but less than $100 million.

1.3 An increase of the statutory cap from $25 million to $100 million for the states would allow for a substantial increase in regulatory oversight and examination frequency of advisers with assets under management of more than $25 million but less than $100 million while alleviating the burden of examination of these firms from the SEC, thereby allowing the SEC to concentrate its efforts on the larger and more systemically important advisers, and thus closing any "examination gap."

1.4 NASAA believes that regulation is properly the province of government rather than member governed self-regulatory organizations. Because NASAA has been the sole regulator of all investment adviser representatives and investment advisers with assets under management of less than $25 million for over a decade it is more experienced and better-suited to the regulation and examination of the investment advisers with assets under management up to $100 million.

1.5. While certain states may have resource constraints relative to their examination programs, many others do not. NASAA stands ready to assist member states in conducting regular, thorough examinations of investment advisers and investment adviser representatives to ensure timely and efficient examinations of state registered investment advisers and closure of the aforementioned "examination gap."

2. AGREEMENT

2.1 In recognition of these mutual interests, to protect the investing public, and to further enhance state effectiveness in the examination of investment advisers and investment adviser representatives, NASAA wishes to enter into an understanding that shall govern cooperative examinations of investment advisers. Accordingly, NASAA agrees as follows:

2.2 NASAA recognizes the importance of a consistent and regular schedule of examinations for investment advisers. NASAA believes that such an approach is particularly important to both the investing public and to investment advisers. In recognition of this understanding, NASAA members agree to consult with each other for the purpose of ensuring that examination resources are augmented, when necessary, with the assistance of sister states. Such assistance shall include, but not be limited to, a request, transmitted to the sister state(s) upon contemplation of any need for assistance, setting forth all elements relevant to the request. The sister state shall then respond as soon as practicable. This process shall at all times be consultative and cooperative.

2.3 Upon acceptance of the request for assistance, the sister state shall, within a mutually agreeable time frame, assign or dispatch the appropriate number of experienced investment adviser examiners to assist the requesting party.

2.4 NASAA further believes that innovative and flexible approaches to examinations are in the best interests of both the investing public and investment advisers. To that end, NASAA has tasked its long-standing Investment Adviser Operations and Training Project Groups with the following ongoing responsibilities:

2.4(i) Investigating, evaluating, and recommending nontraditional examination approaches and solutions to the NASAA membership;

2.4(ii) Providing training on these nontraditional approaches and solutions;

2.4(iii) Facilitating and engaging in cooperative discussions with fellow NASAA members and other governmental regulators regarding new and productive examination methodologies; and, 2.4(iv) Providing leadership in the rapid development of mutually satisfactory positions on examination policies and procedures designed to address any currently unforeseeable challenges to the implementation of an effective, integrated, and coordinated national examination program.

3. COST OF JOINT EXAMINATION PROGRAM

3.1 Costs of the joint examination program shall be funded on a case-by-case basis, as appropriate, by NASAA.

4. PARTICIPATION IN JOINT EXAMINATIONS

4.1 Individual members of NASAA may elect to participate in this joint examination program by notifying the Executive Director or General Counsel.

4.2 The NASAA Board of Directors encourages participation by all U.S. NASAA Members.

THIS THE 2nd day of December 2009.

Denise Voigt Crawford

Denise Voigt Crawford
NASAA President

EXHIBIT 4

PROTECTING SENIOR INVESTORS: REPORT OF EXAMINATIONS OF SECURITIES FIRMS PROVIDING "FREE LUNCH" SALES SEMINARS

BY THE

OFFICE OF COMPLIANCE INSPECTIONS AND EXAMINATIONS
SECURITIES AND EXCHANGE COMMISSION

NORTH AMERICAN SECURITIES ADMINISTRATORS ASSOCIATION

FINANCIAL INDUSTRY REGULATORY AUTHORITY

SEPTEMBER 2007

I. INTRODUCTION AND SUMMARY

With the aging of the baby boom generation, a growing number of our nation's investors are at or near retirement age. Indeed, data presented at the first "*Seniors Summit*" held by the Securities and Exchange Commission (SEC) in July 2006 indicated that 75% of the nation's consumer financial assets, valued at $16 trillion, are held by households headed by someone who is 50 or older. Within the next 20 years, 75 million people will have celebrated their 60th birthday. Because these "senior investors" are a growing segment of investors, financial services firms are increasingly focusing their marketing and sales of investment products towards the senior investor or those investors nearing retirement age. Within this broader context, securities regulators are concerned about the possibility of unscrupulous and abusive sales practices and investment frauds targeted towards senior investors. In fact, some data indicates that although individuals aged 60 or older make up 15% of the U.S. population, they account for 30% of fraud victims.[1]

In response to this concern, in May 2006, the SEC and the North American Securities Administrators Association (NASAA) announced a coordinated national initiative designed to protect seniors from investment fraud and sales of unsuitable securities.[2] Working together with the NASD and the NYSE Member Regulation Inc. (now consolidated as the Financial Industry Regulatory Authority, or FINRA), the SEC and NASAA initiative includes three components: active investor education and outreach to seniors and those nearing retirement age; targeted examinations to detect abusive sales tactics aimed at seniors; and aggressive enforcement of securities laws in cases of fraud against seniors. This joint and collaborative initiative by securities regulators is designed to build on the existing efforts that each regulator had underway, toward a shared mission to protect senior investors. This initiative is active and ongoing.

As part of this effort to protect senior investors, regulators initiated a series of coordinated on-site examinations of broker-dealers, investment advisers and other financial services firms that offer so-called "free lunch" sales seminars. These seminars are widely offered by financial services firms seeking to sell financial products, and they often include a free meal for attendees. Sales seminars are often advertised in local newspapers, through mass-mailed invitations, mass-email, and on websites. While specific data is not available regarding the actual number of sales seminars being conducted, regulators believe that the number of sales seminars has increased in recent years, as financial services firms are increasingly seeking to provide advice to seniors and those approaching retirement.

1 "*NASAA Survey Shows Senior Investment Fraud Accounts for Nearly Half of all Complaints Received by State Securities Regulators*," (July 17, 2006), available at http://www.nasaa.org/NASAA_Newsroom/Current_NASAA_Headlines/4998.cfm.

2 "*Securities and Exchange Commission and North American Securities Administrators Association Launch Program to Protect Senior Investors,*" (May 8, 2006), joint SEC and NASAA press release available at http://www.sec.gov/news/press/2006/2006-65.htm.

Examinations were targeted in areas of the country that have large populations of retirees. Examinations were conducted in Florida, California, Texas, Arizona, North Carolina, Alabama and South Carolina by state securities regulators in those states, NASD and the NYSE Member Regulation Inc. (now FINRA) and the SEC. This report summarizes the results of these examinations and was prepared by the SEC's Office of Compliance Inspections and Examinations, NASAA and FINRA (collectively, referred to in this Report as regulators or examiners).[3]

The purpose of the examinations was to review firms that offer sales seminars targeted to seniors and retirees for compliance with securities laws and rules (federal, state and self-regulatory organization (SRO) rules) designed to protect investors. Specifically, the examinations reviewed:

- Advertisements, seminar materials, and sales literature for any misrepresentations, exaggerations, or omissions of material information;

- Customer transactions engendered by these seminars to evaluate the suitability of investment recommendations that were made; and

- Supervisory systems, policies, and procedures used to detect and prevent violations of the securities laws for adequacy.

We conducted 110 examinations between April 2006 and June 2007. While each of our findings is described in greater detail in this report, in sum, we found that:

- **Sponsors of "free lunch" sales seminars offer attractive inducements to attend**. The seminars are commonly held at upscale hotels, restaurants, retirement communities and golf courses. In addition to providing a free meal, the firms and individuals that conduct these seminars often use other incentives (*e.g.*, door prizes, free books, and vacation deals) to encourage attendance.

- **Often, the target attendees are seniors**. Many of the "free lunch" sales seminars are designed to solicit seniors. They are advertised with names like "*Seniors Financial Survival Seminar*" or "*Senior Financial Safety Workshop,*" and offer "free" advice by "experts" on how to attain a secure retirement, or offer financial planning or inheritance advice. The advertisements used to solicit attendees often imply that there is an urgency to attend. For example, invitations include phrases such as "limited seating available" or "call ***now*** to reserve a seat." Some illustrative examples of advertisements used for sales seminars can be found in Appendix A to this report.

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[3] This report includes examination findings of the SEC's staff, FINRA's staff and the staff of the individual states regulatory authorities, which are not findings or conclusions of the Securities and Exchange Commission, FINRA or NASAA. This report includes findings from examinations conducted by NASD and NYSE Regulation Inc, now FINRA.

- **Seminars are designed to sell.** Many sales seminars were advertised as "educational," "workshops," and "nothing will be sold at this workshop," and many advertisements did not mention any investment products. Nonetheless, the seminars were intended to result in the attendees' opening new accounts with the sponsoring firm and, ultimately, in the sales of investment products, if not at the seminar itself, then in follow-up contacts with the attendees. To the extent that participants may attend a seminar in order to obtain educational insights and information, they should be aware that the primary goal of the sponsors of these "free lunch" seminars is to obtain new customers and sell investment products. Examiners found that the most commonly discussed products at the sales seminars were variable annuities, real estate investment trusts, equity indexed annuities, mutual funds, private placements of speculative securities (such as oil and gas interests) and reverse mortgages.

- **Some firms had particular compliance and supervisory controls that appeared to be effective. And, during a small number of the examinations (5 examination or 4% of those conducted), regulators found no problems or deficiencies.** During examinations, regulators identified specific compliance and supervisory practices that appeared to be effective in ensuring compliance with the securities laws and rules. For example, one broker-dealer required its employees to forward all materials to its home office for a supervisory and compliance review prior to using the materials at sales seminars. Another broker-dealer utilized checklists to aid supervisors with the approval process for seminars and seminar materials. More detailed examples of these practices are set forth in Appendix B to this report.

- **Half of the examinations found that firms used advertising and sales materials that may have been misleading or exaggerated or included seemingly unwarranted claims (in 63 of 110 examinations, or 57%). Many broker-dealer firms did not submit their sales material to NASD (now FINRA) for review, as required by NASD advertising rules.** The most common types of apparently misleading statements appeared on mailers and advertisements for the sales seminars, and involved statements about the safety, liquidity or anticipated rates of return. Statements included, for example: "Immediately add $100,000 to your net worth," "How to receive a 13.3% return," and "How $100K can pay 1 Million Dollars to Your Heirs." Additionally, some sales materials made comparisons between dissimilar investments or services, included representations about the expertise or credentials of the registered representative that may have been misleading or confusing, or involved testimonials that may have been misleading.

- **Individuals attending the sales seminars may not understand that the seminar is sponsored by an undisclosed company with a financial interest in product sales.** The mailers and advertisements for the sales seminars often focused on the individuals who would be conducting the seminar, and often included the name of the registered representative or investment adviser, a photograph and information about his/her background as an expert in providing investment advice, and his/her history in the local community. Individuals who attend the seminars or who are considering attending are not always provided with the name of the firm sponsoring the seminar, and may not be aware that product sponsors (*e.g.*, mutual fund companies and insurance companies) may provide funding for the seminars with the expectation that investment professionals will sell their products. In these situations, seminar attendees may not have known that the financial adviser speaking at the seminar was not unbiased in making product recommendations.

- **Many examinations found indications that firms had poorly supervised these sales seminars.** Examiners found indications of weak supervisory practices in 65 of the 110 examinations (or 59% of the examinations conducted). For example, a common finding was that firms had inadequate supervisory procedures or had not implemented their procedures with respect to sales seminars held by their employees.

- **Some examinations found indications that registered representatives or investment advisers holding the sales seminars had recommended investments that did not appear to be suitable for the individual customers.** In 25 of the 110 examinations (or 23% of examinations conducted), examiners found indications that unsuitable recommendations to purchase investments were made at the sales seminars, or following the seminar when an attendee opened an account. The investments appeared to be unsuitable in light of the customers' investment objectives or time horizon – *e.g.*, a risky investment was recommended to an investor with a "conservative" investment objective, or an illiquid investment was recommended to an investor with a short-term need for cash.

- **In some instances, the sales seminars may have involved fraud.** Examiners found indications of possible fraudulent practices in 14 examinations (or 13% of the examinations conducted), that involved potentially serious misrepresentations of risk and return, liquidation of accounts without the customer's knowledge or consent, and sales of fictitious investments.

As a result of the examinations, most firms have received deficiency letters or letters of caution that outlined apparent rule violations and deficiencies and requested that the firms examined take corrective actions (these letters were provided to 86 firms, or 78% of all examinations conducted). In addition, some examinations (25 of the 110, or 23%) are under review for possible further investigation or action by a state, FINRA or SEC.[4]

The results of these examinations lead regulators to conclude that financial services firms should take steps to supervise sales seminars more closely, and specifically take steps to

[4] Many examinations had multiple dispositions. For example, a deficiency letter may have been provided to the firm requesting corrective action, and findings from that exam may also have been referred for possible disciplinary or enforcement action.

review and approve all advertisements and sales materials for accuracy. In addition, firms should redouble efforts to ensure that the investment recommendations they make to seniors are suitable in light of the particular customer's investment objectives.

Regulators have compiled a list of supervisory practices that have been identified during examinations and that appeared to be effective, which is included in Appendix B of this report. This information may assist firms in considering their own supervisory practices with respect to sales seminars. Regulators further urge financial services firms to take steps to assure that supervisory procedures with respect to sales seminars are being implemented effectively. Regulators participating in these examinations will continue to focus examination, enforcement and regulatory efforts on the use of sales seminars targeted to seniors.

In addition, regulators conclude that, because seniors are targeted as attendees for sales seminars, ongoing investor education efforts for seniors should provide education with respect to "free lunch" sales seminars. Specifically, senior investors should understand that these are *sales* seminars -- that is, they are intended to result in the sales of financial products, and they may be sponsored by an undisclosed company with a financial interest in product sales. Investor education efforts should emphasize that, despite the claims of urgency that are sometimes made by sponsors of sales seminars, and in light of the possibility of misleading or exaggerated statements or claims about investment products or the expertise of the financial adviser, investors should take time to research the firm, the financial adviser as well as the product being offered before opening an account or making a purchase. Regulators make a variety of tools available to investors to assist them in understanding investment products and investigating a broker or other financial professional before investing, and many of these tools are listed in Appendix C to this report.

II. BACKGROUND: RISK ASSESSMENT AND SELECTION OF FIRMS FOR EXAMINATION

As a threshold matter, regulators focused on geographic areas with high populations of seniors. Thus, examinations were first initiated in Florida by the Florida Office of Financial Regulation, NASD and NYSE (now FINRA), and SEC staff. The examinations were then expanded to include other states in geographic areas that had large concentrations of senior citizens. Based on census data, some of the states with the highest senior populations were Florida, California and Texas, among others. In addition, census information reflected a high concentration of retirees in the states of Arizona, North Carolina, Alabama and South Carolina.[5] Regulators in each of these states and examiners from the NASD, the NYSE and the SEC commenced coordinated examinations during 2006 and 2007.

To identify firms for examination, regulators collected publicly available information including advertisements, invitations and websites that sought to target seniors for "free

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5 U.S. Census Bureau, *Current Population Reports, 65+ in the United States* (Washington, D.C.: U.S. Government Printing Office, 2005), 23-209.

lunch" seminars. Examiners then developed a risk assessment model to identify the firms that appeared to present the highest risk of possible violations. Regulators considered the following factors in conducting this risk assessment:

- Whether the advertisements and/or sales literature appeared to target senior citizens;

- Whether the advertisements and/or sales literature appeared to have exaggerated, misleading and/or fraudulent representations, including testimonials;

- Whether the advertisements and/or sales literature discussed or referred to securities that appeared to be of high risk to the average senior citizen;

- Whether the entities/individuals identified in the advertisements and/or sales literature were appropriately registered to sell the securities discussed or referenced in the advertisements and/or sales literature;

- Whether the entities and/or individuals identified in the advertisements and/or sales literature had any prior disciplinary history and/or customer complaints within the last year;

- Whether the advertisements and/or sales literature, when used by a broker-dealer, were filed with and reviewed by NASD pursuant to NASD's advertising rules; and

- Whether the advertisements and/or sales literature offered any incentives to attend the seminars (*e.g.*, prizes, trips, or books).

The regulators then evaluated the risk assessment data and selected firms for examination. Frequent communication among the regulators helped to ensure a consistent approach to examinations, and prevented any duplication in examinations.

The NASD's Department of Advertising Regulation was an integral part of the examination process. For broker-dealer firms, all advertisements and seminar sales literature were reviewed by NASD personnel to determine if the literature was in compliance with NASD's advertising rules. NASD's staff then provided each regulator conducting the examination with information about any areas of apparent non-compliance.

Each regulator conducted examinations. Some examinations were conducted jointly by state regulators and the NYSE or the SEC. Examinations included interviews with firm employees and reviews of records maintained by the firm. In their examination process, state regulators attended some sales seminars to ascertain what was being said during seminar presentations. Regulators followed their own protocols for examination process and disposition. Upon completion, some examination findings were referred to the most appropriate regulatory authority to handle the matter based on the types of potential violations identified.

Most of the firms examined were registered as broker-dealers, and many were also registered as investment advisers with a state or with the SEC. Some firms were registered as investment advisers, but not as broker-dealers. Employees of the firms examined were often licensed as registered representatives with NASD, and may also have been advisory representatives with the state, or advisers registered with the SEC. A small number of firms were not required to be registered under state or federal securities laws, and were examined by state regulators. The firms examined ranged in size and type -- from independent contractors at small firms to large firms with branch offices across the country -- although most were small local or regional firms. Many examinations were conducted at branch offices.

III. KEY SECURITIES LAWS AND REGULATIONS APPLICABLE TO SALES SEMINARS[6]

Registration: Sales seminars may be conducted by a registered representative, investment adviser or an unregistered person. Absent any exception or exemption, any firm that sells securities (as defined by the Securities Exchange Act of 1934, *e.g.*, stocks, bonds) must be registered as a broker-dealer. In addition, in order to discuss securities at a seminar sponsored by a broker-dealer, the presenter must be a licensed registered representative (under NASD Rule IM-1031 and NYSE Rule 345[7]). Investment advisers provide investment advice to purchase or sell securities for compensation and as part of a regular business. Investment advisers also sponsor sales seminars, and they may be required to be registered either with a state or with the SEC. Many sales seminars are designed to sell non-securities products (*e.g.*, insurance). Only firms selling or advising the purchase or sale of securities products are required to be registered.

Sales Literature: The materials used or distributed by broker-dealers at seminars are considered "sales literature" and are subject to the supervisory approval and record-keeping requirements under NASD and NYSE rules. In addition, these rules apply to any communications that are used to promote the seminars, such as advertisements in print, on the web or by radio or television broadcast.[8] Under these rules, sales literature must be approved by a registered principal prior to the seminar; the firm must maintain all sales literature in a separate file for three years; and the file must include the name of the registered principal that approved the seminar and the materials distributed at the seminar

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6 Individual states' securities laws also apply.

7 NASD and NYSE rules are separately cited in this report, as a common FINRA rulebook has not yet been developed.

8 Specifically, each advertisement, market letter, sales literature or other similar type of communication which is generally distributed or made available by a member firm to customers or to the public must be approved in advance by an allied member, supervisory analyst, or qualified person (under NYSE Rule 342(b)(1)).

(under NASD Rule 2210(b) and NYSE Rule 472(d)). The broker-dealer must also maintain information concerning the source of any illustrative data used in the seminar (under NASD Rule 2210(b)(2)(B)).

Seminars are public appearances, as are radio or television interviews or other speaking activities (under NASD Rule 2210 and NYSE Rule 472(1)). NASD and NYSE rules require that: "all member communications with the public shall be based on principles of fair dealing and good faith, must be fair and balanced, and must provide a sound basis for evaluating the facts in regard to any particular security or type of security, industry or service" (under NASD Rule 2210(d)(1)(A) and NYSE Rule 472(i)). These standards also apply to registered representatives' participation at seminars.

Anti-Fraud Rules: Federal and state securities laws and SRO rules prohibit making any untrue statement of a material fact, or omitting to state a material fact that is necessary to make the statements that are made not misleading (*e.g.*, under Section 17(a) of the Securities Act of 1934, Section 10(b) of the Exchange Act and Rule 10b-5, and Section 206 of the Investment Advisers Act of 1940).

Investment advisers (whether registered with the SEC or state or not) also have a fiduciary duty to provide full and fair disclosure of all material facts to their clients and their prospective clients. All advertising materials and other materials distributed at a seminar by an adviser are subject to these restrictions, including any representations about the adviser, its business and investment advice, such as performance data, investment strategies, education, background and experience (under Section 206 of the Advisers Act).

It is fraudulent for an SEC-registered adviser to distribute advertisements that contain or refer to testimonials or past specific recommendations that were profitable (under Rule 206(4)-1 under the Advisers Act). In addition, SEC-registered advisers cannot use advertisements that imply that a graph, chart, or formula will enable investors to make their own investment decisions without disclosing the limitations or difficulties of the approach (under Rule 206(4)-1 under the Advisers Act and various state securities statutes). Advisers may also not falsely promise to provide free services (Rule 206(4)-1 under the Advisers Act).

Broker-dealers may not make exaggerated or misleading endorsements of investments, and unwarranted predictions or projections of investment performance are also prohibited (under NASD Rules 2210(d)(1)(B), (d)(1)(d) and NYSE Rule 472(i)). In addition, broker-dealer testimonials must also include certain information: (1) the fact that the testimonial may not be representative of the experience of other customers; (2) the fact that the testimonial is not indicative of future performance or success; and (3) if more than a nominal sum is paid, the fact that it is a paid testimonial (under NASD Rule 2210(d)(2)(A) and NYSE Rule 472(j)(7)).

To prohibit potentially misleading advertisements and to ensure that communications are fair and balanced, NASD rules require that broker-dealers provide certain sales literature to its Department of Advertising Regulation for review. For example, advertisements and sales literature concerning mutual funds and variable annuities must be submitted to the FINRA for approval within 10 days of the time it is first used or published (under NASD Rule 2210(c)(2)(A)). Firms may also voluntarily submit other material for FINRA review and must pre-file other advertisements in some cases.

Duty to Recommend Securities that are Suitable: A broker-dealer may only recommend a security to a customer that it has determined is suitable for that customer in light of that customer's particular age, financial situation, risk tolerance, and investment objectives (*e.g.*, under NASD Rule 2310 and IM 2310-2 and NYSE Rule 405). Broker-dealers must obtain the customer's name, tax identification number, address, telephone number, date of birth, employment status, annual income, net worth, and investment objectives for each retail customer account (under Exchange Act Rule 17a-3(a)(17)(i)(A)). As a fiduciary, an adviser has an obligation to deal fairly with its clients and to act in their best interests (under Section 206 of the Advisers Act).

Supervisory Requirements: Broker-dealers must establish, maintain, and enforce written supervisory procedures to supervise the types of business in which they engage and to supervise the activities of registered representatives, registered principals, and other associated persons (under Section 15(b) of the Exchange Act and NASD Rule 3010(b) and NYSE Rule 342)). Similarly, investment advisers must adopt and implement written policies and procedures reasonably designed to prevent violations of the Advisers Act by the adviser or any of its supervised persons (Section 206 of the Investment Advisers Act and Rule 206(4)-7(a) thereunder).

IV. EXAMINATION FINDINGS

- **Sponsors of "free lunch" sales seminars often offer attractive inducements to attend**.

We found that sales seminars are commonly held at upscale hotels, restaurants, retirement homes, golf courses and other locations. A few were held at the offices of the firm sponsoring the seminar. Invitees were from the local community. Generally, the seminars were free. In some cases, in addition to providing a free meal, the firms and individuals that conducted these seminars used other incentives such as door prizes, free books ("A Free Tax Payer Awareness Guide"), free portfolio reviews and one even offered a $250 discount on a nursing home protection planning session. To further encourage attendance, some advertisements offered seminar attendees eligibility to win prizes such as tote bags, gift certificates or even a 3 night/4 day cruise for two.

- **Often, the target attendees are seniors**.

We found that many of the seminars were designed to appeal specifically to seniors. Some seminars also targeted religious affinities or associated groups such as the military. Many sales seminars were advertised in local newspapers or attendees were solicited to attend via mass invitations sent through the mail or via email. Many solicitations targeted seniors. Samples of advertisements can be found in Appendix A to this report.

The seminars had titles such as*: "Senior Financial Survival Seminar," "Senior Citizen Tax Specialist," "Senior Financial Safety Workshop,"* and *"Senior Citizen Retirement and Asset Protection Education Workshop."* Some communications explicitly stated that attendance was limited to those between, *e.g*., 60 and 85 years of age, or over 70 years of age. In the advertisements and/or invitations, the seminar sponsors often claim to offer advice on how to attain a secure retirement, financial planning, inheritance advice, and even "nursing home asset protection." Often, the ads and mailers featured photographs of happy and attractive seniors – perhaps to suggest that an attendee could achieve financial security or prosperity by attending the seminar.

Seminar sponsors appeared to target seniors, and to seek to limit attendance by the non-target attendees. Some ads and mailers were explicit in excluding attendance by advisers, attorneys, accountants, agents or brokers, or otherwise discouraged attendance by these professionals by charging them a costly attendance fee (as much as $1,000).

The ads and mailers often implied urgency, and that time was of the essence. They said things like: "Act Now!" "If you are over 60, you cannot afford to miss this seminar" "Seating is Limited!" "Reservations Required" "This is a time-sensitive offer!" "There is a financial storm brewing" "This is a *Must* Attend!" or "Startling presentation reveals costly mistakes that can ruin your finances."

Some ads and mailers used tactics to scare seniors into thinking that they might not be using the right investment professional, or to question their current investments. For example, they say, "If you're retired, <u>YOU'RE A TARGET</u> and you cannot afford to miss this workshop!" "How to Protect your Nest Egg from The Retirement *Vultures*," "Will you cause your family to split up and argue at your passing when your will or trust is read? Would you like to know how to prevent the possible breakup of your family?" and "Seniors, did you know that costly mistakes can tarnish your golden years?" These statements appear to be designed to scare vulnerable senior investors, and may help to open the door for seminar sponsors to sell unsuitable investments.

- **Seminars are designed to sell.**

While many sales seminars were advertised as "educational," "workshops," "educational dining seminar" and "nothing will be sold at this workshop," and many advertisements did not mention any investment products, all of the seminars were intended to result in product sales. They were intended ultimately to result in the attendees' opening new accounts with the sponsoring firm, and the sale of securities and other financial products. To the extent that participants may attend the seminar in order to obtain educational insights and information, they should be aware that the primary goal of the sponsors of the "free lunch" seminars is to obtain new customers and sell financial products.

Typically at a seminar, the seniors arrive at the restaurant or hotel and are shown to a private room, and to a seat. At the outset, they are usually given a questionnaire or contact card to fill out with their name, address, telephone number, and interests in particular investments or financial goals and are asked to return the card to the host. A slide show or power point presentation usually follows as drinks are served. Examiners found that the most commonly discussed products at the sales seminars were variable annuities, equity indexed annuities, real estate investment trusts, mutual funds, private placements and reverse mortgages. The food is usually not served until after the presentation is complete and the host has collected the contact information from the attendees. To ensure the attendees stay until the presentation is over, the door prizes are given last. The financial adviser speaking at the seminar also evaluates individual attendees' level of interest in opening an account and/or purchasing products.[9]

Following the seminar, seminar attendees can expect to receive additional solicitations from the firm to purchase investment products. Attendees are generally contacted by the financial adviser by telephone at least one or more times, using the contact information that the attendee provided at the seminar, and are solicited to schedule a further meeting with the financial professional and/or to open an account and purchase securities or other products. Typically, the attendee will also be added to the firm's mailing list of potential customers, and will receive additional sales materials in the mail following the sales seminar.

- **Some firms had particular compliance and supervisory controls that appeared to be effective. And, at a small number of firms (5 examinations, or 4% of the firms examined), regulators found no problems or deficiencies.**

Some examinations found that firms had specific compliance and supervisory practices that appeared to be effective in ensuring compliance with the securities laws and rules. These practices were in writing and were implemented. Particularly effective practices were those that facilitated a supervisor's advance review of the materials to be used in connection with sales seminars.

For example, one broker-dealer required its employees to forward all materials to its home office for a supervisory and compliance review prior to using them at sales seminars. Another broker-dealer utilized checklists to aid supervisors with the approval process for seminars and seminar materials. Another firm used what it called "mystery shoppers" (who were current firm employees) to attend seminars randomly to identify potential disclosure and compliance weaknesses and report back to their supervisor. These, and additional examples of effective compliance and supervisory practices found during examinations can be found in Appendix B to this report.

[9] At one firm, registered representatives kept a record of those who attended the seminars that included a notation of the attendees who made appointments to meet with the registered representatives after the seminar to discuss opening an account. The record also referred to those attendees who did not schedule a follow-up appointment and apparently only attended the seminar for the free lunch as "clowns."

- **Half of the examinations found that firms used advertising and sales materials that may have been misleading or exaggerated or included apparently unwarranted claims.**

The most common deficiency involved the use of potentially misleading advertising and sales literature in connection with the sales seminars. Examiners found deficiencies in 63 of the 110 examinations conducted (or 57% of the examinations conducted). Most frequently, these potentially misleading statements appeared in mailers and advertisements for the sales seminars, and involved statements about the safety, liquidity or anticipated returns of products. Additionally, some sales materials made comparisons between dissimilar investments or services, included representations about the expertise or credentials of the registered representative that appeared to be misleading or confusing, or involved testimonials that appeared to be misleading, or provided inaccurate or confusing information about the sponsoring firm.[10] Examples are described below.

⇒ *Claims about Safety, Liquidity or Returns*

Some seminar sponsors used what appeared to be misleading or exaggerated promises to lure attendees to sales seminars. For example, one advertisement for a sales seminar, called the "Senior Citizen's Retirement & Asset Protection Educational Seminar," stated, "Learn how you can earn 2-3 times more interest than what banks currently offer…*While keeping your money liquid!*" The following additional examples were found in various advertisements:

> "If you are between the ages of 65-85 join me for the most fascinating hour of your LIFE and I will show you how to immediately earn as much as $100,000, $200,000 or $300,000 . . . or more with the stroke of a pen," and "How to ***guarantee*** your IRA will <u>never</u> run out, regardless of market fluctuations."
>
> "Learn how to pass all of your assets on to your heirs while making sure the IRS gets only what you want them to have."
>
> "Immediately add $100,000 to your net worth"
>
> "You'll learn how to generate returns starting at 40% while your capital is held in an FDIC insured account."
>
> "How to receive a 13.3% return"

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10 Specifically, in 41 of the 110 examinations (or 37%), firms may have made false, misleading, exaggerated or unwarranted statements or claims; and in 29 examinations (or 26%), the firm did not appear to provide a sound basis for evaluating the statements that were made. In addition, two firms appear to have made exaggerated or unwarranted claims, opinions, or forecasts related to the performance of securities, and an additional seven made comparisons in their advertisements and/or sales literature between investments or services, but did not disclose material differences between the investments or services.

“How $100K can pay 1 Million Dollars to Your Heirs”

“Get double digit growth potential with no risk of loss and no fees”

“Your deposit plus all gains are insured 100% without limit.”

Advertisements like these seemed designed to attract attention by using exaggerated and potentially misleading claims. Examiners noted that seminar sponsors may be competing with each other for attendees, particularly in local areas with large populations of retirees, and may use hyperbolic and exaggerated ads in order to “stand out” from other seminar sponsors.

⇒ *Use of Testimonials*

Examiners found that some firms used testimonials from satisfied customers as part of their sales materials and presentations at sales seminars. Examiners observed that firms sometimes used testimonials by seniors who attested to the quality of service or the investments offered by the firm in their marketing efforts to other seniors as prospective customers.

As described above in this report, to protect investors from being misled by testimonials, broker-dealers must prominently disclose that the testimonial may not be representative of the experience of other customers, the testimonial may not be indicative of future performance or success, and if more than a nominal sum is paid, broker-dealers must disclose that it is a paid testimonial (under NASD Conduct Rule 2210(d)(2)(A) and NYSE Rule 472(i)(7)). Investment advisers registered with the SEC may not use testimonials at all (under Rule 206(4)-1 under the Advisers Act).

Examinations found that some firms did not fully comply with these requirements. For example, one broker-dealer firm employed an older gentleman on a part-time basis to help with public relations. He also held accounts with the firm. His job was to attend seminars, state that he was a current customer of the firm, and stand up and give unsolicited testimonials as to the quality of the firm and its investment management. He did not disclose that he was paid to provide the testimonial, that his experience may not be representative of other customers’ experience, and is not indicative of future performance or success (as required under SRO rules).

The same firm invited its current customers to its sales seminars -- to receive a free meal -- and to provide impromptu testimonials to other attendees, *e.g.*: “I am happy with the account and the returns” and “It feels like being part of a family.” These testimonials did not include disclosures that these customers’ experience may not be representative of other customers’ experience, and is not indicative of future performance or success (as required under SRO rules).

Other testimonials identified in the examinations included:

> "The [broker-dealer] puts client's best interest first."
>
> "You can trust [the broker-dealer]."
>
> "[I] like the approach to asset allocation which leads to broad diversification."

⇒ *Representations about the Expertise of the Financial Adviser*

Often, the advertising for sales seminars has a personal appeal and focuses on the individual person who is presenting the seminar. The advertisements frequently include a photograph of the seminar host and a description of that individual's background as an expert in providing financial advice, as well as highlighting his/her involvement in the local community. While examiners did not investigate the accuracy of all of the representations made about the background or expertise of the persons presenting the seminars, we found a few indications that information provided about the experience or the expertise of the presenter could be confusing or misleading to an attendee.

For example, two individuals distributed sales literature during a seminar that included a "team profile" of themselves as hosts of the seminar. The profile stated that one of the representatives used technical knowledge to develop an advanced mutual fund selection system combining various services and numerous data bases. Examination staff discovered that an off-the-shelf software program was used to identify potential mutual fund investments.

In other cases, individuals presenting seminars called themselves a "*Certified Senior Advisor*," or "*Elder Care Asset Protection Specialist*" or "*Chartered Retirement Planning Counselor*" -- terms that suggest that the financial professional has some type of special credential or certification from a regulatory authority, when in fact there is no regulatory qualification or registration that recognizes such special expertise.[11] The use of these titles may be confusing or misleading to the public.

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[11] Regulators have warned that seniors may be confused by designations that imply some expertise in providing services to seniors. NASAA's Investor Alert is available at http://www.nasaa.org/NASAA_Newsroom/Current_NASAA_Headlines/4028.cfm. The SEC has provided information on professional designations, available at http://www.sec.gov/investor/pubs/senior-profdes.htm. Additionally, FINRA provides a list of professional designations and describes them for informational purposes only – without recommending or endorsing any designation. This information is available at http://apps.finra.org/DataDirectory/1/prodesignations.aspx.

- **Individuals attending the sales seminars may not understand that the seminar is sponsored by an undisclosed company with a financial interest in product sales.**

As described above, the mailers and advertisements for the sales seminars often focused on the individual person who conducted the seminar, and often included the name, photograph and background information of the individual registered representative or investment adviser that is scheduled to speak at the seminar. Members of the public who attended the seminars or considered attending were not always provided with the name of the firm that was sponsoring the seminar, and may not be aware that product sponsors (e.g., mutual fund companies and insurance companies) provide funding for these seminars.

Examiners found that advertising and sales material provided to prospective attendees at the seminars did not always disclose the name of the broker-dealer or the investment adviser firm that was sponsoring the seminar. In fact, in 12 of the 110 examinations (or 11% of the examinations conducted), firms used sales literature that provided the name of the individual who presented the seminar, but not the name of the firm where the individual worked.[12] In 7 of these instances, the registered representatives used alternative names to do business and used these names in their advertising or sales literature, but did not also reflect the name of the broker-dealer firm that they worked for and that was offering the products or services**.** Providing the name of the firm would allow a prospective attendee to better research the sponsoring firm in deciding whether to attend a sales seminar.

In addition, seminar attendees and those who considered attending likely did not know that some seminars were paid for (in part or in whole) by product sponsors. This information is not required to be disclosed in advertisements or mailers for sales seminars. Mutual fund firms and insurance companies often reimburse broker-dealers or investment advisers for expenses when they hold sales seminars to solicit investors to purchase the mutual funds or insurance products. In these examinations, examiners found that mutual funds, insurance companies and limited partnership sponsors frequently reimbursed broker-dealers or investment advisers for the costs of putting on the sales seminars (*e.g.*, rental of space, the food and beverages provided, publications, advertising expenses and other free items provided to attendees). Attendees likely did not know that the sponsors of the products discussed at the seminar had paid for the costs of the seminar. In these situations, seminar attendees may not have known that the financial adviser speaking at the seminar was not unbiased in making product recommendations.

[12] Broker-dealers are required to reflect the name of the firm offering products and services in any advertisements or sales literature offering products or services. The name of the member must be prominently disclosed, and may also include a fictional name by which the member is commonly recognized or which is required by any state or jurisdiction (under NASD Conduct Rule 2210(d)(2)(c)(i) and (iii)).

While seminar attendees and those considering whether to attend likely were not aware that the seminar may have been paid for by a product sponsor, if a person attending a seminar purchases a security, they are required to receive relevant disclosure. Broker-dealers and investment advisers are required to disclose certain basic terms of the transaction to the customer or client, such as any payments they receive from third parties.[13] Most frequently, these disclosures are contained in the prospectus for the mutual fund or other product, or in the investment adviser's brochure (or in its Form ADV).[14]

Examinations found that, when customers purchased a security as a result of a seminar, firms provided disclosure that they received compensation from a product sponsor in the prospectus, in a statement of additional information, or in a separate disclosure form. However, in 8 examinations, the disclosure that firms provided in the prospectus stated that the firm *"may"* receive compensation from product sponsors based on assets under management, when, in fact the firm had actually received and was receiving such payments and reimbursements for seminar costs.

For example, examinations found that two broker-dealers had agreements with insurance companies under which the insurance companies paid the broker-dealers to sell their products (often called "revenue-sharing agreements"). With respect to one of these broker-dealers, most of its overall yearly sales were of the variable annuity products of a small number of insurance companies. It maintained compensation agreements with those insurance companies based on the sales that it made, and its customers' variable annuity assets that were held in their accounts with the broker-dealer for a certain length of time. The firm disclosed to investors that it "may" receive additional payments based on assets under management; however, it actually received over $1 million a year from these insurance companies, a significant amount of money for the firm based on its size.

Examinations also identified an instance of double-billing -- a registered representative obtained reimbursement for the same sales seminar expenses from multiple mutual funds. The registered representative had submitted the same restaurant bill to multiple mutual fund companies and received full payment from each of them.

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[13] Broker-dealers must disclose the source and amount of any remuneration received or to be received from third parties in connection with a transaction under Rule 10b-10 under the Exchange Act. Advisers must make similar disclosures, generally under Section 206 of the Advisers Act, and in Form ADV Part II.

[14] "[I]n the case of offerings registered under the Securities Act of 1933, the final prospectus delivered to the customer should generally set forth the information required by the proviso with respect to source and amount of remuneration. . . . In such situations the information specified in the proviso need not be separately set forth in the confirmation." Exchange Act Release No. 13508 (May 5, 1977) at n. 41.

- **Many broker-dealer firms did not submit sales materials to NASD for review as required.**

As described earlier in this report, to help ensure that communications by broker-dealers to the public are fair, balanced and not misleading, broker-dealers must provide certain sales material to NASD's Department of Advertising Regulation for review (now, this function is performed by FINRA's Department of Advertising Regulation). Advertisements and sales literature concerning mutual funds and variable annuities must be submitted for review within 10 business days of first use or publication (NASD Rule 2210(c)(2)(A)).

These examinations found that many firms did not submit materials to NASD as required. Specifically, NASD's Advertising Regulation Department reviewed all the advertisements and sales literature collected in these examinations that were used by NASD member firms or their associated persons. This review found that 31 broker-dealer firms had failed to submit their advertising and sales literature to NASD as required. If these materials had been submitted for review, it is likely that the firms would have been advised of potentially misleading or exaggerated statements or other concerns.

- **Many examinations found indications that firms had poorly supervised these sales seminars.**

One of the most frequent deficiencies cited during the examinations was inadequate supervision of employees who held sales seminars. Examiners found weak supervision during 65 of the 110 (or 59%) examinations conducted. In the other 45 examinations, firms appeared to have implemented adequate supervisory controls over sales seminars.

During the 65 examinations in which deficiencies were found, examiners identified 102 instances in which firms did not appear to have supervised their employees in a manner that was consistent with supervisory requirements under the securities laws and SRO rules. A frequently found problem was that firms had either not established supervisory procedures, or had established procedures but did not put systems in place to properly supervise their employees who held sales seminars consistent with those procedures (in 44 of the 110 examinations, or 40%).

Examinations found deficiencies in several areas. These included: (1) a lack of written policies and procedures to address compensation received by the firm or its employees from issuers for selling the issuers' products; (2) a lack of written policies and procedures relating to the sales literature used at sales seminars; (3) not reviewing or approving materials provided to potential investors at sales seminars; (4) not reviewing incoming and outgoing correspondence; and (5) not adequately supervising branch managers who themselves sold securities to customers, and held sales seminars. Some examples follow.

⇒ *Lack of Policies and Procedures with Respect to Sales Seminars*

Examinations revealed many instances in which firms did not have specific policies and procedures with respect to sales seminars and/or communications with the public. Some firms did not require that all materials used to advertise the sales seminars, or used at the sales seminars be reviewed and approved by a supervisor prior to use. While it is impossible to determine what the outcome would have been had these firms had supervisory procedures in place, because these firms lacked supervisory procedures, it appears they did not provide adequate supervision over sales seminars. This lack of supervision may have allowed potentially exaggerated claims and misrepresentations to be made (which are described elsewhere in this report), and to go undetected by the firm's supervisors.

For example, a firm did not have procedures to monitor effectively the activities of employees in its branch offices concerning their communications with the public. Although the firm's managers knew that employees were conducting seminars, the firm did not have procedures that required that supervisors receive and approve in advance all of the sales literature that its employees distributed to the public. Other examples follow:

- A branch office did not maintain documentation evidencing approval for its registered representatives to hold sales seminars, or approval of the materials used. Dozens of sales seminars were held.

- A branch manager who maintained his own customer accounts (*aka*, a "producing" branch manager) conducted and approved his own seminars, and did not obtain review or approval by his supervisor.

- A firm's advertisement touted a 38% rate of return without any risk. When examiners requested a copy of the firm's approval of the advertisement, it could not be provided, suggesting a lack of supervision.

In a number of instances, examiners found deficiencies relating to the supervisory review of correspondence.[15] For example, at one broker-dealer firm, examiners found that 2 letters from customers authorizing the transfer of securities and funds had been altered. Specifically, the account numbers had been changed without evidence of customer approval. This could have been indicative of a possible attempt at theft. A registered principal had reviewed the correspondence, but failed to do anything about the alteration or even request an explanation as to why it was altered.

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15 In addition to the general requirement to establish, maintain, and enforce written supervisory procedures, broker-dealers must also establish procedures for the review and endorsement by a registered principal, of incoming and outgoing written and electronic correspondence of its registered representatives with the public (NASD Rule 3010(d)(1)). These procedures must be in writing and be designed to reasonably supervise each registered representative. Firms' processes must include methods of control over receipt and delivery of hard copy correspondence, communications received through facsimile transmissions and email (NYSE Rule 342.16 and 342.17 also address the review and approval of communications with the public).

⇒ *Problems with Supervision of Employees' "Outside Business Activities"*

At the outset of these examinations, regulators were concerned about the possibility that registered representatives or investment advisers may be holding sales seminars and selling products outside of their firms' supervisory controls. Thus, examiners paid particular attention to this issue.

To help ensure that broker-dealer firms can provide adequate supervision for the protection of investors, SRO rules address the business activities that can be performed by firm employees "outside" of their employment with a broker-dealer. These rules require that the employee provide notice to the firm, and the firm may also require approval of the employees' outside business activities (NASD Rule 3030 and NYSE Rule 346(b)).

Investment advisers registered with the SEC must implement policies and procedures reasonably designed to prevent violations of the Advisers Act by any of the adviser's supervised persons, including partners, officers, directors or employees of the investment adviser, or other person who provides investment advice on behalf of the investment adviser and is subject to the supervision and control of the investment adviser (under Rules 206(4)-7 and 202(a)(25) of the Advisers Act).

Most of the broker-dealer firms examined had procedures in place that addressed the outside business activities of employees. However, some firms had not actually implemented their own policies and procedures. For example, one firm required all of its registered representatives to complete a questionnaire on an annual basis disclosing their outside business activities. Its policies then required supervisory follow-up on certain outside business activities. In practice, however, the firm did not conduct any follow-up after its employees provided information about their outside activities.

Examinations also found a number of instances in which registered representatives and investment advisers hosted sales seminars and were ultimately selling investment products to the attendees of the seminars without their firms' knowledge of the seminars themselves. The registered representatives and investment advisers incorrectly considered these seminars to be "outside business activities," and thus outside the supervision and compliance controls of the firms. At one firm, for example, a registered representative, who was also a mortgage broker, hosted seminars on the subject of mortgages and then also sold securities products to the seminar attendees. These seminars were not supervised by his firm.

- **Some examinations found indications that registered representatives or investment advisers holding the sales seminars had recommended investments that did not appear to be suitable for the individual customers/clients.**

As described in this report, sales seminars are often used to attract new customers and clients. When opening a new account, customers complete a new account form with a broker-dealer, or sign an investment advisory contract with an investment adviser. As part of this process, a broker-dealer or investment advisory firm will obtain information about the customer/client and his/her investment objectives, risk tolerance, time horizon for investments, and overall investment needs. This information assists the firm in ensuring that the recommendations made are suitable for the particular customer or client in light of their age, income, net worth, investment experience and risk tolerance. The determination about whether a particular investment product is suitable is based on the particular investor and his or her individual investment objectives.

During each examination, examiners reviewed account documents and other information maintained by the firm about a sample of customers to evaluate whether the investments that were recommended to customers appeared to be suitable. Examiners' primary focus was on accounts that were opened by attendees at the seminars, though examiners also reviewed other accounts when appropriate.

In some examinations, examiners found indications that apparently unsuitable recommendations to purchase investments were made at the sales seminars, or following the seminars, when an attendee opened an account. Examiners had concerns about the suitability of products recommended in 25 of the 110 exams conducted, or in 23% of the examinations conducted.

Examiners noted concern that some firms may not be adequately considering the individual needs and circumstances of each customer when determining whether a product was suitable for that customer. For example, at one broker-dealer, examiners noted that the same investment objective was identified on almost every new account form in one branch. Despite differences in the customers' ages, net worth, income levels and investment experience, almost every new account form indicated that the customers had "growth" and "growth with income" as their investment objectives. Almost every customer was invested in the same annuity product, and in the same three sub-accounts. These investments suggest that all customers were treated the same way when the firm was recommending investments, instead of in accordance with their unique needs in light of the variances in their ages, net worth, incomes, and investment experiences. At another broker-dealer, examiners noted four senior investors whose stated incomes and net worth did not meet the requirements of the products they were sold.

Examiners also found situations in which specific products and types of accounts were recommended to individual seniors, which may have been unsuitable or inappropriate for these particular customers. We note that these products and accounts are suitable and appropriate for some investors, but are not suitable and appropriate for others in light of their investment objectives, the time horizon for investment, or the risk involved. Examples follow.

⇒ *Variable Annuities*

Variable annuities are generally considered long-term investment vehicles, and therefore, the investor's time horizon for holding the investment and the investor's liquidity needs are particularly relevant in determining whether it is a suitable investment. Also relevant is whether the investor already holds a variable annuity investment, and whether the various features and costs make the product suitable in light of the investors' existing holdings. In particular, firms are required to ensure that a new variable annuity is suitable when recommending that an existing variable product be "exchanged" for a new one. A replacement that doesn't improve the customer's existing position, and that is designed merely to generate new sales commissions, would be prohibited by NASD rules (Rule IM-2310.2).[16]

At one firm, a review of account records for a sample of customers who had purchased a variable annuity based on the firm's recommendations indicated that 66% of the customers had sold a variable annuity in order to purchase a new one, and that most of the customers had investment time horizons of 3-5 years or less (including some with horizons of 1-3 years). Because of the significant surrender fees that are charged to customers who sell their variable annuities within a certain time-frame (usually within seven years of purchase), these products did not appear to be suitable for these customers.

At another firm, a registered representative recommended that a customer invest approximately 80% of his stated net worth in variable annuities. To finance the purchase of these variable annuities, the registered representative recommended that the customer sell his existing investments that were providing greater diversification, liquidity and annual income to his portfolio. The customer's previous portfolio holdings also included a variable annuity with a death benefit valued at over $30,000, income-producing investments such as investment grade corporate bonds, preferred stock, and money market funds. Based on the customer's other diversified portfolio holdings, and the customer's investment objectives of growth and income, the recommendation to sell virtually all of the customer's assets and purchase a variable annuity appeared to be unsuitable.

⇒ *Real Estate Investment Trusts*

At one firm, examiners found that registered representatives recommended that customers with a conservative investment objective and risk tolerance invest in a real estate investment trust, which was an illiquid and speculative investment. The prospectus for the investment stated that "these investments entail a high degree of risk, are long term investments and are suitable if investors have no immediate need for liquidity or can bear the complete loss of the investment." Because of the lack of liquidity, high degree of risk and long term nature of the investment, these investments appeared to be unsuitable for customers with conservative investment objectives.

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16 "*NASD Regulation Reminds Members And Associated Persons That Sales of Variable Contracts Are Subject to NASD Suitability Requirements*" (Oct. 1989) NASD Notice to Members 96-86, available at: http://www.finra.org/web/groups/rules_regs/documents/notice_to_members/p004697.pdf FINRA has proposed a new rule that would create requirements for recommendations, review by a principal, and supervisory and training requirements tailored specifically to transactions in deferred variable annuities (proposed Rule 2821).

⇒ *Low-rated Municipal Bonds*

At one firm, a registered representative recommended that two senior investors with conservative investment objectives purchase non-rated and low-rated municipal bonds. One investor purchased multiple issues that subsequently went into default or that failed to pay interest. The non-rated municipal bonds represented approximately 80% of her stated liquid net worth. In another instance, a retired over 70 year old investor with a primary objective of income and a liquid net worth of between $25,000 and $49,999 had the majority of his liquid net worth invested in non-investment grade speculative bonds. These investments may not have been suitable for these customers.

⇒ *Collateralized Mortgage Obligations*

At one firm, several registered representatives had recommended that customers with conservative investment objectives purchase certain collateralized mortgage obligations (CMOs) with high degrees of risk (based on the particular tranches being sold). In some cases, the customer accounts used high percentages of margin to purchase the securities. In addition, these CMO positions were being actively traded in the customer accounts, generating significant commissions for the registered representatives involved. These transactions appeared to be unsuitable for the particular customers involved.

⇒ *Fee-Based Accounts*

Financial services firms offer different types of accounts to customers. In particular, in recent years, fee-based accounts have become a popular account choice, and have been offered by broker-dealers and investment advisers. In a fee-based account, a customer pays a fee based on the amount of assets in the account. In a commission-based account, a customer pays a commission charge on each transaction.[17]

Prior to opening a fee-based account for a customer, a broker-dealer must have reasonable grounds to believe that such an account is appropriate for that particular customer (under NASD NTM 03-68 and NYSE Rule 405A). In addition, broker-dealers must disclose all material components of the fee-based program to the customer, including the fee schedule, the services provided and the fact that the program may cost more than paying for the services separately (under NASD NTM 03-68). It may be inappropriate to place a customer in an account with a fee structure that reasonably can be expected to result in a greater cost than an alternative account offered by the firm (under NASD NTM 03-68, NYSE Rule 405A).

[17] In a recent decision, the Court of Appeals for the District of Columbia Circuit vacated Rule 202(a)(11)-1 under the Advisers Act, which provided, among other things, that fee-based brokerage accounts were not advisory accounts and were thus not subject to the Advisers Act. Financial Planning Ass'n v. SEC, 2007 U.S. App. LEXIS 7356, 482 F.3d 481 (D.C. Cir. 2007).

Examiners found indications that fee-based accounts may have been recommended to customers for whom they may not have been appropriate. At one firm, a registered representative recommended a fee-based account to a senior investor. The account charged a fee of 1.838% of assets under management. This customer's account had no transactions, and held three variable annuities, which had separate, total internal management costs of approximately 3% of the assets. The customer was being charged two levels of fees on the same assets, once by the insurance company for management fees and again by the broker-dealer for the account fee. This type of account may not have been appropriate for this particular customer, in light of her investment objectives and the portfolio holdings.

⇒ *Recommendations that Customers Use Equity from their Homes*

Regulators have urged caution about recommendations that investors, especially senior investors, obtain loans on their homes in order to finance the purchase of securities. By doing so, customers may suffer investment losses that could result in their inability to pay off the loans on their homes, and ultimately, risk the loss of their homes altogether.[18]

In one examination, an investment adviser had recommended that senior investors obtain mortgages or refinance their homes and liquidate their existing retirement accounts, in order to purchase equity-indexed universal life insurance (EIUL) policies. This investment strategy speculated that the rate of return earned on the EIUL policy would exceed the cost of the new mortgage on the client's home. Dozens of senior investors followed this advice and effectively mortgaged 100% of the value of their homes. This type of investment strategy may not have been suitable for individuals on a fixed income because if the market index failed to perform, the policy provided a low return, and the client remained responsible for the annual mortgage cost and insurance premiums associated with the EIUL policy. In addition, the adviser's seminar materials only provided a positive analysis of potential returns that could be earned by clients and did not appear to offer discussion of any risk factors in using this investment strategy. This may have been an unsuitable high-risk investment strategy for these clients.

- **In some instances, the sales seminars may have involved fraud.**

Examiners found indications of possible fraudulent practices in 14 examinations (or 13% of the examinations conducted). These involved potentially egregious misrepresentations of risk and return, liquidation of accounts without the customer's knowledge or consent, and sales of fictitious investment notes. Some instances of apparent fraud are described below. In total, 25 of the 110 examinations (or 23%) are under review for possible further investigation or action by a state, FINRA or SEC.[19]

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18 *See* NASD Investor Alert, *Betting the Ranch: Risking Your Home to Buy Securities* (March 15, 2004), available at http://www.finra.org/InvestorInformation/InvestorAlerts/MarginandBorrowing/BettingtheRanchRiskingYourHometoBuySecurities/P005961; NASD Notice to Members 04-89, *available at* http://www.finra.org/RulesRegulation/NoticestoMembers/2004NoticestoMembers/P012715.

19 Many examinations had multiple dispositions. For example, a deficiency letter may have been

It is important to note that the types of potentially fraudulent conduct identified in these examinations are not limited to sales seminars; rather, the types of potential frauds described below are similar to the types of fraud perpetuated against seniors and other types of investors through means other than sales seminars. Indeed, securities regulators have brought numerous enforcement actions involving these types of frauds.[20]

⇒ *Possible Misrepresentations about Risk and Expected Returns*

Several examinations uncovered instances where registered representatives or investment advisers may have overstated the potential benefits of a product or failed to disclose important risks for investors. In one instance, for example, the firm's seminar advertisement indicated that customers could earn up to a 38% rate of return without any risk, and incorrectly implied that fixed annuities were guaranteed by the government.

⇒ *Liquidating Accounts Without Investor Knowledge or Consent*

In another examination, examiners found that an investment adviser had liquidated clients' investments and used the proceeds to purchase potentially unsuitable investments apparently without the client's knowledge or consent. The investment adviser conducted seniors-only seminars at hotels, offering retirees free breakfast and financial advice. He used marketing materials that claimed to teach seniors how to eliminate taxes on IRA accounts, reduce or eliminate taxes on social security income, and increase yields on investments from 20% to 300%. After the seminars, the investment adviser scheduled one-on-one meetings with interested individuals on the pretext of preparing a financial plan for them. During these meetings, the investment adviser may have misled seniors into signing several blank authorization forms, claiming that he needed the forms to obtain additional financial information. Instead, the financial plans appear not to have

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provided to the firm requesting corrective action, and findings from that exam may also have been referred for possible disciplinary or enforcement action.

[20] *See, e.g.*, SEC v. C. Wesley Rhodes, Jr., et al., SEC Lit. Rel. No. 20144 (June 5, 2007) (defendants allegedly defrauded seniors of $38 million by misrepresenting stock and bond purchases); SEC v. One Wall Street, Inc, et al, SEC Lit. Rel. No. 20123 (May 22, 2007) (defendants allegedly defrauded seniors of at least $1.6 million through false and misleading statements regarding investment risks); SEC v. Empire Development Group, et al., SEC Lit. Rel. No. 20122 (May 18, 2007) (defendants allegedly defrauded unsuspecting senior investors with limited means of nearly $2 million through the sale of unregistered securities in bogus real estate development companies); *Citigroup Global Markets to Pay Over $15 Million to Settle Charges Relating to Misleading Documents and Inadequate Disclosure in Retirement Seminars, Meetings for BellSouth Employees*, FINRA News Release (June 6, 2007), *available at* *http://www.finra.org/PressRoom/NewsReleases/2007NewsReleases/P019240*; *NASD Investor Alert Warns Workers About Early Retirement Investment Pitches*, FINRA News Release (Sept. 14, 2006), *available at* *http://www.finra.org/PressRoom/NewsReleases/2006NewsReleases/P017386*; *Kenneth Edward Stephens*, Decision 06-216, 2006 WL 3900166 (N.Y.S.E. Hearing Board December 13, 2006) (defendant allegedly defrauded seniors of over $1.3 million through unauthorized trading); *David A. Noyes & Co., Inc.*, Decision 05-98, 2005 WL 3439785 (N.Y.S.E. Hearing Panel November 9, 2005) (defendant allegedly made unsuitable sales of variable annuities to unsuspecting seniors resulting in a loss of approximately $375,000).

been created, and it appears that the investment adviser later completed the forms in order to liquidate the clients' existing portfolios and purchase equity-indexed annuities, without the knowledge, authorization, or consent of each of the clients.

⇒ *Possible Fraud in the Sale of Oil and Gas Partnerships*

At one firm, examiners discovered that the broker-dealer was involved in an apparent scheme that targeted elderly investors by selling unsuitable, unregistered oil and gas partnerships. The partnerships were sold through sales seminars. As part of this scheme, it appears that investors' funds may have been misappropriated. It also appears that the broker-dealer may have made misrepresentations regarding the risks involved with these partnerships, stating that they were safe investments that would generate an income of 10-12%, with minimal risk. It appears that approximately $10 million was raised from dozens of elderly retired investors. This registered representative may have made material misrepresentations and omissions to investors concerning the value, nature and/or disposition of their purported investments by reflecting the market value of these partnerships as the original principal invested. The market value was not ascertainable because a ready market did not exist for such securities.

⇒ *Sales of Fictitious "Notes"*

At another firm, examiners found indications that a registered representative, who conducted business out of a retirement community, may have sold a non-existent investment to a senior investor for approximately $10,000. The investor was told that her money would be loaned to real estate developers, when the money may have been used for personal expenses of the registered representative, mostly to repay trading losses he had incurred years prior, as well as interest on those losses.

V. CONCLUSION

The results of these examinations lead regulators to conclude that financial services firms should take steps to supervise sales seminars more closely, and specifically take steps to review and approve all advertisements and sales materials for accuracy and to ensure that they do not contain exaggerated or misleading claims. In addition, firms should redouble efforts to ensure that the investment recommendations they make to seniors are suitable in light of the particular customer's investment objectives. With the growing senior demographic, firms might consider specific training for their registered representatives and investment advisers regarding sales to senior investors.

Regulators have compiled a list of supervisory practices that have been identified during examinations and that appeared to be effective, which is included in Appendix B of this report. This information may assist firms in considering their own supervisory practices with respect to sales seminars. Regulators further urge financial services firms to take steps to assure that supervisory procedures with respect to sales seminars are being implemented effectively.

Regulators participating in these examinations will continue to focus examination, enforcement and regulatory efforts on the use of sales seminars targeted to seniors.

In addition, regulators conclude that, because seniors are targeted as attendees for sales seminars, ongoing investor education efforts for seniors should provide education with respect to “free lunch” sales seminars. Specifically, senior investors should understand that these are *sales* seminars -- that is, they are intended to result in the sales of financial products, and they may be sponsored by an undisclosed company with a financial interest in product sales. Investor education efforts should emphasize that, despite the claims of urgency that are sometimes made by sponsors of sales seminars, and in light of the possibility of misleading or exaggerated statements or claims about investment products or the expertise of the financial adviser, investors should take time to research the firm, the financial adviser as well as the product being offered before opening an account or making a purchase. Regulators make a variety of tools available to investors to assist them in understanding investment products and investigating a broker or other financial professional before investing, and many of these tools are listed in Appendix C to this report.

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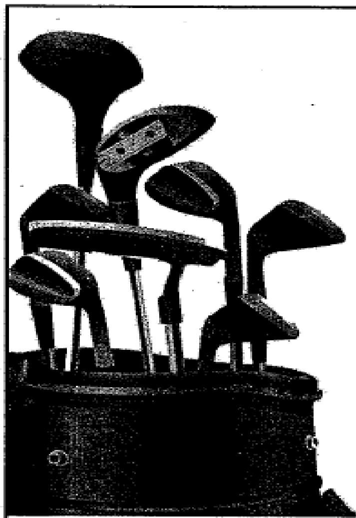
APPENDIX A

SAMPLE ADVERTISEMENTS

This appendix contains a sample of advertisements (many of which appeared in local newspapers and mass-mailed invitations) soliciting attendance at sales seminars. They are included as illustrative examples of the types of advertisements commonly used. Including them in this report does not indicate that they contain either accurate or inaccurate statements. The names of the sponsors, addresses, telephone numbers and other identifying information have been redacted.



FREE FOOD. FREE GOLF. FREE DRINKS.

It doesn't get any better than this!

JOIN US FOR GOLF NIGHT TUESDAY, MARCH 14, 2006

Enjoy a beautiful sunset!
Enjoy a complimentary gourmet dinner!
Enjoy an open bar!
And...

A special presentation on advanced estate and financial strategies for wealth retirees ages 70-85. This presentation is appropriate for those with a net worth of $3 million or more. It will be held at the finest penthouse office in all of South Florida — [redacted]

Attendees will receive...

- Priceless information
- An incredible dining experience
- A free sleeve of Titleist, Callaway or Nike golf balls
- A chance to win a free set of Callaway golf clubs

Presentation begins at 5pm...

- Followed by gourmet dinner
- An incredible sunset
- And free golf equipment

SEATING AVAILABLE TO FIRST 40 CALLERS. PLEASE RSVP 1-888[redacted]

The Experts in Retirement Income Planning

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How To Avoid the Costly Mistakes That Cause Retirees to Lose Their Financial Independence

8 Strategies to Protect Your Financial Security

We are conducting an informational workshop that covers many topics related to your retirement. NO, this is not another presentation by your local brokerage firm about investing. **There will be nothing sold at this workshop.** Our speaker will inform you about recent changes in Federal and State laws and show you how to avoid the biggest financial mistakes seniors make.

I would like to personally **invite you and up to three guests** to attend this workshop designed exclusively for seniors. As usual, when the government changes laws that apply to you, they do not personally notify you. You will learn about...

- **TAXES:** Lower or eliminate taxes on Social Security, Interest Income, Capital Gains, and taxes upon death.
- **INCOME:** Learn the techniques to increase your spendable income.
- **PROBATE:** Become aware of critical facts regarding Trusts and Lawsuits.
- **TOD and POD:** Learn how these can benefit seniors.
- **S-T-R-E-T-C-H IRAs:** How to prevent your IRA from becoming an Internal Revenue Account upon death.
- **ANNUITIES:** What are the Pros and Cons?
- **LOST MONEY IN THE MARKET?** Learn what you can do about it!
- **NO LONG TERM CARE?** Learn how you can protect your assets from a nursing home situation without expensive insurance!

Due to the popularity of this workshop, available seating is limited and reservations are required. Please respond immediately to guarantee a seat.

Monday
June 19, 2006
11:00 am & 3:00 pm
(meal following)

OR

Tuesday
June 20, 2006
11:00 am
(meal following)

LOCATION

[redacted]*Cafeteria*
[redacted]

Seating is limited. To make your reservations, call Toll Free 1-877-[redacted] (24 Hours)

PS: THE LAST WORKSHOP WAS FULL. IT COULD CHANGE YOUR LIFE!
(NOTE: LAWYERS, BROKERS, CPA'S OR ADVISORS MAY NOT ATTEND AS SPACE IS NEEDED FOR SENIORS.)

The presenter, speaker and sponsor of this information is a licensed, independent Insurance agent. The presenter, speaker and sponsor of this information (Invitation) as well as the information presented at the seminar is not related to, endorsed by, nor connected with and not approved by any Government Agency or organization. Although the seminar is providing information of value for consumers, the seminar is a solicitation for Insurance products such as Medicare supplements, Long Term Care Insurance, Life Insurance & Annuities. Some of the Insurance Companies that the licensed agent represents are [redacted]

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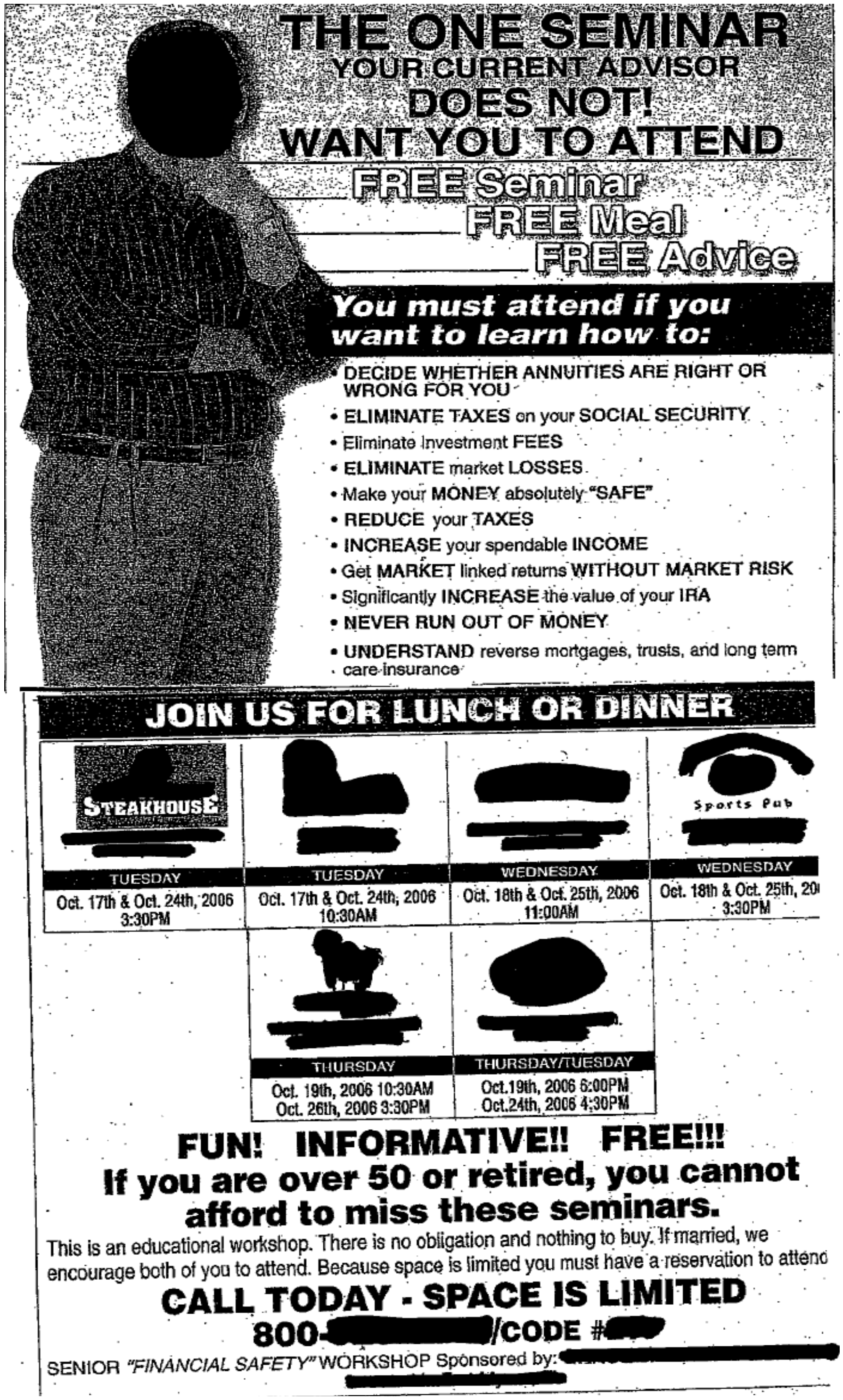

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FINALLY, A DIFFERENT SEMINAR!

If you own a mutual fund you must attend!

QUESTION? Is your mutual fund really performing as well as you think?

FACT: There are Mutual Funds that have an average annual return in excess of **12%*** for the past 70 years!

Learn how we:

- Select the most consistent performers
- Explore the most cost effective means of acquiring funds
- Choose the best money managers on Wall Street
- Use methods to minimize income tax consequences**

Come join our FREE Workshop with Lunch to follow

Wednesday, July 13	Thursday, July 14	Friday, July 15
11:00-12:30	11:00-12:30	11:00-12:30
[redacted]	[redacted]	[redacted]
Lunch to be served	*Lunch to be served*	*Lunch to be served*

Seating is limited.

Please call [redacted] or [redacted] at [redacted] for a reservation, 24 hours, 7 days a week

PLEASE BRING A COPY OF YOUR EXISTING MUTUAL FUND STATEMENTS FOR AN EYE OPENING ANALYSIS

[redacted]

Investment decisions by [redacted], Inc. are made based on a client's specific investment objective, time horizon and risk tolerance. Information may not be [redacted] investors. Investments offered may involve risks, including [redacted]rincipal. Past performance does not guarantee future [redacted] Consult your Registered Representative a[redacted] for more information. *Source from [redacted] the composite listings dated 07/31/2004 based on [redacted] **We do not provide tax advice; re[redacted]

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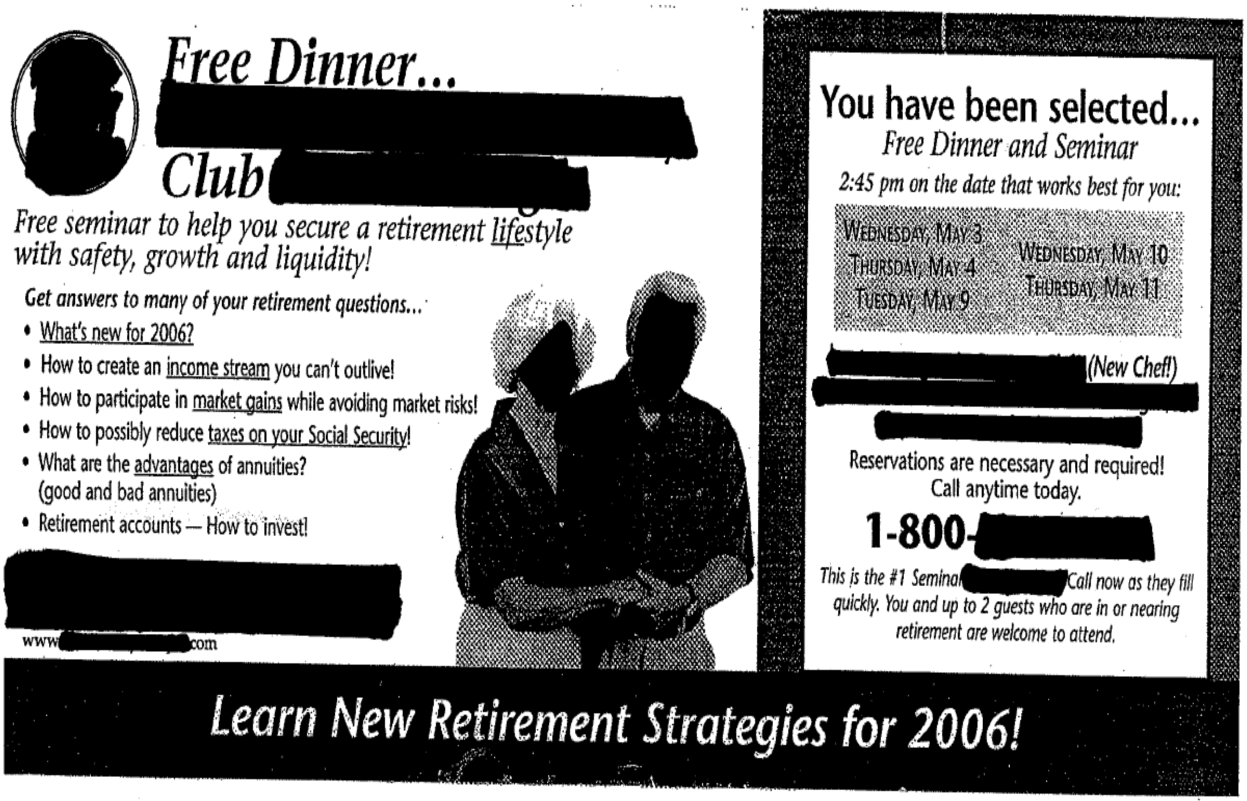

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Senior Financial Preservation Workshop

Are You Dissatisfied With Your Investment Performance?

If you are retired or nearing retirement, this is the one workshop you cannot afford to miss!

You and a guest are cordially invited to attend a
FREE SENIOR FINANCIAL PRESERVATION WORKSHOP.
Your lunch and program are
ABSOLUTELY FREE.
No products will be sold.

During the workshop we will discuss several areas that affect today's retirees.

Including:

- The most up to date Medicare information and recent changes
- Wills and Trusts
- Long-Term Care Insurance and is it right for you
- How to protect your assets from catastrophic illness and nursing home costs WITHOUT the high cost of long term care insurance
- How to earn Stock Market Linked Gains without Market Risk
- How to double, even triple your returns on what your CDs (certificates of deposit) are paying with no risk to your principal
- How to minimize taxes on your Social Security Income
- How to protect your assets from PROBATE
- How to increase your net worth
- Answers to YOUR most important retirement concerns

[redacted]
[redacted]
Monday, April 17th
Workshop begins at 11:00 a.m.
Lunch will be served immediately after the workshop.

[redacted]
[redacted]
Monday, April 17th
Workshop begins at 2:00 p.m.
Dinner will be served immediately after the workshop.

Brokers & Insurance Agents cost: $750.00

Seating is limited and reservations are required.
Call the 24-Hour seminar reservations hotline to make your reservation TODAY. Call NOW!!
TOLL FREE 1-800-[redacted] ext. 200

[redacted]

IF YOU ARE 50 OR OVER, DON'T MISS THIS FREE INFORMATION WORKSHOP!

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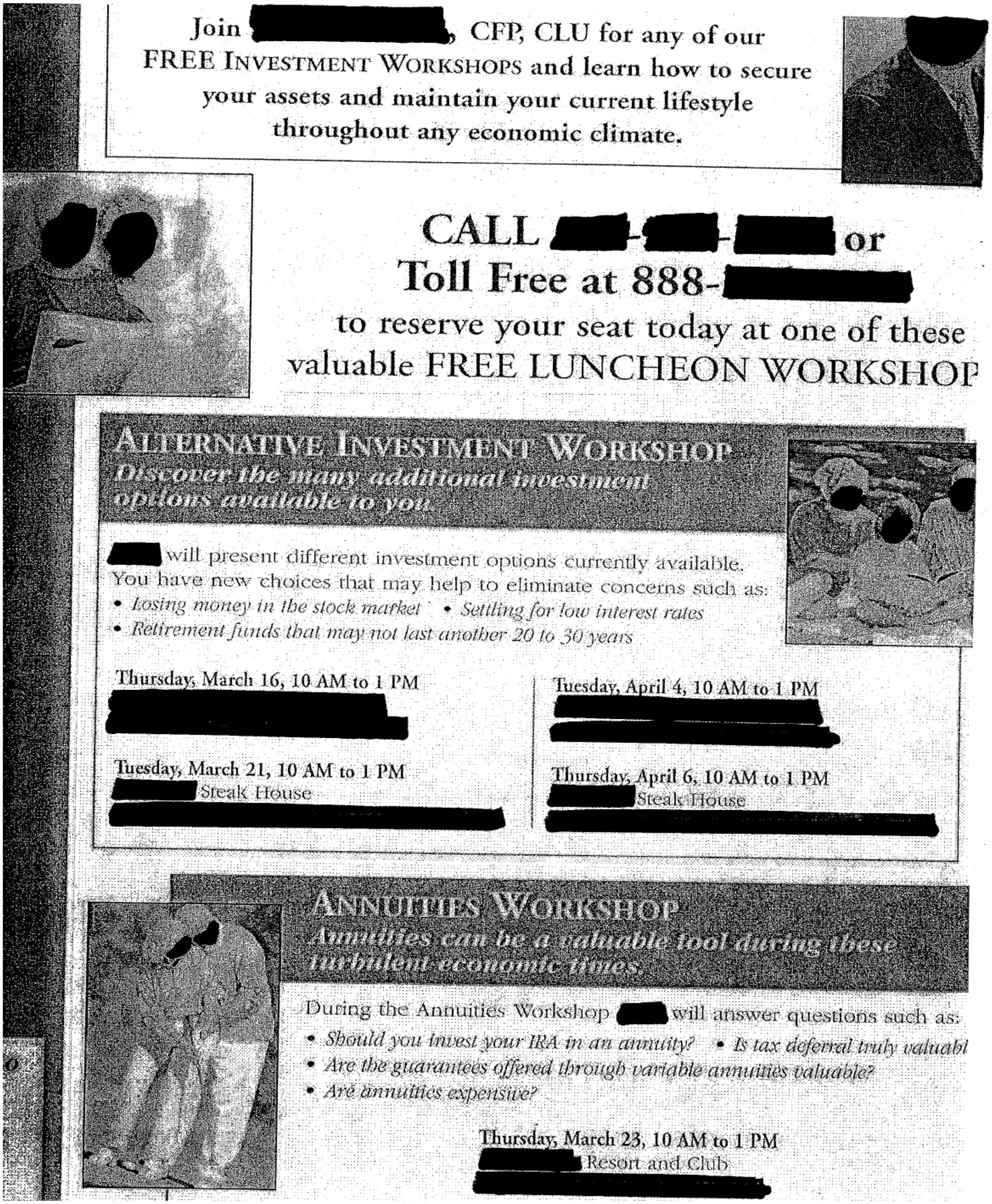

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[redacted] Cordially Invite You To Attend A Complimentary Dinner Workshop On:

FINANCIAL DEFENSE FOR SENIORS

If you're retired YOU'RE A TARGET and you cannot afford to miss this workshop!

This workshop is a broad collection of facts and circumstances intended to further educate you. Don't be fooled by workshops and seminars that focus on losing money to taxes and income increasing schemes. Often times, these seminars are geared toward funneling attendees into a single investment product that may be **very inappropriate.**

Call Today! As Seating Is Limited [redacted]

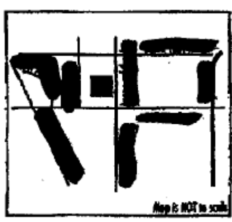
TOPICS TO BE DISCUSSED:

- What the true intentions of most seminar pitches really are.
- How financial "professionals" hide fees and commissions.
- What a real vs. a phony financial designation is.
- Why 99% of local seminars are attempting to sell Equity Indexed Annuities.
- The ANNUITY BONUS SCAM!
- Why so many " Financial Planners" call themselves President, CEO and/or Vice President of whatever company they represent.
- How many seminar presenters are just insurance agents masquerading as financial planners. The average person can study for 2 weeks and become an insurance agent.
- Why a revocable trust is not a "fix all."
- Why it takes more than one person to effectively manage your finances.
- Why REAL Financial Advisors have nothing to fear and why imitators are running for cover.

The Financial Defense For Seniors Workshop is Presented by [redacted] " Come hear facts, not smoke and mirrors - real life strategies on how to sift through the noise. This is an educational workshop with ABSOLUTELY no attempts to sell specific products. There is no cost or obligation to attend. We guarantee it will be time well spent.

Free Gourmet Meal immediately following the workshop!

DINNER	DINNER	DINNER
Tues., May 23, 2006	Wed., June 7, 2006	Wed., June 21, 2006
4:30 pm	4:30 pm	4:30 pm



Legal Counsel and Documents Prepared by.

[redacted]

LOCATION

[redacted] *Art Museum*

[redacted]

Spouses are urged to attend

No Brokers or Agents Admitted.

[redacted]

The Ethical Alternative

[redacted]

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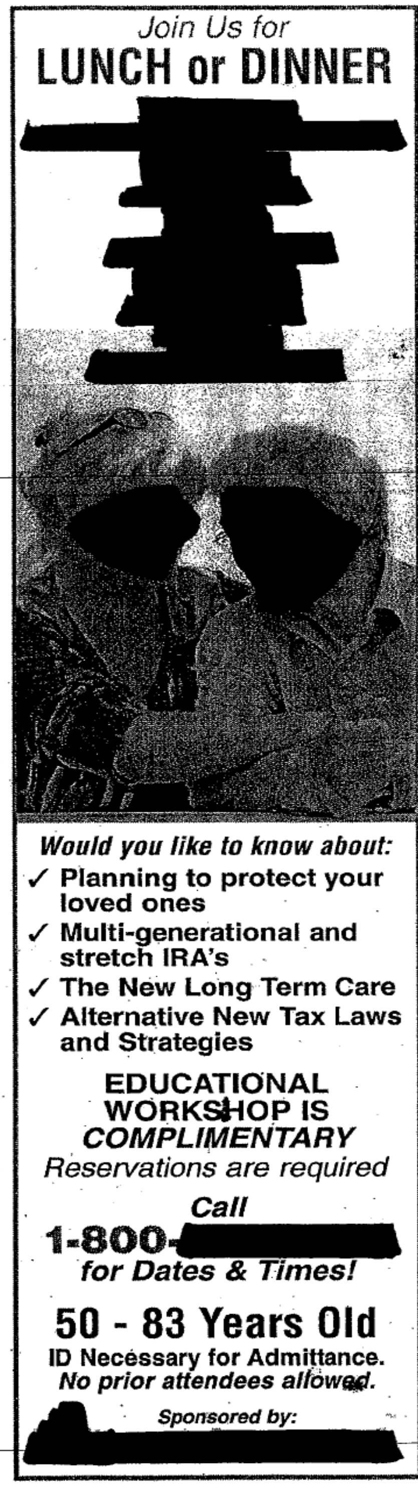

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[redacted]

Dinner Is On Us!

PRSRT STD
U.S. POSTAGE
PAID
[redacted]

Attn: Postmaster
Dated Material
[redacted]

[redacted]

Senior andVeterans Dinner 2006

Dinner Is On Us!

We would like to invite you to spend 60 minutes with The [redacted] **ADVISORY GROUP** as our guest for dinner. This dinner is by invitation only and is intended for persons age 60 and older that are interested in safely investing their retirment "nest egg".

LEARN THE FOLLOWING:

- ***Safety:*** *How to avoid losses on your investments, really!*
- ***Retired Veterans:*** *You may be eligible for $1,674 per month in unknown benefits!*
- ***CD Investors:*** *How to increase your CD interest rates!*
- ***Taxes:*** *How to reduce taxes on your social security, bank CD interest and others!*
- ***Fees:*** *How to eliminate the outrageous fees on your investments!*
- ***Creditors and Lawsuits:*** *How to protect your retirement "nest egg" with one simple beneficiary form!*
- ***Advanced Tax Planning:*** *$2 Million Estates and above - eliminate capital gain taxes!*
- ***Probate:*** *How to avoid probate expenses, time delays and lawyer fees at death!*
- ***IRA's and 401(k)'s:*** *Know your options!*

Your speaker will be [redacted]
"I enjoy helping retirees with financial decisions and protecting their retirement "nest egg". I would encourage you to attend and receive a valuable financial 2nd opinion."

As a **SPECIAL BONUS**, you will learn how you can earn a guaranteed 13.58% for the next 12 months.

Dinner Dates Available

Tuesday, April 18, 2006 - 3:00 p.m.
Wednesday, April 19, 2006 - 3:00 p.m.
Thursday, April 20, 2006 - 3:00 p.m.
(If married, both husband and wife should attend)
(Agents, Brokers, and Children Will Not Be Admitted)

[redacted]

Call
1-866-[redacted] (24 hrs)
Seating Is Limited And Fills Quickly
[redacted]

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[redacted]

DELIVERY CONFIRMATION NOTICE

Congratulations [redacted]

You are invited to join us for a <u>FREE LUNCH</u> *at* [redacted] immediately following our "<u>SECURE RETIREMENT & ESTATE PLANNING SEMINAR.</u>"

[redacted]

[redacted]

Tuesday, April 18th at 10:45 AM

OR

[redacted] COUNTRY CLUB

[redacted]

Wednesday, April 19th at 10:00 AM

<u>LEARN HOW TO</u>

* Reduce or Eliminate Social Security Taxes
* Protect your assets
* Participate in the Stock Market <u>without risk</u>
* Create income for life

DISCOVER THE FACTS AND STRATEGIES THAT WORK!

Presented by [redacted]

<u>Nothing</u> will be sold at this educational workshop.
There is <u>no cost or obligation</u>. <u>We guarantee it will be time well spent!</u>

Please RSVP to 1-800-[redacted]

All spouses are urged to attend. You may also invite a guest!

Call now, seating is limited! **Free Lunch!**

PLEASE RSVP

PRESORTED
FIRST CLASS
US POSTAGE
PAID
TAMPA, FL
PERMIT #78

FREE
Lunch at:

[redacted]

Tuesday, April 18th at 10:45am
or

[redacted]

COUNTRY CLUB
Wednesday, April 19th at 10:00am

COMPANY
[redacted]
STREET ADDRESS
[redacted]
CITY AND STATE
[redacted]
ZIP CODE
[redacted]

[redacted]

N1766--00002789

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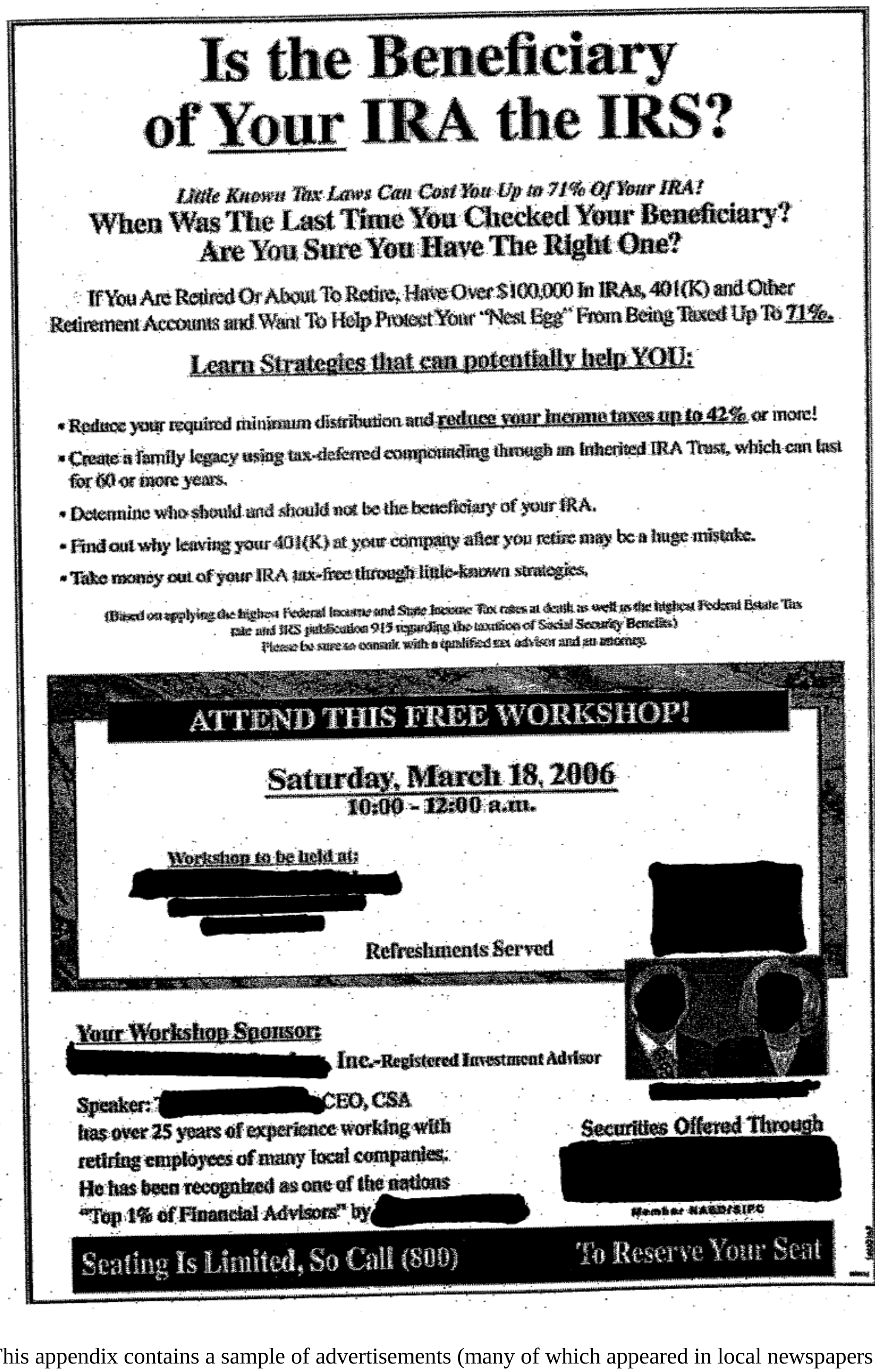

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SENIOR FINANCIAL SURVIVAL SEMINAR

2006 Income Tax Update, Probate Questions Answered and Federal & State Guidelines to Help Protect Your Assets from Nursing Home Expense.

If you are age 55 or over, don't miss this FREE information seminar that could help protect your financial future.

CONTENTS OF THIS SEMINAR

- ❑ How to protect your assets for your loved ones from catastrophic illness and nursing homes without purchasing nursing home insurance.
- ❑ Learn what is exempt from Nursing Home attachment.
- ❑ How Investments (Annuities, Life Insurance, CDs, etc.) are affected by the "Spend Down Process".
- ❑ How to lower your income taxes.
- ❑ Reduce taxes on your Social Security benefits.
- ❑ Learn how a Revocable Living Trust may help you.
- ❑ How to increase your spendable income.
- ❑ How to avoid probate.

There are federal laws that will enable you to avoid paying thousands of dollars out of your pocket for taxes, probate and nursing home costs. The government will not notify you of your eligibility. You must educate yourself.
Come join us for this important information.

Seating is limited – there is no admission charge!
No food – just the facts!

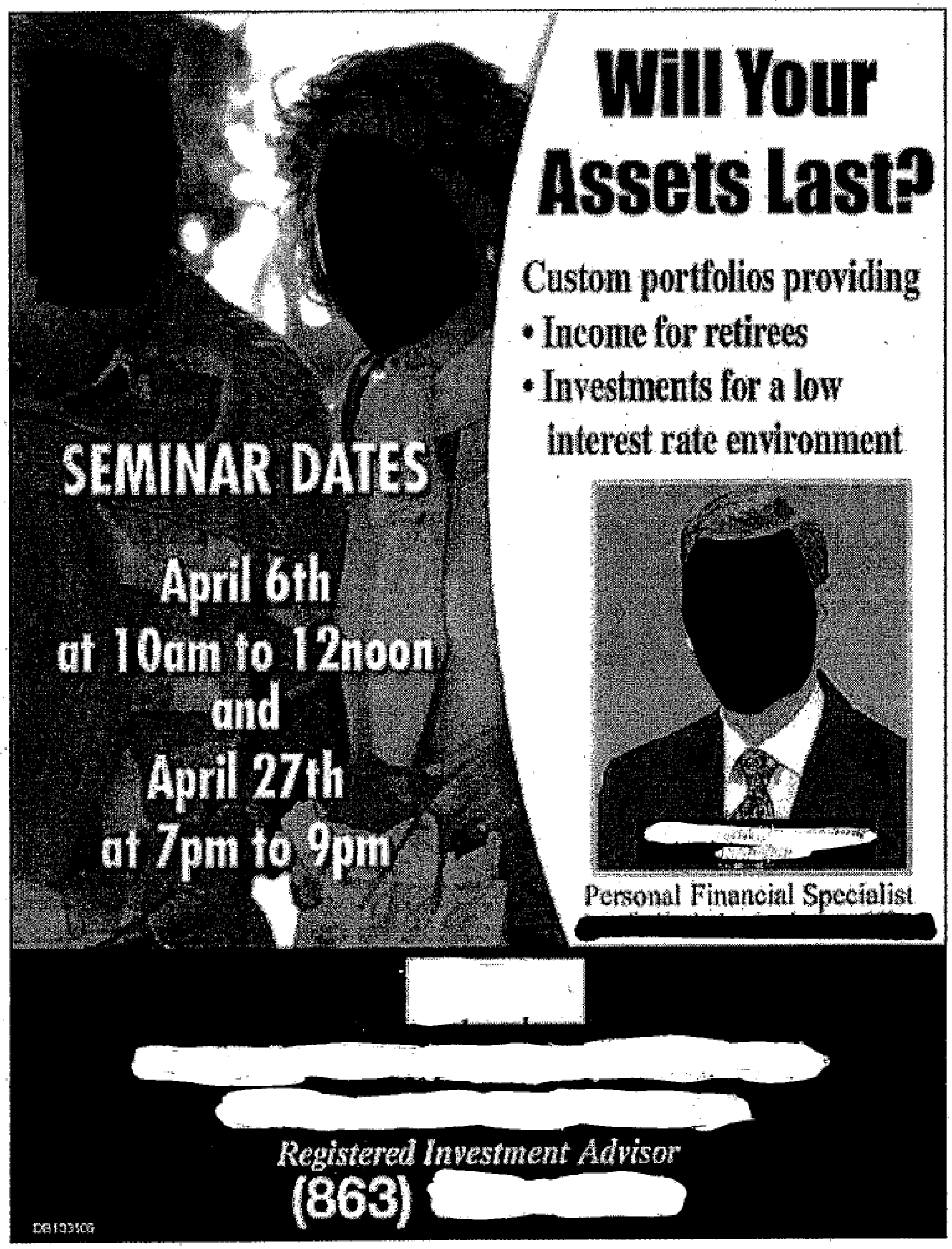
Nothing will be sold at this seminar! Please call to reserve your seat.

Call: 1-800-[redacted] Ext. 700

Time: 10:00 a.m.
When: Monday, April 3, 2006
Where: [redacted]

Sponsored by the [redacted] Call between 8:00 am and 8:00 pm.
Note: This seminar is free to the public. Insurance agents and financial advisors – $750 Admission Fee. We are members of the [redacted]

This appendix contains a sample of advertisements (many of which appeared in local newspapers and mass-mailed invitations) soliciting attendance at sales seminars. They are included as illustrative examples of the types of advertisements commonly used. Including them in this report does not indicate that they contain either accurate or inaccurate statements. The names of the sponsors, addresses, telephone numbers and other identifying information have been redacted.



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APPENDIX B

EFFECTIVE COMPLIANCE and SUPERVISORY PRACTICES

During examinations of securities firms that provided "free lunch" sales seminars and in other examinations, examiners took note of several supervisory and compliance practices that appeared to be effective in ensuring adequate supervisory oversight and compliance with the securities laws with respect to sales seminars. These practices are described below. While these practices are not specifically mandated by the securities laws, individually or in combination they may be helpful to consider as securities firms are reviewing their supervisory and compliance practices in these areas.

Supervision of Seminars and Advertising

Regulators noted the following practices that were used in supervising individual registered representatives/investment advisers who held sales seminars and for reviewing and approving advertising materials for the seminars:

- The process for reviewing and approving proposed seminars and the advertising and other materials for the seminars was centralized, and included a dedicated compliance person with knowledge of the securities laws and rules with respect to advertising materials. The firm's policies and procedures clearly set forth the process for proposing seminars and advertising materials, and they were made known to all firm employees. Supervisory reviews of advertising and sales materials generally identified disclosure mistakes and potential problem areas that were corrected prior to the time the advertising materials were to be used.

- Policies and procedures for submitting proposals for sales seminars included specific timeframes for supervisory review and approval. For example, the approval and review process for seminar and advertising material required submissions of all materials three to four weeks prior to the seminar date. This allowed adequate time for supervisors to review and correct disclosure issues and any other issues identified prior to the seminar.

- All advertising material was forwarded to the home office for review and approval prior to use. This firm required information on seminar guest speakers to be forwarded and approved as well.

- One firm had two levels of supervisory approval for seminars and all sales materials and advertisements to be used at those seminars. The branch manager review was the first level of approval. The materials were then sent to the main office to be reviewed and approved by the compliance department.

- Written guidance was provided to all individuals who may be involved in sales seminars – the registered representatives who conduct sales seminars, the branch office manager and other supervisors who review and approve the seminars and sales materials as well as any compliance staff who may also review the sales seminars and materials prior to use. The guidance provided clear explanations of what was permissible and what was not permissible, both in terms of compliance with the securities laws, and compliance with the firm's own policies.

- Written checklists were used to aid firm employees in reviewing and approving sales seminar advertisements and sales literature to ensure that the materials used complied with regulatory requirements and the firm's policies.

- One firm's procedures required that supervisors or compliance staff make written edits to proposed sales seminar materials or advertising, and required that this marked-up draft be provided along with a final copy of the materials (showing that the changes had been made) to the reviewing official for the permanent file.

- Standardized, pre-approved materials and advertisements were used for sales seminars. The firm's procedures required that all marketing materials be created at a central level; individual registered representatives were not involved in creating their own seminar materials or advertisements. Registered representatives also used a standard outline for seminars.

- Materials for sales seminars were maintained in a centralized location. A complete package of seminar and advertising materials were filed and maintained in one place, including a copy of the request to host the seminar with indications of approval by the branch office manager and any other authorized approving official. The file included the title of the seminar, date, location, speaker, any guest speakers, the company they represent, the date the approval was given and the list of people who were invited to attend the seminar. The file also contained a list of attendees, whether they were a client or prospect, a photocopy of the actual seminar ad that ran in the newspaper, the approved marketing pieces that were distributed at the seminar, approved copies of the slide presentation and any other information given to attendees.

- Branch managers were expected to attend a percentage of the sales seminars presented by the sales people they supervised.

- "Mystery shoppers" (who were firm employees) were utilized on a random basis to attend sales seminars and to identify potential disclosure and compliance weaknesses, and report any issues back to the direct supervisors of the seminar hosts.

- All registered representatives were required to certify to their branch manager each month that they had provided all advertisements, sales literature, and correspondence items used during the month.

General Supervisory Practices

- Procedures explicitly addressed the review and monitoring of communications with clients and prospective clients. For example, monitoring systems were in place to effectively detect problematic communications by registered representatives in e-mail communications.

- The supervising principal actively reviewed correspondence, made frequent inquiries and provided feedback to the employed representative. This involvement appeared to enhance the firm's ability to identify and prevent any sales practice issues that may exist, and also provided supervised persons with individual training and guidance through active supervisory feedback on their communications.

- Annual training programs provided thorough and clear information about compliant and non-compliant practices. Training did not simply recite rule requirements, but included examples that were relevant to the nature of the work performed by the employees being trained.

APPENDIX C

RESOURCES FOR SENIORS

- The SEC provides important information for senior investors including explanations of different products, asset allocation and risk. You can also get information on affinity fraud, "senior specialists" and investment advisers and what to look for to identify and steer clear of potential frauds. http://www.sec.gov/investor/seniors.shtml

- FINRA also provides important information for senior investors. Its website has such items as *Broker Check* – that gives you the ability to look up the history of your investment professional to see if they have prior complaints or problems: http://www.finra.org/InvestorInformation/InvestorProtection/ChecktheBackgroundofYourInvestmentProfessional/index.htm

  FINRA's website also has tools and resources to protect senior investors and help them make informed investment decisions, including "Investor Alerts" that provide timely information on steering clear of investment scams and problems instead of just dealing with their aftermath. Subjects of recent alerts include "*Look Before You Leave: Don't Be Misled by Early Retirement Investment Pitches That Promise Too Much," Annuities and Senior Citizens: Senior Citizens should be Aware of Deceptive Sales Practices when Purchasing Annuities," and "Seniors Beware: What you should know About Life Settlements."* http://www.finra.org/InvestorInformation/InvestorAlerts/index.htm

- The North American Securities Administrators Association (NASAA) also has helpful information available for seniors on its website: http://www.nasaa.org/Investor_Education/Senior_Investor_Resource_Center/

  Resources include: a quick checklist of questions to ask before you invest, 10 tips to protect your nest egg and guidance on where to turn for help.

- Regulators have warned that seniors may be confused by designations that imply some expertise in helping seniors. Information regarding professional designations is available through NASAA's Investor Alert is at www.nasaa.org, the SEC's information on professional designations at http://www.sec.gov/investor/pubs/senior-profdes.htm and NASD's professional designation database found at http://apps.finra.org/DataDirectory/1/prodesignations.aspx.

EXHIBIT 5

PROTECTING SENIOR INVESTORS: COMPLIANCE, SUPERVISORY AND OTHER PRACTICES USED BY FINANCIAL SERVICES FIRMS IN SERVING SENIOR INVESTORS

Securities and Exchange Commission's
Office of Compliance Inspections and Examinations,*
North American Securities Administrators Association, and
Financial Industry Regulatory Authority
September 22, 2008

Statistics show that baby boomers today control more than $13 trillion in household investable assets, or over 50% of total U.S. household investment assets.[1] Projections also show that nearly one in every six Americans will be 65 or older by the year 2020.[2] Given the increasing number of investors who will need advice and guidance, financial services firms are actively developing new products and seeking to provide financial advice and services to investors as they prepare for and reach retirement.

In light of these demographics, Staff at the Securities and Exchange Commission ("SEC"), the Financial Industry Regulatory Authority ("FINRA") and the North American Securities Administrators Association ("NASAA") view the protection of senior investors as a top priority. While securities regulators have long focused on the senior population and its particular vulnerability to fraud and abuse, beginning in 2006 securities regulators expanded collaborative efforts aimed at protecting seniors by providing educational programs targeted to senior investors, conducting focused examinations of financial services firms doing business with senior investors, and prosecuting numerous investment scams preying on senior investors.[3] Securities regulators have also provided information and guidance to financial services firms regarding senior investors.[4] These efforts are part of our shared mission to protect senior investors.

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* This is a report of the Commission's Staff, FINRA and NASAA, and does not reflect the views of, or include findings or conclusions by the Securities and Exchange Commission.

1 "*Retirement of boomers will create market for advisers*" by Sue Asci, InvestmentNews, November 5, 2007. http://www.investmentnews.com/apps/pbcs.dll/article?AID=/20071105/FREE/711050311/-1/INIssueAlert.

2 U.S. Census projections as of August 2008, available at http://www.census.gov/population/www/projections/files/nation/summary/np2008-t2.xls. At year end 2007, approximately 38 million people were 65 or older. By 2020, they will number almost 55 million people.

3 On July 17, 2006, the SEC held its first "Seniors Summit" to examine how regulators and others could better coordinate efforts to protect older Americans from investment fraud. http://www.sec.gov/news/press/2006/2006-109.htm.

4 See: "*Protecting Senior Investors: Report of Examinations of Securities Firms Providing 'Free Lunch' Sales Seminars*" (Joint Report of SEC Staff, NASAA, and FINRA, September 2007) http://www.sec.gov/spotlight/seniors/freelunchreport.pdf; "*Senior Investors: FINRA Reminds Firms of Their Obligations Relating to Senior Investors*," (Regulatory Notice 07-43, September 10, 2007) http://www.finra.org/RulesRegulation/NoticestoMembers/2007NoticestoMembers/P036815; and

As part of this ongoing effort, in February 2008, the SEC Staff, NASAA and FINRA undertook a new initiative to identify and publish examples of practices that financial services firms have developed with respect to their interactions with senior investors. To that end, we invited securities professionals, financial services firms, and industry groups to voluntarily share their practices with us.[5] A cross-section of firms and financial services industry groups and others chose to participate in this effort, including broker-dealer and investment advisory firms, larger firms and smaller firms, and firms with a variety of organizational structures. We gratefully acknowledge their contributions and their commitment to work with us on this initiative.

This Report summarizes practices used by financial services firms and securities professionals in serving senior investors in the following areas:

- Getting started: how firms are thinking of ways to remodel their supervisory and compliance structures to meet the changing needs of senior investors;
- Communicating effectively with senior investors;
- Training and educating firm employees on senior-specific issues (such as how to identify signs of diminished capacity and elder abuse);
- Establishing an internal process for escalating issues and taking next steps;
- Encouraging investors of all ages to prepare for the future;
- Advertising and marketing to senior investors;
- Obtaining information at account opening;
- Ensuring the appropriateness of investments; and
- Conducting senior-focused supervision, surveillance and compliance reviews.

By sharing this information, we hope to provide practical examples to firms that are seeking to strengthen their infrastructure to assist them in working with senior investors in an ethical, respectful and informed manner. This Report does not create or modify existing regulatory obligations with respect to senior investors. It also does not catalog the full range of compliance practices applicable to senior investors. Rather, this Report focuses on specific, concrete steps that firms are taking to identify and respond to issues that are common in working with senior investors. By sharing this information, we also hope that financial services firms will continue to identify and implement additional practices to help ensure that the financial services industry continues to consider the particular needs of senior investors.

I. The Challenges

Any discussion about seniors raises the obvious question of who, exactly, is a "senior investor." Because investors of any age do not necessarily share the same characteristics, investment objectives, risk tolerances, or financial profiles, any definition of the term "senior investor"

NASAA's proposed model rule on the use of senior-specific certifications and professional designations (April 1, 2008) http://www.nasaa.org/NASAA_Newsroom/Current_NASAA_Headlines/8423.cfm.

5 "*Notice of Solicitation of Public Views Regarding Practices Being Developed to Deal with the Increasing Number of Senior Investors*" (SEC Release No. 34-57308, February 11, 2008) http://www.sec.gov/rules/other/2008/34-57308.pdf

would be either under-inclusive or over-inclusive. Thus, we do not define "senior investor" by reference to a specific age, but rather use the term to include investors who have retired or are nearing retirement.

An investor's age and life stage are critical components of an investor's profile and firms cannot meet their regulatory obligations without considering these factors.[6] Nonetheless, issues such as diminished mental capacity may be more prevalent among older investors and older investors may also be more frequent targets for financial abuse.

It is also important to note that not all firms are alike, and therefore practices that may make sense for one firm may not make sense for another. Our meetings with firms have demonstrated however, that there are certain issues and challenges that many firms commonly encounter in working with senior investors. Some of those issues relate to meeting regulatory obligations, such as assessing the appropriateness of an investment for investors at different stages of life, or marketing retirement products to investors who are at or near retirement age. Other challenges, such as recognizing the signs of diminished capacity or financial abuse, are not unique to the financial services industry. We have included in this Report examples of various steps that firms are taking to address these challenges because firms indicated to us that these issues are becoming increasingly common, and are of concern to the financial services industry. Ultimately, investors will benefit when financial services firms consider and address these challenges in a proactive way.

The following scenario, along with others provided throughout this Report, illustrates some of the challenges that firms face when working with senior investors and demonstrates the importance of taking steps to implement a program to address these issues.

Mr. Investor is a 76 year old widower. Bob Securities Professional has handled his investment portfolio for 25 years. His investment objective for the last 10 years has been to generate income. Recently, Mr. Investor told Bob Securities Professional that he wanted to generate higher returns from his account, and to change the beneficiaries on his IRA and Trust account from his children to his sister-in-law. Bob Securities Professional also began to notice that Mr. Investor didn't always return his telephone calls, which was unusual, as they spoke regularly over their 25 year relationship.

Bob Securities Professional is concerned about altering the investment strategy to take on more risk and also about changing the beneficiary of Mr. Investor's account under these conditions. Bob Securities Professional wonders what, if anything, he should do next.

[6] Generally, "life stage" refers to the key milestones in an investor's life, such as marriage, buying a home, saving for children's college education, preparing for retirement and retirement.

II. Practices Used by Financial Services Firms In Serving Seniors

During our meetings, many firms indicated that they have implemented and are implementing new processes and procedures aimed at addressing common issues associated with their interactions with senior investors. Some firms have indicated that they sought to consider a full range of issues, such as how to communicate effectively with senior investors; how to train and educate firm employees on senior-specific issues; how to establish an internal process for escalating issues and taking next steps when issues or questions are identified; how to encourage investors of all ages to prepare for the future; how to advertise and market to senior investors; obtaining information at account opening; how to ensure the appropriateness of investments; and how to conduct supervision, surveillance and compliance reviews focused on senior-specific issues.

A. Getting Started: How firms are thinking of ways to remodel their supervisory and compliance structures to meet the changing needs of senior investors

Some firms told us that they have sought to develop a consistent process for addressing senior-related issues throughout the firm. To accomplish this goal, some firms created internal working groups, task forces, or committees, while others have designated one or more individuals within compliance, legal or management to focus on senior-related issues. The role of these groups or designated individuals varies greatly among firms, and examples of their responsibilities, some of which already are required, include:

- Conducting an inventory of the firm's operations and identifying areas of the firm that need to emphasize investors' life stage issues.
- Reviewing the adequacy of existing policies and procedures within different areas of the firm that need to incorporate investors' life stage issues.
- Reviewing products for appropriateness for senior investors.
- Establishing age-based restrictions on certain products or product features.
- Reviewing the use of proposed senior designations.
- Reviewing and approving marketing materials aimed at senior investors.
- Developing firm-wide escalation procedures to assist securities professionals in raising concerns about potential diminished capacity or elder financial abuse situations.
- Making in-depth training opportunities available for the firm, including training by experts on issues related to aging.
- Consolidating all senior investor-related information into one website for easy access for securities professionals.

- Reviewing, and modifying when necessary, criteria used for risk-based supervisory and compliance reviews.

- Providing input in connection with the firm's annual risk assessment regarding risks related to senior investors.

For many firms, this type of group or task force was viewed as helpful in streamlining processes across business units, acting as a central resource for issues related to seniors, and serving as a contact for employees as they come across situations they need help to resolve. In establishing and operating such groups, some firms:

- Include individuals from various areas of the firm and with different operational experience on the committee or taskforce, including but not limited to staff from portfolio management, sales, marketing, legal, compliance, and/or internal audit.

- Meet on a regular basis to discuss issues surrounding senior-specific policies and procedures.

For some firms, based on their size or other factors, establishing committees or working groups may not make sense. For these firms, designating a specific individual or a department to identify and develop protocols for working through senior-related issues or to serve as a central point of contact for questions about senior issues may be an alternative to establishing a committee or working group.

B. Communicating Effectively With Senior Investors

Financial services firms explained that they have adopted practices that they believe improve their communication with senior investors. These include:

- Increasing the frequency of contact with senior investors to remain informed about changes in investors' financial needs, employment status, health, and other life events.

- Encouraging securities professionals to talk to investors about having an emergency or alternate contact on file with the firm, such as a trusted family member or other trusted individual.

- Educating investors about the benefits of having a power of attorney and when appropriate, encouraging investors who are in good health to share details of their financial affairs with trusted family members, estate lawyers and/or other professionals to help ensure that if the investor's health deteriorates, their financial affairs will be properly handled.

- Documenting conversations with investors in case they have problems with lack of recall or to help resolve any misunderstanding.

- Sending follow-up letters to investors after conversations to document and reiterate what was discussed.

- Avoiding financial jargon, using plain language, and having larger font versions of marketing materials available.

- Providing brochures that explain to investors how to identify, locate, organize and store important documents so that they are easily accessible in case of an emergency.

Many firms produce brochures, newsletters and magazines aimed at educating senior investors. Some firms include educational materials in their monthly or quarterly mailings to investors. These materials are targeted to both a particular age group and life stage, and examples include:

- Marketing pieces (*i.e*., booklets, magazines, and single page flyers) to assist investors in understanding specific products, meeting financial goals and investment strategies for pre-retirement and retirement.

- Publications that are education-oriented and cover topics such as analyzing social security and retirement benefits, identifying healthcare and estate planning resources.

- Educational materials created by third parties and educational resources from public websites targeted to senior investors.

We note that many of these materials may be primarily designed to market retirement-oriented services and products to senior investors. Firms must make sure that these materials, like all materials provided to investors, are not misleading and comply with relevant regulatory requirements.

C. Training Firm Employees On Senior-Specific Issues

In the subsequent months, Bob Securities Professional spoke with Mr. Investor at least twice a month. Mr. Investor seemed disoriented and did not recall transactions that he had previously authorized. Bob Securities Professional noted these observations in his file. Bob Securities Professional asked Mr. Investor whether he had all of his financial information in one place. Mr. Investor was not sure where his financial information was located. Bob Securities Professional encouraged Mr. Investor to invite his Daughter to their meetings.

Many firms have taken a proactive approach in training their securities professionals to help ensure that when they are faced with similar difficult and sensitive situations, they have the proper tools to address the issues raised. Firms utilize a variety of training methods to help ensure that the training is effective, including the following:

- Using hypothetical examples to illustrate the potential issues that securities professionals may encounter.

- Creating web-based modules focused on diminished capacity, suitability, communicating with senior investors, advertising, the use of professional designations and elder financial abuse.

- Distributing periodic newsletters or emails that contain articles or reminders about current policies and procedures related to senior investors.

- Collaborating with gerontologists and other aging experts to help securities professionals understand and meet the needs of senior investors.

- Creating educational materials on multi-generational and wealth transfer issues and the transition from planning for retirement to managing financial needs during retirement.

- Using small, interactive groups of securities professionals as forums to discuss senior issues in depth.

Regardless of the mechanism used, many firms appear to be developing training for their employees on senior-specific issues. Two areas that firms mentioned in particular are how to identify signs of diminished capacity and elder financial abuse. Each area is discussed below.

- **Training on How to Identify Diminished Capacity**

Some firms told us that a critical aspect of their educational programs for employees is focused on identifying signs of diminished mental capacity in an investor. The ability to observe changes in investors' behavior places securities professionals in a unique and challenging position. Firms shared their concerns about steps they are taking when an investor shows signs of diminished capacity, about their responsibilities in these instances, and about their potential liability in instances where the securities professional does not address the issue.

We note that securities professionals cannot take advantage of investors in a manner that would violate an adviser's fiduciary duty to the investor or a securities broker's responsibility to follow just and equitable principles of trade. Firms have an obligation to supervise employees to prevent this behavior. In circumstances where the investor appears to lack capacity to understand an investment or to provide informed consent, firms may want to consider implementing procedures for securities professionals to follow, such as seeking advice from supervisors about contacting a trusted family member or the person designated in the investor's power of attorney.

Many firms have included segments in their educational programs to help securities professionals identify signs -- or "red flags" -- that may indicate that an investor may have diminished capacity or a reduced ability to handle financial decisions. Examples of signs include, but are not limited to, the following:

- The investor appears unable to process simple concepts.

- The investor appears to have memory loss.

- The investor appears to have difficulty speaking or communicating.

- The investor appears unable to appreciate the consequences of decisions.

- The investor makes decisions that are inconsistent with his or her current long-term goals or commitments.

- The investor's behavior is erratic.

- The investor refuses to follow appropriate investment advice; this may be of particular concern when the advice is consistent with previously-stated investment objectives.

- The investor appears to be concerned or confused about missing funds in his or her account, where reviews indicate there were no unauthorized money movements or no money movements at all.

- The investor is not aware of, or does not understand, recently completed financial transactions.

- The investor appears to be disoriented with surroundings or social setting.

- The investor appears uncharacteristically unkempt or forgetful.

- **Training on How to Identify Elder Financial Abuse**

Elder abuse comes in a variety of forms. It can be physical or emotional and can be in the form of neglect, abandonment, or through financial exploitation. Elder financial abuse is generally referred to as the misuse of a person's money or belongings by a family member or a person in a position of trust.

Similar to detecting diminished capacity, firms indicated that securities professionals are on the front lines of seeing indications of possible financial abuse and, as a result, have included segments in their educational programs to help securities professionals identify signs -- or "red flags" -- that may indicate that an investor may be subject to elder abuse. Examples of these signs include:

- The investor gives a power of attorney to someone that, to the investor's securities professional, appears inappropriate.

- Indications that the investor does not have control over or access to his/her money.

- The investor's mailing address has been changed to an unfamiliar and unexplained address.

- Inability of the securities professional to speak directly to the investor, despite attempts to do so.

- The investor appears to be suddenly isolated from friends and family.

- There is a sudden, unexplained or unusual change in the investor's transaction patterns.

- There are unexplained disbursements made in an investor's account that are outside of the norm.

- The sudden appearance of a new individual involved in the investor's financial affairs.

D. Establishing an Internal Process for Escalating Issues and Taking Next Steps

Many firms told us that the key to responding to signs of diminished capacity or financial abuse is to establish internal procedures that permit the securities professional to obtain advice from others within the firm on possible next steps to take. The following are examples of escalation procedures or next steps identified by some firms:

- Requiring a securities professional to document suspected diminished capacity or elder financial abuse, and escalate the issue immediately.

- Clearly designating the individual or groups to whom the securities professional is to escalate the matter, *e.g.*, a branch manager, a designated member of the legal or compliance department or a specially-created senior task force within the firm.

- Training employees to escalate early - at the first sign.

- Embedding escalation procedures in employee training and continuing education courses.

Firms also told us that they had created and adopted policies with respect to the next steps to take after an issue was identified and escalated. These policies include:

- Prohibiting the securities professional from making securities recommendations to the investor or investments in the account until the concern no longer exists.

- Communicating with the investor's designated emergency contact or the person provided with power of attorney for the investor.

- Conducting a review of the investor's account and identifying any transactions or patterns that could indicate a problem (*i.e.*, financial abuse by a securities professional or other individual).

- Maintaining frequent contact with the investor to assess any new developments.

- Having a manager or designated individual communicate with the investor along with the securities professional who has direct responsibility for the investor's account.

- Notifying the legal and compliance departments of further conversations with the investor, and involving them as appropriate.

- Consulting appropriate state statutes to determine next steps, which may include alerting appropriate authorities, including a government protective services organization, if elder abuse is suspected.

- Documenting any contact with the legal department in the investor's file.

Firms indicated that having effective escalation procedures and a process for considering and taking further steps to be critical in helping to ensure that they address issues of possible diminished capacity or financial abuse.

E. Encouraging Investors of All Ages to Prepare for the Future

Financial services firms also told us that they are considering steps that help them and their investors prepare for the future. Investors of *any* age can take steps to plan for the event of mental or physical incapacity.

As stated above, some firms are asking investors to provide them with emergency or alternate contacts for use in the event that the firm is unable to contact the investor or if the firm suspects diminished capacity or elder abuse. Some firms specify the permitted purposes for contacting this alternate person and receive permission to keep this information in the investor's files.

Another approach is for the securities professional to ask the investor whether he/she has provided a power of attorney granting authority over the investor's account to a trusted friend or family member under certain circumstances. These arrangements may more formally facilitate the management of an investor's account should certain circumstances occur. Practices in this area include:

- Encouraging securities professionals to have conversations about the benefits of executing powers of attorney with all investors as a matter of routine during the account opening process.

- Encouraging securities professionals to have a conversation with the investor prior to opening an account as to whether anyone else should be consulted with regard to the account.

Firms were mindful that powers of attorney can be abused and have developed practices to address risks associated with abuse of a power of attorney. Practices identified in this area include:

- Having a process for identifying accounts of investors where a power of attorney is added or changed, followed by a change in activity compared with the investor's stated financial objective and profile. For example, firms looked for evidence of unusual checks written out of the account within a given timeframe, and a concentration of checks to a single, third-party payee.

- Requiring that copies of all confirmations and account statements be sent to both the account holder and the power of attorney.

- Having a process to check the signature of the investor against other signed documents received in order to determine authenticity.

Whether by encouraging investors to provide alternate contact information or to execute a power of attorney, firms stated that encouraging all investors to be prepared for the future was an increasingly important issue.

F. Advertising and Marketing to Seniors

Mr. Investor met with Bob Securities Professional to discuss his portfolio. At the meeting, Mr. Investor showed Bob Securities Professional an advertisement that he had received from another securities professional. The advertisement indicated that Mr. Investor would receive a 50% return on his investment. The bottom of the advertisement included the designation "Senior Specialist." The title confused Mr. Investor.

Many firms indicated that they have adopted one or more practices that were outlined in the public report issued in September 2007 by the SEC's Staff, NASAA and FINRA titled, "*Protecting Seniors: Report of Examinations of Securities Firms Providing "Free Lunch" Sales Seminars.*"[7] In that report, in Appendix B, "Effective Compliance and Supervisory Practices," we noted examples of compliance and supervisory practices that appeared to be effective in helping to ensure adequate supervisory oversight and compliance with the securities laws. While that Report did not create or modify existing regulatory obligations to senior investors, we provided those practices in that Report in order to assist financial services firms in reviewing their practices in this area. While the complete list is not reiterated here, some of the practices that many firms have adopted include:

- Banning securities professionals from using marketing materials to target particular age groups, such as referring to an event as a "senior seminar" or a "senior meeting."

- Providing an online brochure with detailed instructions accessible to all employees describing the approval process required for seminars, investor appreciation events, continuing education seminars, outside speaking events, booths/exhibits, and business building/networking events.

[7] Joint Report of the SEC's Staff, NASAA, and FINRA September 2007 available at http://www.sec.gov/spotlight/seniors/freelunchreport.pdf.

- Providing a library of pre-approved materials that were reviewed and approved by supervisory and compliance personnel.

- Using a web-based training module for securities professionals to use as reference when they are creating materials for senior-oriented events.

- Performing a minimum number of unannounced compliance visits to seminars on a yearly basis.

- Instituting a "mystery shopper" program where a compliance professional attends seminars unannounced to verify that securities professionals are conducting seminars in accordance with firm policies and procedures.

Firms told us that these are among the mechanisms that they are using to heighten their review and approval processes for the use of marketing and sales materials and sales seminars by their employees with respect to seniors.

- **The Use of Senior Designations**[8]

Regulators have identified the use of senior designations in advertising and marketing materials as a possible risk to investors because a designation may be used to imply expertise or credentials, which may be inaccurate or misleading.[9] Many states are limiting the use of designations.[10]

As a result of increased scrutiny by regulators, many firms have heightened their review and approval processes for the use of senior designations by their employees, and they monitor and limit their use. Some examples of these policies include:

- Reviewing the training materials used by entities or organizations that confer a designation to ensure that predatory sales techniques are not included as part of the training.

- Verifying the appropriate use of designations during field office inspections by reviewing securities professionals' business cards.

- Maintaining a list of approved designations.

- Maintaining a list of prohibited designations.

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8 Some professionals use titles that imply they are experts at helping seniors with financial issues; these titles are known as Senior Designations. *See* '"Senior" Specialists and Advisors: What You Should Know About Professional Designations" at http://www.sec.gov/investor/pubs/senior-profdes.htm.

9 http://www.nasaa.org/NASAA_Newsroom/Current_NASAA_Headlines/8423.cfm#

10 For example, Massachusetts, Nebraska, New Hampshire, Virginia and Washington have restricted the use of senior designations.

- Banning the use of any designation that includes the word "Senior" to help ensure that investors are not confused.

- Permitting the use of designations only if accredited by a national accreditation organization.

Firms told us that they are using these mechanisms to heighten their review and approval processes for the use of senior designations by their employees, and to monitor and limit their use.

G. Obtaining Information at Account Opening

Mr. Investor's Daughter opened an account with Betty Securities Professional over the phone. Daughter informed Betty Securities Professional that she was nearing retirement and wanted to preserve her nest egg. Betty Securities Professional asked Daughter to provide financial information and then filled in the remainder of the new account form herself. Under investment objectives, Betty Securities Professional put "speculative." Betty Securities Professional purchased speculative stocks in Daughter's account.

Pursuant to a variety of securities laws, and rules, financial services firms are required to obtain sufficient information about an investor to ensure that recommendations are appropriate for the investor, and that the investor's account is managed consistent with the investor's investment objectives. This information includes the investor's age, financial and tax status, and investment objectives.[11]

We noted that some firms use the account opening process to ask questions that may broaden the conversation with investors. For example, some firms are:

- Documenting the response to lifestyle questions such as, "When do you plan to retire?" "How much money do you need to retire in the fashion you want?" "Do you have any other issues or expenses that we should contemplate as you retire?" "Do you have children or grandchildren who are dependent on you financially?" and "Do you have a will and a financial power of attorney?"

- Requiring in-person meetings with the investor to fill out the new account form. This helps to ensure that all investor information on the new account form is accurate and up-to-date.

- Encouraging the investor to bring a trusted family member or trusted individual to meetings.

- Requiring frequent updates of new account information, such as on an annual basis.

[11] Under, for example, NASD Rule 2310.

Firms told us that these steps better help them to obtain information about investors at account opening to aid in determining whether particular investments are appropriate.

H. Ensuring the Appropriateness of Investments

> *Mr. Investor also maintains an account with Betty Securities Professional. Recently, Betty Securities Professional suggested that Mr. Investor re-evaluate his portfolio and shift his investments from income-orientated securities to growth stocks. She also suggested that Mr. Investor add more speculative investments, in order to generate higher returns. Mr. Investor had difficulty understanding the complex structure of some of the recommendations. Currently Mr. Investor's portfolio is diversified and holds bonds and other income-producing products.*

Investors who are the same age can have very different investment profiles, and what is appropriate for one investor may not be appropriate for another investor. However, an investor's age and life stage are important factors in assessing the appropriateness of recommendations for that investor. Some firms are using age in their risk-based supervisory reviews of investors' accounts, as well as other information, to identify accounts or transactions for heightened review. These reviews may include the following:

- Assigning investment objectives to each product that the firm sells in order to aid securities professionals in assessing the appropriateness of the product for a particular investor, and to facilitate comparisons between the objective of the product and the investor's stated investment objective by supervisors and compliance personnel.

- Conducting periodic supervisory interviews with securities professionals to discuss the portfolios of their senior investors.

- Conducting periodic calls with senior investors to confirm whether there have been changes that would impact the investor's account information, such as financial changes or changes to their investment objectives.

- Confirming with the investor directly whether particular transactions were solicited or unsolicited.

- Using financial planning tools that help investors plan for retirement, and anticipate expenses, lifestyle changes, and goals during retirement. The tools provide guidance to securities professionals regarding investment choices that may help the investor reach their stated objectives.

- Using a filtering program based on age and investment objectives to assist securities professionals in selecting appropriate annuity products for investors.

- Requiring special supervisory review of all new account forms reporting investment objectives more aggressive than "income" for investors over a certain age.

- Conducting specialized reviews of new accounts that are opened as guardianship or conservatorship relationships for verification of proper documentation.

Some firms have also implemented product-specific practices or limitations in order to reduce the likelihood that a product will be recommended to an investor for whom it is inappropriate. Some firms have included age-restrictions in their product-specific practices, including:

- Limiting or prohibiting purchases of certain investment products, such as certain structured products, based on an investor's life stage and risk profile.

- Prohibiting purchases of certain variable life insurance products by investors who are above a certain age.

- Imposing an age maximum on certain annuity riders that have actuarially little or no benefit to persons above that age.

- Requiring completion of additional or "targeted" suitability documentation before a transaction is processed.

Other firms have implemented heightened reviews of all variable annuity purchases. For senior investors, deferred annuities may pose special appropriateness concerns depending on the investor's liquidity needs and investment time horizon.[12] To help address these issues, some firms are:

- Creating a central review and approval process for all variable annuity transactions with special focus on purchases with additional riders. These firms have a process, independent of the securities professional, which compares the attributes of the product to the needs of the investor.

- Training a dedicated team of annuity application reviewers to be aware of the special nuances of these products.

- Requiring a heightened review of annuity applications for investors over a certain age in a low tax bracket or with low liquid net worth.

- Requiring securities professionals to fill out an annuity worksheet with the investor's age, net worth, assets, and other factors. This information is used by the firm to assign a risk score to determine whether a more enhanced review is required.

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12 Broker-dealer firms have specific responsibilities with respect to transactions in deferred variable annuities (NASD Rule 2821).

- Requiring the investor to select an investment time horizon for a variable annuity purchase. This helps supervisors review the variable annuity subaccount allocations for consistency with the designated investment time horizon.

- Requiring securities professionals to complete an individual attestation that they made certain representations and disclosures to the investor in connection with the annuity transaction, including the accuracy of the investor's profile, time horizon and the reason for purchase.

- Implementing a hard block that prohibits variable annuity products to be sold to investors above a certain age based on the time horizon required for the instrument to accrue any benefit to the investor, and/or the length of the surrender period in light of the age group's typical investment time horizon and liquidity needs.

As described above, firms are using a variety of techniques to help ensure the appropriateness of investments for seniors.

III. Conducting Senior-Focused Supervision, Surveillance and Compliance Reviews

Mr. Investor, Jr. is 49 years old and plans to retire next year. Mr. Investor's investment objective is conservative and he holds bonds and blue chip stocks in his portfolio. Last month, a highly speculative investment was purchased in his account. The Branch Manager/Chief Compliance Officer noted this apparent discrepancy during his review of transactions and inquired further.

While firms conduct supervisory and surveillance review of the activity in investors' accounts regardless of the age of the investor, some firms told us that they use age or other parameters in their exception reports and other supervisory review activities in order to pay special attention to seniors' accounts. These firms attempt to capture transactions and practices that may particularly impact seniors. Some examples of these practices include:

- Maintaining trade blotters that contain account information (such as age, net worth, investment objective) alongside the transactions for ease in supervisory review.

- Restricting high-risk trading for investors over a certain age unless pre-approved.

- Using exception reports to isolate activities and accounts for additional review, such as IRA distributions above the minimum required distribution, 1035 exchange transactions or investors over a certain age that list "speculative" as an investment objective.[13]

[13] "1035 exchanges" are so named because IRS Code Section 1035(a)(3) provides that no gain or loss shall be recognized on the exchange of one annuity contract for another annuity contract.

- Requiring that all 1035 exchanges and 72T distribution requests be approved by a direct supervisor *and* a central review unit to verify that the exchange is suitable.[14]

- Blocking a transaction if the surrender charge is greater than a pre-determined amount.

Some firms use exception reports to identify and monitor portfolio allocations, commissions, and other issues in accounts. The thresholds used in some of these exception reports are designed to identify risks that are common to senior investors, however, the individual thresholds used differ among firms. Some practices include:

- Identifying accounts of investors over a certain age that generated a commission-to-asset ratio above a certain percentage over a preceding period.

- Identifying accounts of investors over a certain age that generated commissions in speculative or complex investments.

- Identifying accounts of investors over a certain age that have “conservative” or “income” stated as their investment objective, and also have a margin loan balance above a certain threshold, and/or have options trading losses above a certain threshold over the preceding several months.

- Identifying accounts of investors over a certain age that have concentration and margin debit balances above a certain threshold.

- Identifying accounts of investors who are over a certain age, or of any age, in which a change in trading activity has occurred and a power of attorney has recently been added or amended.

- Identifying investors over a certain age with IRA rollover accounts to review activity relative to age, financial information, investment objectives, and risk tolerance.

In addition to performing supervision, surveillance and compliance reviews of investors’ accounts, firms also generate targeted reports concerning the activities of their securities professionals to help spot potentially inappropriate or abusive activity relating to senior investors. For example, firms use surveillance reports that identify securities professionals that:

- Sell a threshold number of annuities to investors over a certain age during a specified period.

- Sell a threshold number of annuities with the same rider.

[14] “72T distributions” are so named because IRS Regulation 72t permits early withdrawal from a retirement account without the usual tax penalty (IRS Code Section 72(t)(2)(A)(iv)).

- Have a senior investor base that is above a certain threshold percentage of the total investor base.

- Generate commissions above a threshold amount during a particular period from investors over a certain age.

- Have a certain percentage of their rolling 12-month fees generated by investors over a certain age.

Firms stated that these types of supervisory, surveillance and compliance reviews were helpful to identify potentially inappropriate or abusive transactions or practices with respect to senior investors. As critical as identifying the questionable transaction or activity is effective investigation and follow-up to ensure that the investor is receiving appropriate financial service from the securities professional and the firm.

IV. Conclusion

Given the increasing number of Americans who will need advice and guidance as they near and reach retirement age, the issues described in this Report could not be more important for financial services firms that provide services to senior investors. And, as noted at the outset of this Report, we view the protection of senior investors as a top priority.

This Report describes a myriad of practices used by financial services firms when working with senior investors. Many firms are implementing new processes and procedures aimed at addressing common issues associated with their interactions with senior investors, including with respect to: communicating effectively with senior investors; training and educating firm employees on senior-specific issues (such as how to identify signs of diminished capacity and elder abuse); establishing an internal process for escalating issues and taking next steps when issues or questions are identified; encouraging investors of all ages to prepare for the future; advertising and marketing to senior investors; obtaining information at account opening; ensuring the appropriateness of investments; and conducting supervision, surveillance and compliance reviews focused on senior-specific issues.

By sharing this information, the SEC Staff, NASAA and FINRA hope that it will be helpful to financial services firms that are seeking to ensure that they serve senior investors in an ethical, respectful and informed manner. We also hope that by publishing this Report, financial services firms will be encouraged to identify additional practices that will help them to better serve senior investors.

RESOURCES

Below is a list of supplemental informational materials related to the topics discussed in this Report that may be helpful. We have included this list for your convenience.

1. "*When the Baby Boom Era Becomes the Retirement Explosion: A Securities Compliance Professional's Guide to Protecting Her Firm and Senior Investors,*" (Sept. 2007), National Society of Compliance Professionals, et al, available at http://nscp.org/media/whitepapers/nscp-seniors.pdf

2. "*Assessment of Older Adults With Diminished Capacity: A Handbook for Lawyers,*" (2005), American Bar Association Commission on Law and Aging & American Psychological Association.

3. "*A Financial Professional's Guide to Working with Older Clients,*" AARP and the Financial Planning Association, www.aarp.org

4. American Geriatrics Society at http://www.healthinaging.org/

5. "*Financial Abuse of the Elderly: Risk Factors, Screening Techniques, and Remedies,*" Lori Stiegel, Bifocal, Vol. 23, No. 4 (Summer 2002), Newsletter of the ABA Commission on Legal Problems of the Elderly available at: http://www.abanet.org/aging/publications/bifocal/summer02.pdf.

6. "*Bits Fraud Protection Toolkit Protecting the Elderly and Vulnerable from Financial Fraud and Exploitation*" (February 2006), available at: www.bitsinfo.org/downloads/Publications%20Page/bitstoolfeb06.pdf

7. "*65+ in the United States: 2005*", a special study by the U.S. Census Bureau and the National Institute on Aging, available at: http://www.census.gov/prod/2006pubs/p23-209.pdf

AGENCIES ON AGING

Organization	Website
Administration on Aging	http://www.aoa.gov/
American Association of Retired Persons	http://www.aarp.org/index.html
American Institute of Financial Gerontology	http://www.aifg.org/aboutaifg.cfm
Area Agencies on Aging	http://www.familycaregiversonline.com/aaa_by_state.html
Certified Financial Planner Board of Standards, Inc.	http://www.cfp.net
Elder Law Answers	http://www.elderlawanswers.com/
Financial Industry Regulatory Authority - Smart Tips for Older Investors (Fighting Fraud)	http://www.finra.org/InvestorInformation/InvestorProtection/p019140
H.E.L.P. for Seniors	http://www.help4srs.org/
International Network for the Prevention of Elder Abuse	http://www.inpea.net.
Investor Protection Center (Retirement Calculator)	http://www.sos.mo.gov/securities/mipc/java/calculatorTerms.asp
National Adult Protective Services Association	http://www.apsnetwork.org
National Association of Area Agencies on Aging	http://www.n4a.org/default.cfm
National Center on Elder Abuse	http://www.ncea.aoa.gov
National Committee for the Prevention of Elder Abuse	http://www.preventelderabuse.org
National Consumer Law Center - Seniors Initiative	http://www.consumerlaw.org/initiatives/seniors_initiative/index.shtml
National Council on Aging	http://www.ncoa.org/index.cfm?bType=ns4
National Fraud Information Center	http://www.fraud.org/
North American Securities Administrators Association - Senior Investment Resource Center	http://www.nasaa.org/Investor_Education/Senior_Investor_Resource_Center/
Preventing & Reporting Elder Abuse	http://www.safestate.org/documents/citizens_guide.pdf
Senior Citizen News & Information	http://www.seniorjournal.com
Senior Net	http://www.seniornet.org
Senior Sites	http://www.seniorsites.com/resource.html
Solutions for Better Aging	http://www.agenet.com/
Third Age	http://www.thirdage.com/
U.S. Department of Health & Human Services - Aging	http://www.hhs.gov/aging/index.html
U.S. Government Senior Citizens' Resources	http://www.usa.gov/Topics/Seniors.shtml
U.S. Senate Special Committee on Aging	http://aging.senate.gov/resources.cfm
Securities Exchange Commission - For Seniors	http://www.sec.gov/investor/seniors.shtml

STATE WEBSITES on AGING ISSUES

	Website	Phone	Hotline Information
ALABAMA	http://www.adss.state.al.us/	(334) 242-5743 or 1-800-243-5463	Elder Law Helpline: 1-866-456-3959
ALASKA	http://www.alaskaaging.org/	(907) 465-4879	State Securities Fraud Hotline: 1-888-925-252
ARIZONA	https://www.azdes.gov/aaa/	(602) 542-4446	Elder Abuse Hotline: 1-877-767-2385
ARKANSAS	http://www.arkansas.gov/dhs/aging/	(501) 682-2441	Adult Protective Services Hotline: 1-800-482-8049
CALIFORNIA	http://www.aging.ca.gov/	(916) 419-7500 or 1-800-510-2020	Abuse Hotline: 1- 866-225-5277
COLORADO	http://www.cdhs.state.co.us/aas/	(303) 866-2800 or 1-888-866-4243	Report Abuse: 1-303-866-2800
DELAWARE	http://www.dhss.delaware.gov/dhss/dsaapd/	(302) 255-9390 or 1-800-223-9074	
DISTRICT OF COLUMBIA	http://dcoa.dc.gov	(202) 724-5622	Report Elder Abuse: (202) 541-3950
FLORIDA	http://elderaffairs.state.fl.us/	(850) 414-2000 or 1-800-963-5337	Report Elder Abuse: 1-800-962-2873
GEORGIA	http://aging.dhr.georgia.gov	(404) 657-5258 or 1-866-552-4464	Report Elder Abuse: 1-888-774-0152
GUAM	http://dphss.guam.gov/about/senior_citizens.htm	735-7382 or 735-7384	
HAWAII	http://www2.state.hi.us/eoa/	(808) 586-0100	
IDAHO	http://www.idahoaging.com/abouticoa/	(208) 334-3833 or 1-877-471-2777	Adult Protection Hotline: 1-800-786-553
ILLINOIS	http://www.state.il.us/aging/	(217) 785-3356 or 1-800-252-8966	Adult Protective Services Hotline: 1-800-992-6978
INDIANA	http://www.in.gov/fssa/da/	1-888-673-0002	
IOWA	http://www.state.ia.us/elderaffairs/	(515) 725-3333 or 1-800-532-3213	Abuse Hotline: 1-800-362-2178
KANSAS	http://www.agingkansas.org/	(785) 296-4986 or 1-800-432-3535	Elder Abuse Hotline: 1-800-922-5330
KENTUCKY	http://chfs.ky.gov/Services/Seniors.htm	(502) 564-7043	Adult Abuse Hotline: 1-800-752-6200
LOUISIANA	http://goea.louisiana.gov/	1-800-351-4889 or 1-877-340-9100	Elderly Affairs Hotline: 1-800-259-4990
MAINE	http://www.maine.gov/dhhs/beas/	(207) 287-9200 or 1-800-262-2232	Adult Protective Services Hotline: 1-800-624-8404
MARIANA ISLANDS	http://www.dcca.gov.mp/index.cfm?pageID=4	(670) 233-1321	
MARYLAND	http://www.mdoa.state.md.us/	(410) 767-1100 or 1-800-243-3425	Elder Abuse Hotline: 1-800-917-7383
MASSACHUSETTS	http://www.mass.gov/?pageID=eldershomepage&L=1&L0=Home&sid=Eelders	(617) 727-7750 or 1-800-243-4636	Elder Abuse Hotline: 1-800-922-2275
MICHIGAN	http://www.michigan.gov/miseniors	(517) 373-8230	Vulnerable Adult Helpline: 1-800-996-6228
MINNESOTA	http://www.mnaging.org/	(651) 431-2500 or 1-800-882-6262	Senior LinkAge Line: 1-800-333-2433
MISSISSIPPI	http://www.mdhs.state.ms.us/aas.html	1-800-222-8000	Adult Abuse Hotline: 1-800-222-8000
MISSOURI	http://www.dhss.mo.gov/SeniorServices/	1-800-235-5503	Elder Abuse & Neglect Hotline: 1-800-392-0210
MONTANA	http://www.dphhs.mt.gov/sltc/services/aging/index.shtml	(406) 444-4147 or 1-800-332-2272	Abuse Info Line: 1-800-551-3191
NEBRASKA	http://www.hhs.state.ne.us/ags/agsindex.htm	(402) 471-4623 or 1-800-942-7830	Adult Abuse Hotline: 1-800-652-1999
NEVADA	http://aging.state.nv.us/	(775) 687-4210 or (775) 738-1966	Crisis Call Center: 1-800-992-5757
NEW HAMPSHIRE	http://www.dhhs.state.nh.us/DHHS/BEAS/default.htm	(603) 271-4680 or 1-800-351-1888	Elderly Abuse Reporting Line: 1-800-949-0470
NEW JERSEY	http://www.state.nj.us./health/senior/index.shtml	(609) 943-3437 or 1-800-792-8820	
NEW MEXICO	http://www.nmaging.state.nm.us/	(505) 476-4846 or 1-800-432-2080	Elder Abuse Report Line: 1-866-654-3219
NEW YORK	http://www.aging.ny.gov/	1-800-342-9871	
NORTH CAROLINA	http://www.dhhs.state.nc.us/aging/home.htm	(919) 733-3983	Care Line: 1-800-662-7030
NORTH DAKOTA	http://www.nd.gov/dhs/services/adultsaging/	(701) 328-4601 or 1-800-366-6888	Senior Info Line: 1-800-451-8693
OHIO	http://www.goldenbuckeye.com/	(614) 466-6191 or 1-800-266-4346	
OKLAHOMA	http://www.okdhs.org/divisionsoffices/visd/asd/	(405) 521-2281 or 1-800-211-2116	Adult Abuse Line: 1-800-522-3511
OREGON	http://www.oregon.gov/DHS/spwpd/index.shtml	(503) 945-5921 or 1-800-282-8096	Report Abuse Hotline: 1-800-232-3020

STATE WEBSITES on AGING ISSUES

PENNSYLVANIA	http://www.aging.state.pa.us/	(717) 783-8975 or (717) 265-7887	Elder Abuse Hotline: 1-800-490-8505
PUERTO RICO	http://www.familiesusa.org/resources/program-locator/resources/puerto-rico/page.jsp?itemID=29154750	1-877-725-4300	
RHODE ISLAND	http://www.dea.ri.gov/	(401) 462-3000 or (401) 462-0555	DEA Protective Services Unit: (401) 462-0555
(AMERICAN) SAMOA	http://americansamoa.gov/departments/agencies/taoa.htm	(684) 633-4116 or (684) 633-1251	
SOUTH CAROLINA	http://www.aging.sc.gov/	(803) 734-9886	
SOUTH DAKOTA	http://dss.sd.gov/elderlyservices/index.asp	(605) 773-3656 or 1-866-854-5465	
TENNESSEE	http://www.state.tn.us/comaging/	(615) 741-2056	Report Elder Abuse Line: 1-888-277-8366
TEXAS	http://www.dads.state.tx.us/services/index.html	(512) 438-3011 or 1-800-252-9240	Legal Hotline: 1-800-622-2520
U.S. VIRGIN ISLANDS	http://www.seniorresource.com/virgin.htm	(340) 692-5950 or (809) 772-0930	
UTAH	http://www.hsdaas.utah.gov/	(801) 538-3910 or 1-877-424-4640	
VERMONT	http://ddas.vermont.gov/	(802) 241-2214 or 1-800-642-5119	Report Abuse Line: 1-800-564-1612
VIRGINIA	http://www.vda.virginia.gov/	(804) 662-9333 or 1-800-552-3402	Adult Protective Services Line: 1-888-83-ADULT
WASHINGTON	http://www.aasa.dshs.wa.gov/	1-866-363-4276	Adult Abuse Line: 1-866-363-4276
WEST VIRGINIA	http://www.wvseniorservices.gov/	(304) 558-3317	
WISCONSIN	http://www.dhfs.state.wi.us/Aging/	(608) 266-1865	Elder Abuse Helpline: 1-800-435-7335
WYOMING	http://wdh.state.wy.us/aging/index.html	(307) 777-7986 or 1-800-442-2766	

EXHIBIT 6

PROTECTING SENIOR INVESTORS: COMPLIANCE, SUPERVISORY AND OTHER PRACTICES USED BY FINANCIAL SERVICES FIRMS IN SERVING SENIOR INVESTORS 2010 Addendum

U.S. Securities and Exchange Commission's Office of Compliance Inspections and Examinations,* North American Securities Administrators Association, and Financial Industry Regulatory Authority

August 12, 2010

Today in the United States, nearly 40 million people are age 65 and older. This number is expected to more than double to 89 million by 2050.[1] In addition to these staggering numbers, many seniors find themselves with smaller nest eggs than they anticipated as a result of the economic downturn experienced over the past 18 months. Estimates show that total retirement assets decreased by $4.5 trillion, or 25%, from 2007 to the first quarter of 2009.[2]

In light of these demographics, Staff at the Securities and Exchange Commission ("SEC"), the Financial Industry Regulatory Authority ("FINRA") and the North American Securities Administrators Association ("NASAA") continues to view the protection of senior investors as a top priority. With this in mind, in March 2008, NASAA adopted the NASAA Model Rule on the use of Senior-Specific Certifications and Professional Designations in response to the possible risk to investors that a designation may be used to imply expertise or credentials, which may be inaccurate or misleading. As of February 2010, 19 states have adopted the NASAA Model and two states have adopted state specific rules prior to adoption of NASAA's Model.

As part of securities regulators' collaborative efforts to protect senior investors, we released a public report in September 2008 that summarizes practices used by financial services firms and securities professionals in serving senior investors. The report entitled "*Protecting Senior Investors: Compliance, Supervisory and Other Practices Used by*

* This is a report of the Commission's Staff, FINRA and NASAA, and does not reflect the views of, or include findings or conclusions by, the Securities and Exchange Commission.

1 http://www.transgenerational.org/aging/demographics.htm#ixzz0bqbUpAAv.

2 At the end of 2007 U.S. retirement assets stood at $17.9 trillion. By the end of the first quarter of 2009 they were down to $13.4 trillion. See *The U.S. Retirement Market, 2008* at www.ici.org/pdf/fm-v18n5.pdf and *The U.S. Retirement Market, First Quarter 2009* at www.ici.org/pdf/09_q1_retmrkt_update.pdf.

Financial Services Firms in Serving Senior Investors"[3] ("2008 Report") was intended to assist industry firms in enhancing their compliance, supervisory and other practices.

To continue our efforts to protect senior investors, we asked some of the firms that participated in the original fact finding initiative to share with us any additional practices they may have implemented since the 2008 Report was published. In addition, Staff researched additional practices identified in various industry publications. This addendum to the September 2008 Report summarizes additional practices used by financial services firms and securities professionals in serving senior investors in the following areas:

- Communicating effectively with senior investors;
- Training and educating firm employees on senior-specific issues;
- Establishing an internal process for escalating issues and taking next steps;
- Obtaining information at account opening;
- Ensuring appropriateness of investments; and
- Conducting senior-focused supervision, surveillance and compliance reviews.

As stated in the 2008 Report, by sharing this information, we hope to provide practical examples to firms that are seeking to strengthen their infrastructure to assist them in working with senior investors in an ethical, respectful and informed manner. This 2010 Addendum does not create or modify existing regulatory obligations with respect to senior investors. It also does not catalog the full range of compliance practices applicable to senior investors. Rather, the 2010 Addendum focuses on specific, concrete steps that firms are taking to identify and respond to issues that are common in working with senior investors. By publishing this information, we also hope that financial services firms will identify and implement additional practices to help ensure that the financial services industry continues to be mindful of the particular needs of senior investors.

I. Practices Used by Financial Services Firms in Serving Seniors

During 2009, firms continued to implement new processes and procedures aimed at addressing common issues associated with their interactions with senior investors. Responding firms indicated they are enhancing procedures in the following areas:

A. Communicating Effectively With Senior Investors

Some firms indicated they are producing brochures and information aimed at educating senior investors on various topics. Examples include:

- A brochure outlining fraud awareness, advising clients to monitor their credit report for potential unauthorized activity, warning clients never to sign a blank or incomplete document or to give cash to a securities professional.
- A link on the firm's website to the following sites: SEC Investor Information for Seniors; FINRA Investor Alerts; and NASAA Senior Investor Resource Center.

3 *http://www.sec.gov/spotlight/seniors/seniorspracticesreport092208.pdf.*

- Recommendations to customers to maintain the following information in a safe and secure place to ensure that documents are easily accessible in case of an emergency, including:

  - An inventory of assets with account numbers, passwords and locations of safe-deposit boxes.
  - A list of debts and regular obligations, with a list of the institutions to which they are owed and account numbers.
  - A list of important contacts, such as doctors, lawyer, and securities professional.

B. <u>Training Firm Employees on Senior-Specific Issues</u>

Firms continue enhancing training for its securities professionals to focus on senior specific issues and to help securities professionals recognize potential financial abuse and signs of potential diminished capacity. These firms utilize a variety of training methods to help ensure the training is effective that include the following:

- Implementing a Firm Element continuing education course[4] providing guidance to help securities professionals identify special considerations they should be aware of when working with senior clients or clients approaching retirement.
- Reminding securities professionals what types of sales practices have been identified by regulators as posing potential risks when marketing to seniors.
- Providing real-life examples of SEC, FINRA and State actions taken with respect to senior financial abuse.
- Utilizing testing at the end of a training session to ensure learning.
- Providing enhanced training to supervisors regarding the review of a transaction based on specific factors or "red flags" the supervisor should consider in the review.
- Designating a particular individual/supervisor responsible for addressing questions regarding activities, practices and policies related to seniors.
- Providing a link on the internal website to outside resources that may be useful when selling securities to seniors such as: 1) SEC Investor Information for Seniors, 2) FINRA Investor Alerts, and 3) NASAA Senior Investor Resource Center.
- Providing a brochure or flyer for securities professionals to help them recognize issues that are unique to older clients: (i) best practices when working with seniors; (ii) information about identifying and recognizing diminished capacity and elder financial abuse; and (iii) the policies and procedures to be followed once diminished capacity or elder financial abuse is suspected. Examples of procedures include: asking clients to carefully read the materials discussed and, if desired, to take extra time to consult with a trusted family member or friend; avoiding use of financial jargon; familiarizing themselves with the resources in

[4] NASD Rule 1120.

the community for addressing the unique needs of older clients; and allowing extra time to meet so the client does not feel rushed.
- Providing a script to aid securities professionals in having difficult conversations with clients.

Firms told us they continue to include segments in their educational programs to help securities professionals identify signs or "red flags" that may indicate that an investor may have diminished capacity or a reduced ability to handle financial decisions. Firms indicated additional signs now included are:

- Recurring cognitive problems that become worse over time.
- Behavior that is out of character (e.g., the frugal client who becomes a spendthrift, the client who wants to upset a long-established investment strategy).
- Difficulty in understanding important aspects of the account.

C. <u>Establishing an Internal Process for Escalating Issues and Taking Next Steps</u>

Some firms told us they had created and adopted policies with respect to the next steps to take after an issue was identified and escalated. These policies include:

- Identifying a central point of contact within the Compliance Department to provide guidance on senior investor issues.
- Creating a mailbox for all senior investor related questions for follow-up.
- Escalating any suspected elder abuse to branch management and then to divisional counsel to determine whether the situation requires reporting to state authorities.
- Potentially declining a transaction or declining to open an account if there is suspicion of financial abuse or diminished capacity.

D. <u>Obtaining Information at Account Opening</u>

As discussed in the 2008 Report, pursuant to a variety of securities laws and rules, financial services firms are required to obtain sufficient information about an investor to ensure that recommendations are appropriate for the investor. The firms are also required to ensure that the investor's account is managed in a manner that is consistent with the investor's investment objectives. The information to be obtained includes the investors' age, financial and tax status, and investment objectives. We noted that some firms use the account opening process to obtain additional information about the client. For example, some firms are:

- Encouraging clients to identify a third party emergency contact. Allowing the firm to notify the identified individual if there is an issue or concern related to diminished mental capacity or financial abuse by a third party.
- Requiring that the employment status field on the new account form be filled out with one of the possible responses being "retired." This data helps the firm

identify clients who are in the "distribution" stage of life, as distinct from the "accumulation" stage.

E. Ensuring the Appropriateness of Investments

An investor's age and life stage are important factors in assessing the appropriateness of recommendations for that investor. To address this issue, some firms are:

- Enhancing the firm's new product committee process by analyzing and identifying potential risks to senior investors when creating new products and services.
- Conducting quality assurance calls to customers of a certain age or parameters as determined by the firm.
- Asking the following questions: How recently has the client profile information been updated? Have there been any significant changes with regard to the client's employment status, marital status, physical condition or the needs of the client's family or significant others? Has the client made the securities professional aware of recent changes or plans to change living arrangements that may have an impact on the client's present or future financial needs? When a securities professional is advised or becomes aware that a client's circumstances have changed the securities professional should obtain updated information and further consult with the client about whether the client's investment objectives or needs have also changed.
- Reminding securities professionals that everyone goes through life stages and at each stage, the suitability or appropriateness of a product or service may shift. For example, clients in their late twenties might be getting married or starting a family.

F. Conducting Senior-Focused Supervision, Surveillance and Compliance Reviews

Firms continue to utilize supervision and surveillance reports to attempt to capture transactions and practices that may impact seniors negatively. Some examples include:

- Using trending reports to identify patterns that may be indicative of potential abusive behavior by securities professionals.
- Analyzing the firm's client base with respect to age demographics and using this information to help meet current and prospective customer needs.
- Creating policies that require a discussion during the annual branch audit with supervisors and sales professionals about sales to seniors.
- Maintaining trade blotters that can be filtered by "senior investor" status, as defined by the firm.
- Using the customer's age as one factor in evaluating the appropriateness of an investment in light of risk tolerance.
- Conducting risk based statistical sampling based upon variables such as the customer's age, product type, and whether a product replacement is involved.

- Requiring corrective action be taken when there is incomplete customer account documentation.
- Identifying securities professionals whose book of business includes a large percentage of sales to seniors where the subsequent activity associated with this business (such as cancellations or large outflows), could be an indicator of unsuitable sales practices.
- Reviewing the entire book of business and compliance records for those securities professionals whose book of business includes a large percentage of sales to seniors.

II. Conclusion

The protection of senior investors is a priority. The practices described in the 2010 Addendum and the 2008 Report should be particularly helpful to the financial services industry and securities professional that provide services to senior investors. As the number of senior investors increases each year and many senior's retirement assets decreased, it is important that firms remain mindful of the concerns in dealing with senior investors.

By sharing this information, the SEC, NASAA and FINRA Staff hope that financial services firms that are seeking to ensure that they serve senior investors in an ethical, respectful and informed manner will find useful suggestions. We also urge financial services firms to continue to develop practices that will help them to better serve senior investors.