Input on the Report to Congress on How To Modernize and Improve the System of Insurance Regulation in the United States
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ATTN: Michael T. McRaith,
Director, Federal Insurance Office,
Department of The Treasury.

Dear Mr. McRaith,

I appreciate the opportunity to provide the Federal Insurance Office ("FIO") with my personal comments on how to modernize and improve the system of insurance regulation in the United States. Am a licensed Life Agent in CA as well as a CA State Registered Investment Adviser, CFP® Certificant, Former President of the Institute of Certified Financial Planners, Los Angeles (1999) and former Chairman of the Financial Planning Association Los Angeles (2000). For purposes of this submission I intend to restrict my comments and recommendations to consumer and senior protection issues, the lack of national uniformity of State insurance regulations, and the regulatory licensing process for life/health agents and producers.

Regulation at the federal level for certain aspects of the business of insurance would be beneficial and desirable because:

- **Insurance producers are competing for the same trillions of investment dollars that stockbrokers and registered investment advisers have traditionally managed**

- **Utilize similar or identical titles such as Financial Planner and Financial Adviser or identical professional Designations such as CFP® (Certified Financial Planner) of ChFC® (Chartered Financial Consultant), but**

- **Operate under entirely different sets of rules and regulations and with entirely different and possibly adverse long-term consequences for the American economy.**

As the post-war baby boom generation prepares for, or already has retired, the search for a safer, guaranteed vehicle for retirement dollars has led many to rely on the advice of insurance agents for guidance. Why? Perhaps because their advice is "ostensibly" FREE and

comes with free lunch seminars for our struggling seniors?

Insurance products should **not** be advertised or sold as investment products, in my opinion, but many companies and marketing organizations are selling products such as index annuities, fixed and variable annuities, index fixed and variable life insurance products as safe **"investment"** vehicles for senior citizens, providing a guarantee of principle and a guaranteed rate of return based on the claims paying ability of the company and in the case of the life insurance products, tax free withdrawals for life.

Over two trillion dollars alone, had been deposited in fixed and variable annuities by the end of 2010 and trillions more dollars are likely to be transferred in the next 10 years as baby boomers retire and seek a safer vehicle for their retirement income. Even more money has been transferred to Variable Universal and indexed life insurance products. According to a new study released by the Insured Retirement Institute and Cogent Research in November of 2011, over two thirds of all advisers selling annuities have reported receiving at least one client request for an annuity and nearly two thirds of licensed producers currently offering annuities opine that guaranteed income options will increase in importance over the next five years.

If this trend continues without adequate consumer protection, oversight, supervision, audit or any kind of fiduciary liability attaching to the sell recommendation of regulated securities in brokerage or advisory accounts to facilitate the purchase of said insurance products, it could diminish the amount of free capital available for investment in America and have an adverse effect on our regulated markets and national exchanges. Exactly this is happening at this time because of a flaw in the Investment Adviser's Act of 1940 and a lack of foresight on the part of insurance regulators.

In a nutshell; a registered investment adviser has a fiduciary duty to his client while a registered representative of a broker dealer has a duty to know his client and recommend only suitable products. HOWEVER, an insurance agent has NONE of these duties. He/She can, without violating the law, recommend unsuitable products for his/her customers with the sole purpose of putting a commission in his or her pocket. And that inconsistency in legal obligations is not transparent to the customers because they often do not know that they are dealing with an insurance agent who is neither an Investment Adviser nor a registered representative, but still wraps themselves in a cloak of legitimacy by claiming "titles", designations or professional credentials that are often meaningless and have no value.

The major challenges facing this sector of the insurance industry as I see them are:

- **There is little or no uniformity in the regulation of the business of insurance across State lines**

- **There is little or no supervision, examination or audit of life insurance agents / producers**
- **The business of insurance is not adequately defined.**
- **The use of specious designations and titles by insurance producers to pad résumés is an alarming trend, particularly when marketing to senior citizens.**

There is little or no uniformity in the regulation of the business of insurance across State lines:

While I still believe that the primary responsibility for regulating and overseeing insurance producers should continue to rest with individual States, meaningful and beneficial reform in specific areas of the business of insurance, for example as it relates to financial service professionals (financial planners, insurance agents and brokers) could be achieved through either; the creation of a federal uniform statute to be adopted by States or a revision of the McCarran–Ferguson Act. The imposition of federal law is justified under the theory that the sale of certain instruments developed by insurance companies in the 21st Century, (often advertised as savings, retirement or investment vehicles) occur in such volume as to substantially affect interstate commerce, the national economy, national securities exchanges, and other securities markets. The abuses within the regulated securities markets during the 1920's and 1930's became subject to federal regulation for these same reasons.

McCarran–Ferguson, which granted States the authority to regulate the business of insurance, was enacted because of a Supreme Court decision in re. United States v. South-Eastern Underwriters Association, 322 U.S. 533 (1944), which overturned a previous decision in re Paul v Virginia, and thereby recognized the federal government's authority to regulate the business of insurance under the Commerce Clause of the Constitution, giving Congress the authority to regulate all or part of the business of insurance if it is deemed in the national interest to do so.

There is no uniformity of producer licensing, qualification or mandatory continuing education between the States. These issues could easily be resolved by creating a national standard to be adopted at the state level. My recommendation would be a federal mandate of at least 40 hours of classroom training followed by a written exam, 30 hours of basic continuing education on insurance related matters in each two year licensing period approved by each State's dept of insurance (unless the state already has higher requirements) plus two hours of ethics and with additional hours for those selling long term care products, equity index and variable annuities. (These are current requirements in CA but not elsewhere)

In many States there are separate analyst or counselor licensing requirements for those desiring to charge a "fee for service" for advice in the business of insurance rather than to

sell product for a commission. Everywhere else it seems to be a free-for-all. In some States that have them, analyst/counselor laws are often ignored or flagrantly violated due to lack of enforcement. I published a white paper in 2002 on extensive violations of the law in California, a copy of which was recently supplied to Congressman Royce and has been supplied to 3 CA insurance commissioners, although they completely ignored it.

It should be noted that the insurance analyst statute in California is woefully outdated and would need a massive overhaul. For example, it requires any person desiring to offer advice for a fee as an analyst to first "sell" insurance for a commission for 5 years with a traditional insurance agent license. This may have been acceptable 30 years ago when advisers came into the insurance business and decided after years of experience to move forward with a fee practice. However, in the 21st Century, many fee-only planning firms are recruiting individuals with an accredited bachelors or masters degree program in financial planning in addition professional certification marks such as CFP®, CLU or ChFC and the face of financial planning and the business of advice has advanced far beyond the scope of current law.

In some states such as Illinois, it is legal for life producers to charge a fee without separate licensing if they so desire. Some States prohibit a licensed agent from charging a fee for insurance advice, and then earning an additional commission for selling the same person the recommended insurance product (double dipping) others apparently do not have such restrictions.

Additionally, those who charge a fee for providing advice in the business of insurance and do not transact, or, those who refer mutual clients to licensed agents, but demand to supervise, review or authorize transactions recommended by insurance licensees for compensation should be required to do so in a fiduciary capacity and be required to obtain insurance "registration" and authorization by the States.

A federal Act could be used, for example, to introduce a new class of insurance "registration", which would permit the proffering of untainted and unbiased advice in the business of insurance without the necessity of appointment by an insurance company. Because this would be a "registration" **not** a license, each state's dept of Insurance would develop regulations to supervise and audit registrants, or, this supervision and audit could be performed by means of cooperation between the State securities regulatory body who audits financial planning practices anyway and the State Department's of Insurance.

Registrants will be required to act as Fiduciaries and the audit and examination procedures would be similar to those implemented for registered investment advisers under state investment adviser laws. The term fiduciary should be properly defined at the federal level to ensure uniformity of application. Registration at the federal level by all such fee advisers in the business of insurance, coupled with audits and examinations of their practices by

state Department of insurances would protect American consumers by ensuring that those who offer such advice do so in a fiduciary capacity and have complied with federally established and clearly ascertainable standards of education, examination, registration and continuing education.

For this newly created insurance analyst/counselor "registration", 60 hours of continuing education in the business of insurance in each two-year period should be mandated. After all, they will receive no training or support from any insurer and would rely completely on such continuing education to maintain their skills.

One potential barrier to the introduction of such a registration would be the lack of "no" premature use penalty commonly referred to as no-load) products available to the market for fee only advisers, meaning the client will essentially pay twice for one piece of advice; once in the form of a fee and once in the form of commission to the writing agent. This situation already exists in many States, although in some, writing agents may be permitted to rebate commissions to the client in the form of discounts. (Currently prohibited, however, by many insurance companies in the agent's contract and also by some States)

There is little or no supervision, examination or audit of life insurance agents / producers:

Currently, individuals who are "licensed", rather than "registered" conduct the business of insurance. As with other licensed occupations such as law, accountancy and the practice of medicine, Insurance "licensees" are not subject to supervision or audit by any regulatory body. Because insurance producers are merely agents of the insurer, discipline and regulatory compliance is reactive, based on complaints to the authorities, rather than pro-active through supervision, oversight and audit. By contrast, registered representatives of broker dealers and investment advisers are subject to severe restrictions on advertising, and are regularly supervised, and audited.

As previously stated, in some states, a licensed insurance producer is authorized to either charge a fee or a commission depending on the situation, in others separate licensing as either an analyst or counselor is required in order to charge fees for advice in the business of insurance. These laws are consistently ignored with impunity by many Investment Advisers who, despite regulatory bulletins to the contrary, insist that the Investment Advisers Act provides an exemption from insurance licensure.

In CA and in some but not all States, the Department of Insurance can only take administrative and regulatory action against individuals licensed by their department. Any non-licensee providing advice in the business of insurance for compensation in an unlicensed capacity in CA must be referred to local District or City's offices for prosecution as a misdemeanor. (In some states the offense is administrative not criminal) Prosecution

in CA has, on information and belief, never taken place because DA's or city attorneys are too overwhelmed and too underfunded to prosecute "high-paper" complicated and often "victimless" crimes where no jail time would be served due to overcrowding. Their case load of murders, rapes, drug offenses and vehicular insurance fraud etc. takes precedence and District and City Attorneys view the task of regulating the business of insurance licensing as within the purview of the Insurance regulator even though the "law" as currently written does not support this. Conveniently, private, self-regulatory organizations such as CFP Board and the National Association of Personal Financial Advisers (NAPFA) have also declined to discipline their members for acting outside the law because the Public prosecutors decline to prosecute. (Please refer to my attached white paper titled "Illegal Activities of Fee-Only Planners In The Business Of Insurance", attached)

By contrast, in regulating the business of investment advice, the CA Dept. of Corporations has the power to investigate non-registered individuals holding out as investment advisers and take regulatory action including examining their business models, demanding the production of documents, contracts agreements and other materials, holding hearings before an administrative judge, imposing fines and penalties and filing cease and refrain orders, also against non registered persons. **It is time to empower the Departments of Insurance in all 50 States with the same authority to act against unlicensed individuals engaging in the business of insurance for compensation without any kind of state mandated ascertainable standard of education, examination and licensing.**

While the cost of regulatory audits and supervision of an insurance agents' activities would be prohibitively expensive and create "big government", mandating that insurance companies create filters and rules for suitability and appropriateness and requiring them to review questionable practices would cost federal/state governments far less and rein in some abuse. Other examples of supervision could include requiring insurance companies approve seminar and all marketing materials used by insurance producers when offering their products and services. Stockbrokers and investment advisers must generally submit seminar materials and publications to compliance experts to ensure adherence to the law.

Additionally, under current law, an investment adviser is highly restricted in claims he can make when advertising and the use of testimonials is banned in many States. A life insurance producer has little if any restrictions on advertising in many states.

Many cases of wrongdoing in the business of insurance are directly attributable to false and misleading marketing and advertising, as well as misrepresentation of products. However, a still bigger concern is the fact that many insurance producers engage in emotions based selling techniques in order to close a sale. This pattern of behavior is particularly prevalent in sales of annuities and life insurance to senior citizens. By employing emotions based techniques to unsettle the client with horror stories of seniors who have lost "everything" in the stock market, these producers are able to move the client with completely lopsided

presentations to request a transfer for all assets from regulated securities accounts to insurance products without proper review or any fiduciary liability attaching to them. This is possible because the producer claims that he did not "recommend" the transfer, the client "requested" the transfer. High paper crimes are extraordinarily difficult to prosecute and senior citizens make poor witnesses long after the transaction. It is often marketed to producers that seniors will forget 85% of the presentation made to them after 3 days.

In the securities business, a significant supervisory requirement for suitability, appropriateness etc. is imposed on Broker Dealers by the federal regulatory authority FINRA. Broker-dealers, in turn, require registered representatives be supervised by a trained Series 8 or 24 Registered Principal, who must approve EVERY transaction.

Insurance companies have no such regulatory and compliance structure in place and while there is a structure whereby agents are given "titles" such as, agent, general agent, regional general agent, managing general agent… (The percentage commission rises with the title, for example a managing general agent may earn 120% first year commission on a product, and every one in the recruiting down line takes 10% overwrite while the writing agent gets 50% first year commission) It is my experience, however, that titles are meaningless in the insurance business because insurance companies ignore the intent of the law, i.e. Supervision and oversight of Agents, by General agents, overseen by regional general agents etc., and instead, hand out contracts piecemeal to anyone promising the company high "production".

A system should be implemented to require an agent be supervised and each transaction approved using basic suitability rules to prevent particularly "elder abuse" For example, an equity index annuity with 14 years of premature use charges beginning as high as 20% of the amount invested "may or may not" be appropriate for a 30 year old, but often, these same annuity contracts are sold and issued to 80 year olds without a word from insurers. California has just introduced such a statute. What is needed in addition is a mechanism to attach fiduciary liability to any transfer coming from a regulated securities account to an insurance company. This can attach to the producer or insurer but is more complicated if attached to the producer because he is, after all, a fiduciary agent of the insurer and owes no fiduciary duty to the client. Here, again, State law may vary but this is certainly the case in California. If insurers are required to review such transfers in a fiduciary capacity to the client, they will largely eliminate the kinds of abuses we are seeing right now by producers.

To further illustrate:

A pre-retiree client, age 60 with $500,000.00 to invest, seeks guidance from a Registered Investment Adviser. Any investment advice is offered in a fiduciary capacity with prior, full written disclosure of fees, conflicts of interest and any material facts that would affect the planner/client relationship. The adviser's practice is subject to oversight, examination and

audit by either the SEC or State's dept of corporations. In the case of hourly, as needed advice, an investment adviser may charge between $1 - 4,000.00 for his counsel. If the adviser is hired to manage the assets, he may charge an average, for example, of 1% for assets under management or possibly $5000 per annum flat fee and waive hourly fees. These fees vary according to the adviser's business model but must be fully disclosed in advance along with any conflicts of interest that exist between the client and adviser. An ongoing fiduciary relationship then exists between the planner and client.

An insurance agent visits the same client age 60 with $500,000 in investable assets. With no securities license and the claim that he does not offer advice as to the benefit of investing in regulated securities, this insurance agent may call himself an expert "financial planner" without the necessity of registration as an investment adviser. As an insurance "licensee" rather than a registered representative, his practice and the advice he gives are not subject to oversight, examination or audit by anyone. If this agent recommends an equity indexed annuity with 14 years of premature use charges, caveat emptor applies to the advice and purchase and the agents compensation could be as much as **$46,000** with no fiduciary liability. However, there is no requirement for full disclosure of the relationship to be created in writing prior to the sales presentation. Often as we have seen in regulatory actions against licensed life against active in the senior citizen markets, emotions based selling techniques are employed that, in the words of the marketing companies offering specious senior designations, will have seniors "begging you to liquidate their portfolio". Of course and as previously stated, a request by the consumer to liquidate a securities portfolio cannot be interpreted as a sell recommendation by the insurance agent and the agent skirts any potential fiduciary liability on the sell side of the equation.

Because the insurance contract is created between the Insurer and the client, for the insurance producer this advice boils down to one transaction, 3 hours of work and never having to see the client again… (Unless of course the producer believes there are more products to be sold) I believe that's more than most CEO's make per hour and certainly more than Congressmen, Senators or the President of the United States makes.

As an additional example, consider the very large and lucrative business model developed by Phillip Cannella, III, and chief executive officer of First Senior Financial Group in King of Prussia, Pennsylvania. SEC Inspector General H. David Kotz has come under scrutiny for comments he made in a 75-minute videotaped interview about the SEC and the stock market to Mr. Cannella, who markets a "crash-proof retirement" plan through the Internet and a paid radio program. This interview, among other things, is being utilized by Mr. Canella to "sell" fixed and equity indexed annuities to senior citizens through dissemination of these videotaped interviews over, among other mediums, YouTube. Mr. Cannella advertises himself as a "Master Elite IRA Advisor", a title that sounds impressive. The Elite IRA Advisor program is a "two day" sales techniques course in insurance products run by

Ed Slott. The "Master" Elite Advisor training is an additional two days of training in insurance sales techniques.

Mr. Canella claims in a recent interview with Financial Adviser magazine, to be creating financial and retirement plans "for free". He states he is licensed to sell insurance in over 40 states. ***"His company puts together individual plans for clients and then earns commission on products they buy from an insurance company. He described the investments as "guaranteed, tax-deferred contractual agreements with income options from a statutory corporation." The investments are "outside of the securities industry" and "many of them have outperformed the markets since their inception with no market risk, no market fees, no upfront commissions or sales costs," he added. The trade magazine Senior Market Advisor in January 2008 reported that Cannella said he wrote about $25 million in premiums in 2007 for fixed index annuities. Cannella said he didn't want to put a specific name on the investments he sells because he thinks the media has misreported on the products. "I'm not well-liked among securities guys because I am speaking truth and logic to a deceptive industry," Cannella said. "You can't beat the sword of truth.""*** (Source Financial Advisor Magazine – Article Attached)

His company name in Pennsylvania is "First Senior Financial Group". This may be legal in Pennsylvania, but would be most certainly need to be modified to "First Senior Financial ***And Insurance Services*** Group" under CA law to prevent misleading consumers. This is perhaps why Mr. Cannella is only licensed as an individual producer in CA and his company, on information and belief, does not hold an agency license.

Questions: Why should I, as a Registered Investment Adviser, CFP® Certificant and licensed life agent, subject myself to registration, supervision, oversight, restrictive advertising regulations and be required to work as a fiduciary with clients? Where is my incentive to continue with my current business model as a Registered Investment Adviser? How should I compete with financial plans offered for "free" by Mr. Cannella in CA when I am so heavily regulated and he can pretty much say and do as he pleases because he has nothing but an insurance license? Should I drop everything but my insurance license in favor of utilizing senior citizen marketing systems that will easily earn me high six or even seven figure income numbers rather than the five figure numbers I earn now, and with NO fiduciary liability attaching?!

Who is the greater fool here?

The system of regulation is currently broken and the Investment Advisers Act of 1940 needs to be amended to prevent this kind of uneven playing field **at the same time** as consideration is given to potentially introducing regulatory reforms in the business of insurance. It's a simple fix really, as illustrated below. Insurance agents need to go back to being insurance agents and not financial planners, financial advisers, financial consultants

or “master elite” anything and insurance products should not be allowed to utilize the term “investment”, period!

Concurrent with an introduction of federal insurance licensing regulations, you should recommend Congress amend the Investment Advisers Act. I can only speak to California, which incorporated the Uniform Act into CA law and in a white paper I wrote a number of years ago I suggested the following changes be made to California law to protect California’s consumers from harm. The following refers to California’s Corporations, Insurance and Financial Codes but obviously, a uniform act could be introduced, which could be incorporated into each State’s Corporations and Insurance Codes:

California Corporations Code Section 25009 (b):

Current Law	**Proposed Law**
25009 (b) "Investment adviser" also includes any person who uses the title "financial planner" and who, for compensation, engages in the business, whether principally or as part of another business, of advising others, either directly or through publications or writings, as to the value of securities or as to the advisability of investing in, purchasing or selling securities, or who, for compensation and as part of a regular business, publishes analyses or reports concerning securities. This subdivision does not apply to: (1) a bank, trust company, or savings and loan association; (2) an attorney at law, accountant, engineer, or teacher whose performance of these services is solely incidental to the practice of his or her profession, so long as these individuals do not use the title "financial planner;" (3) an associated person of an investment adviser where the investment adviser is licensed or exempt from licensure under this law; (4) an agent of a broker-dealer where the broker-dealer is licensed or exempt from licensure under this law, so long as (A)	25009 (b) "Investment adviser" also includes any person who uses the title "financial planner**”, OR who holds out as providing financial planning services** and who, for compensation **of any kind**, engages in the business, whether principally or as part of another business, of advising others, either directly or through publications or writings, as to the value of **“financial planning” as defined in section 25006.5(1)(a), or** securities**, or** as to the advisability of investing in, purchasing or selling securities, or who, for compensation and as part of a regular business, publishes analyses or reports concerning securities **or financial planning subject areas as defined in section 25006.5(1)(b).** This subdivision does not apply to: (1) a bank, trust company, or savings and loan association; (2) an attorney at law, accountant, engineer, or teacher whose performance of these services is solely incidental to the practice of his or her profession, so long as these individuals do not use the title "financial planner;" **or hold out as offering financial planning**

the performance of these services by the agent is solely incidental to the conduct of the business of the broker-dealer, and (B) the agent receives no special compensation for the performance of these services; or (5) a publisher set forth in paragraph (5) of subdivision (a), so long as the publisher or the agents and servants of the publisher are not engaged in any other activity which would constitute that person an investment adviser within the meaning of this section.	**services** (3) an associated person of an investment adviser where the investment adviser is licensed or exempt from licensure under this law; (4) ~~an agent of a broker-dealer where the broker-dealer is licensed or exempt from licensure under this law, so long as (A) the performance of these services by the agent is solely incidental to the conduct of the business of the broker-dealer, and (B) the agent receives no special compensation for the performance of these services; or (5)~~ a publisher set forth in paragraph (5) of subdivision (a), so long as the publisher or the agents and servants of the publisher are not engaged in any other activity which would constitute that person an investment adviser within the meaning of this section.

A new section 25006.5 should be added to CA Corporations Code that could be added by means of a federal Act or change in the IA Act:

25006.5 For purposes of this section and unless otherwise exempt;

(1) (a) an individual is deemed as engaging in financial planning when they claim expertise by means of advertisements, representations, titles, utilization of designation or certification programs or by any other device or means or method, in any of the financial planning subject areas defined in Section 25006.5(2) and;

(b) represents that he or she will, and / or actually engages in financial planning by (1) gathering confidential financial data, and/or (2) gathering personal information concerning client financial goals and objectives, and/or (3) Analyzing and evaluating the client's current financial status, and/or (4) Developing and presenting financial, retirement or estate planning recommendations and/or alternatives.

25006.5 (2) financial planning subject areas are defined as, but not necessarily limited to, the preparation and analysis of financial statements (including net worth, cash flow analysis/planning and budgeting), Investment planning (including portfolio design, i.e. asset allocation and portfolio management), Income tax planning, Education planning, Risk Management, Retirement planning, and Estate or Senior Citizen issues planning.

This modification would not affect “insurance agents” acting in their capacity as insurance agents and “selling or transacting the business of insurance”, but would curtail activities of insurance agents posing as experts in senior matters and financial planners, which by its very title suggests expertise in financial planning subject areas, including regulated securities, without adequate supervision, oversight and audit. Concurrently with this change in corporate securities law, the following revisions could be made to the California Insurance Code, or in the alternative, similar language could be developed and incorporated into a federal Act:

New Insurance Code Section

CIC Section 2192.1 (a) Any person acting in any of the capacities defined in Article 1 (commencing with Section 1621) of this chapter and who represents himself or herself to be an expert shall be subject to the provisions set forth in Section 25009(b) of the CA Corporations Code and must prove that any services performed while acting in any of the capacities defined in Article 1 (commencing with Section 1621) were performed with the due care and skill reasonably to be expected of a person who is such an expert.

(b) For the purposes of this section, the following apply:

(1) A person represents that such person is an "expert" within the meaning of this section if such person represents that he or she is a "financial planner," "financial adviser," "financial counselor," "financial consultant" or an "investment adviser," "investment counselor" or "investment consultant," “Senior Advisor,” “Senior Consultant,” “Estate Planner,” “Estate Planning Specialist,” “Elder Planner,” “Elder Counselor,” “Elder Specialist,” or, any of the foregoing titles in conjunction with the term “Chartered,” “Certified,” or “Specialist” or, uses any other title, professional designation, academic credential or professional certification mark that would lead a reasonable person to conclude that he or she possesses such expertise, or that such person offers and /or renders

"financial planning services," "financial advisory services," "financial counseling services," "financial consulting services" or "investment advisory services," "investment counseling services" or "investment consulting services" “trust services” “elder,” “estate,” or “senior” advisory services, consulting services , or counseling services or any combination thereof, or makes substantially equivalent representations with respect to such person's business or qualifications.

(2) "Person" includes an individual, corporation, partnership, limited liability company, joint venture, an association, joint stock company, a trust or unincorporated association.

(c) The following persons are not liable under the provisions of this section:

(1) Any person, when engaged in the purchase or sale of tangible personal property for his or her own account, and the agents and employees of such persons.

(2) Any person, and the agents and employees of such person, licensed under, exempted from licensing under, or not subject to licensing under by reason of an express exclusion from a definition contained in, the Commodity Exchange Act, the Investment Advisers Act of 1940, the California Commodity Law, the Corporate Securities Law of 1968, the Real Estate Law, or any state or federal law for the licensing and regulation of banks or savings and loan associations.

Section 2192.3 - Necessity of License

The following activities are not exempt from licensure under Insurance Code Section 1631, because they are directly related to solicitation, negotiation, or effecting the sale of insurance:

(a) Explanations, discussions, or interpretations of, and offering of opinions or recommendations on, insurance coverages, exposures, limits, premiums, rates, deductibles, payment plans, or any other insurance contract, or potential insurance contract, terms.
(b) Recommending advising, or urging applicants for insurance coverage, potential applicants for insurance coverage, or policyholders to buy particular insurance policies or to insure with particular companies or insurers.
(c) Binding of insurance coverages.

Note: Authority: Section 8 of AB 393, Chapter 321, States of 2000. Reference: Insurance Code Section 1631.

In California, the CA Dept. of Corporations and the CA Dept. of Insurance are the two State agencies responsible for the supervision of almost all individuals and firms who hold out as providing "financial planning" services, which include estate planning, senior and elder planning. However, the disparity in disclosures, oversight and supervision among those professions who "hold out as" financial planners, senior advisors or experts is huge.

FINRA Registered Representatives are somewhat restricted in utilizing the term financial planner or advertising "financial planning" services by their broker dealers because their job description of providing investment advice in securities with the utilization of such terms would necessitate registration as investment adviser representatives of the firm. However, oversight and supervision at the Broker Dealer level also leaves much to be desired, and significant documentation can be provided to legislators showing the types of abuse consumers suffer at the hands of unethical and unsupervised registered representatives and insurance agents. It should also be forcefully conveyed to legislators

that; insurance companies do not supervise, audit, oversee or examine the advertising or sales practices of their agents.

California's statutes contain hopeless flaws, which the above language would fix. Currently, the CA Dept of Corporations interprets the IA statute literally, differentiates between the term financial "planner" and financial "planning" and ignores any individual or firm who offers or engages in "financial planning" **UNLESS they also offer advice in "securities".** In the 21st. Century, with new and exceedingly complex products, which can easily mislead a person into believing they are securities particularly when they are advertised and marketed as having all of the upside of the stock market with none of the downside", this outdated mode of regulation makes no sense whatsoever.

If it makes sense for Dept of Corporations examiners to supervise, audit and examine the type and quality of financial, retirement and estate planning advice offered by an investment advisory firm when the typical fee earned by a fiduciary adviser is between $2,000- $4,000 for a plan involving $500,000.00 of assets, then surely it makes even more sense to audit and examine the type and quality of financial, retirement and estate planning advice offered by a non-fiduciary insurance agent who claims to offer the "same level" of expert financial, retirement and estate planning services while earning an average of $45,000.00 on a single $500,000 index annuity transaction, does it not?

Retirement Planning, Estate Planning, Tax Planning, Risk Management and the preparation of net worth, cash flow and budgeting statements as part of any financial plan requires significant expertise, none of which is currently contained within the series 7 or 65 or insurance licensing curriculum. To allow a person to use the title "financial planner" offer these services ostensibly for free in direct competition with fiduciary investment advisers and engage in "financial and elder planning" without supervision by the CA Dept of Corporations simply because they claim not to offer advice in securities is asinine and does not encourage ethical conduct, but rather, actually rewards those who opt out of additional regulation, supervision and audit with less responsibility and liability for their actions.

The largest number of complaints flowing through regulators in all 50 states at this time in regards to fixed and index annuities and life products seem to be lodged against insurance agents who hold out as experts in financial, retirement and estate planning and who utilize emotions based selling techniques taught at "The Annuity University" (among others) to "invest" in fixed and Equity Index Annuities and life products. In the case of equity index products, which are not regulated as securities, claims are often made that such products offer all the upside of the stock market with none of the downside. Agents are taught to paint prospects into a corner and wait for the prospect to beg for a liquidation of their securities portfolio in favor of an annuity. By doing so, the unlicensed agent avoids any fiduciary liability on the "recommendation to sell" and there is no fiduciary liability or supervision in recommending the purchase of an index annuity for an insurance agent, not

affiliated with a FINRA firm. In California at least, a prudent expert standard can be asserted against financial planning charlatans under Section 3372 of the Civil code. However, to do so, the damaged party needs to sue in civil court and the question always asked is, what is the extent of the damages and with plaintiffs whose age exceeds 70-85 years in many cases, how many lawyers will prosecute the case, particualry since there is an additional element to consider…

While equity index annuities with 11 years of penalties may be totally inappropriate for many senior citizens particularly the target audience of over 75 year olds many agents seek out, the account values before surrender charges still reflect the initial investment. Until the consumer exits the contract there are no damages. In this case, it is rare that a lawyer will take such a case on contingency and the cost of litigation for poor advice from a non-fiduciary financial planner / insurance agent is prohibitive given the "perceived" lack of damages. The State Attorney General's office and local district attorneys are loathe to prosecute such cases because the sentences they can expect to achieve from a successful prosecution in such a high paper crime are paltry and their budgets are better spent on more serious crimes. Additionally, lawyers are often able to obtain rescission on the contract and the return of funds to the client with no lawsuit filed, but also no complaint filed against the "agent", who may continue selling product unabated.

Effectively, these officers of the court facilitate the crimes perpetrated by unethical planners through inaction and the lack of supervision and oversight of such rogue planners by the Dept of Corporations and Dept of Insurance leaves most consumers to their own devices because there are no effective administrative remedies available and, the legal system ensure the conduct continues because the client wants their money back without to much fuss.

Action is being taken in all states and by FINRA to stem the tide of unethical practices in this industry. Most recently, FINRA issued regulations requiring all Broker Dealers supervise sales of equity index annuities made by their registered representatives. As a result, many of the less ethical representatives are leaving broker dealers, dropping their securities licenses to exclusively offer index products outside of FINRA's supervisory structure. Unfortunately, the loopholes in California's laws and lack of regulation of "all" financial planners, leaves California's consumers at the mercy of these unethical individuals.

Additionally, CIC Section 2192.3 fleshes out the current necessity of licensure and spells out in necessary detail, what constitutes "advice in the business of insurance", another contentious issue among financial planners, which absolutely needs to be addressed, and could be at a federal level to make the regulation uniform across all 50 states. This brings me to:

The business of insurance is not adequately defined:

Before **"The Business Of Insurance"** can be effectively and efficiently regulated nationwide, it must first be adequately defined in many States.

A federal Act could create uniform definitions for "solicitation", "negotiation", "transaction" and, additionally, "necessity of licensure/registration" for individuals who do not intend to "sell" insurance as agents of the insurer, but rather, intend to provide advice for a negotiated fee and/or to supervise and approve the actions of a licensed insurance agent with a mutual client because of an existing relationship in a different capacity. (Examples include stockbrokers, financial planners, investment advisers and CPA's) An exclusion from registration would be lawyers, who may advise on all aspects of contract law and how a person should hold title to assets.

In a discussion paper dated September 25, 1998, the California Producer Licensing Working Group recommended defining "solicitation" in the following manner:

Solicitation: Any oral or written statement or image (1) made by any person, either directly or by another person acting pursuant to the first person's authorization, direction, or control; (2) which statement is made with the intention or likely effect of provoking, directly or indirectly, a recipient's interest in potentially purchasing an insurance product.

This effort failed in the California legislature.

California also recently **tried but failed** to enact Section 2192.3 - Necessity of License:

The following activities are not exempt from licensure under CA Insurance Code Section 1631, because they are directly related to solicitation, negotiation, or effecting the sale of insurance:

• Explanations, discussions, or interpretations of, and offering of opinions or recommendations on, insurance coverages, exposures, limits, premiums, rates, deductibles, payment plans, or any other insurance contract, or potential insurance contract, terms.

• Recommending and/or advising, or urging applicants/potential applicants / policyholders applicants for insurance coverage, potential applicants for insurance coverage, or policyholders to buy particular insurance policies or to insure with particular companies or insurers.

• Binding of insurance coverages.

Such language would be unequivocal and could be incorporated into a Federal Act. If penalties were stiff enough, it would force those providing illegal advice in the business of insurance for a fee to submit to State or federal mandated licensing, examination and continuing education with an ascertainable standard developed by the State or Federal Regulator.

There is an additional ongoing problem with insurance marketing agencies licensed in multiple states offering trust and estate planning services, (Trust Mills) which constitutes the unlawful practice of law, or in the alterative, the unlawful sharing of legal fees with non-lawyers. Interstate trust mills, many of them located in Nevada at this time, and some run by organizations already fined or censured in other states openly solicit insurance agents and encourage them to use back-door selling techniques in order to gain a senior citizens trust while gathering significant financial information that will later be used to sell annuities or life insurance products. This practice is rampant and continues despite the introduction of regulations in states such as California. A federal Act with stiffer sanctions and penalties for violations could reduce or eliminate these practices.

Specious elder/estate planning designations:

There should be a broad and comprehensive prohibition on specious elder and estate planning designations, with the introduction of regulations similar to those in California. As in California, State Department's of Insurance would prepare a list of approved designations and would develop a vetting process to include examination of all educational elements, reviewing whether the examination process is proctored or open book, whether State approved continuing education is required to maintain or renew any such designation, whether any advice given is done so in the capacity of a fiduciary, and what policies and procedures are in place to accept complaints, or discipline holders of any such certifications and when necessary procedures for revocation and reporting of disciplinary procedures to the authorities. This mandate could be imposed with a federal law.

Financial Planner / Financial Planning:

If insurance agents are prevented from utilizing specious elder and estate planning designations in order to fabricate the appearance of expertise, it is likely they will turn to the only other title available to them, that of financial planner. And this, of course, brings me full circle to my previous comments on the necessity of a change in the Uniform Investment Advisers Act. (Supra) Therefore I propose that the term financial planner and financial planning be restricted and defined under federal law, to be incorporated into state law and that any person who holds out as a financial planner or offers financial planning services (also to be defined) be required to register as an investment adviser and provide such advice as a fiduciary irrespective of whether they also offer any advice as to the value

of investing in regulated securities. An extensive study was performed already by the Government Accountability Office on the topic of financial planners and financial planning (report attached) and, while I do not agree with all their conclusions, they make very astute observations, hence the inclusion for contextual purposes, as an attachment to this report.

I will be happy to expand on any of these topics and provide additional information and real-life examples and anecdotes upon request.

Respectfully Submitted,

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Illegal Practices Of Fee-Only Financial Planners In The Business Of Insurance

(Problems & Solutions)

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Illegal Activities in the Business Of Insurance By Fee-Only Financial Planners (Problems And Solutions)

Prepared by
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INTRODUCTION:

Overwhelming media focus on "methods of compensation" for financial services in the recent past, rather than competence and regulatory compliance, has fueled an ever increasing, consumer-driven demand for FEE-ONLY advice in insurance planning. Media and marketing hype has influenced the consumer's perception and led many to conclude that; "fee-only planners" are the **only** planners capable of giving objective, unbiased advice relating to insurance matters because they receive no compensation from third parties, are not affiliated with, represent or take compensation from insurers and therefore, have **no** conflicts of interest and loyalty that could impair their ability to provide objective and unbiased information. Unfortunately however, many fee-only financial planners in California and 38 other States with similar regulations are operating outside the law in order to provide this "objective and untainted" advice. This discussion will highlight these illegal insurance activities and provide potential solutions, (initially for California, although the suggested solutions could be used as a model for other States) to increase compliance with current California insurance law. It will also discuss developing trends in the business of offering insurance advice in California, particularly in relation with the provision of insurance advice as a component of a "Comprehensive Financial Plan". All Statutes herein are California statutes unless otherwise indicated.

INSURANCE LICENSING:

The three most widely held insurance licenses issued to individuals who provide general advice to families and consumers on general insurance matters in California are; The Life Agent License,(LX) the Fire and Casualty Broker-Agent (FX) and, to a negligible degree, the Life and Disability Analyst License.(LA) A full list of other licenses is available at www.insurance.ca.gov.

Life Agent (LX)

The licensing requirements for a Life Agent license are set forth in Chapter 5, Part II, Division 1 of the Insurance Code and are attached hereto as Exhibit I. A Life Agent (LX) is defined as: ***a person authorized by and on behalf of a life or disability, or life and disability insurer, to transact life, disability or life and disability insurance***.[1]

Generally, a life agent advises consumers as to the benefits and disadvantages of life, health, disability and long term care insurance etc. and transact business on behalf of one or more insurance companies, offering products to consumers. A Life Agent must be compensated

by the insurer on the sale of product in the form of commissions and cannot accept fees for service from the consumer. There are approximately 154,664 resident and non-resident LX agents serving Californians.[2]

Fire & Casualty Broker-Agent (FX)

A fire and casualty licensee is a person authorized to act as an insurance agent, broker, or solicitor, and a fire and casualty broker-agent license is a license so to act. The FX licensee's authority to act is determined by which documents are initially submitted:

- A $10,000 Bond of Insurance Broker, form 417-5, authorizes the licensee to act as an insurance broker. An insurance broker is a person who, for compensation and on behalf of another person transacts insurance other than life with, but not on behalf of an insurer.

- An Action Notice of Appointment, form 447-54, authorizes the licensee to act as an insurance agent. An insurance agent is a person authorized by and on behalf of an insurer to transact all classes of insurance, except life insurance.

- An Action Notice of Solicitor, form 417-31, authorizes the licensee to act as an insurance solicitor. An insurance solicitor is a natural person employed to aid an insurance agent or insurance broker in transacting insurance other than life.

There are approximately 88,300 resident and non-resident FX agents serving Californians.[3]

Life & Disability Analyst (LA)

The licensing requirements for a Life and Disability Analyst license are set forth in Chapter 8, Part II, Division 1 of the Insurance Code and are attached hereto as Exhibit II. A Life and Disability Insurance Analyst is defined as: ***a person who, for a fee or compensation of any kind, paid by or derived from any person or source other than an insurer, advises, purports to advise, or offers to advise any person insured under, named as beneficiary of, or having any interest in, a life or disability insurance contract, in any manner concerning that contract or his or her rights in respect thereto.***[4]

Generally, a LA is trained to a significantly higher level than a LX and can advise a consumer not only as to the advantages and disadvantages of all forms of insurance, but can also provide competent, unbiased comparative analysis of various policies for a fee, as well as interpret the rights of consumers under any insurance contract. The LA must, among other things;

- Have been licensed as a Life Agent (LX) for a period of at least 5 years preceding a LA application[5] and
- Must complete a comprehensive course of education covering significantly more topics than the LX and,
- Pass a rigorous examination before obtaining the LA license.

It should be noted that the LA license currently authorizes a person to provide advice for a fee on all insurance related matters, but does not currently require **any** training or examination in Long-Term Care insurance, or require a minimum number of hours of continuing education credit in each licensing period. In the past ten years, the number of CA Life And Disability Analysts has remained stable at approximately 44 (forty four) for the entire State's population.[6]

"FINANCIAL PLANNERS" OFFERING INSURANCE ADVICE

There are over 34,000 (thirty four thousand) Registered Investment Advisors and Investment Advisor Representatives in California.[7] An Investment Advisor in California is authorized under §25009(b), California Corporations Code[8] to utilize the title of "financial planner" (without any statutory requirement to substantiate his / her competence to perform the tasks of a financial planner) and perform comprehensive financial planning services on a fee-only basis. The examination and qualification requirements for the Series 65 (Uniform Investment Adviser Law Examination) are attached hereto as Exhibit III. **NO knowledge of insurance products or the business of insurance is required** in order to register as an Investment Advisor. "Financial Planning" and "Financial Planners" are having an ever increasing and significant impact on the provision of insurance services in California. It is important that State Agencies and boards such as the CA Dept of Insurance (CDI) Agent and Broker Advisory Committee (ABAC) provide input to regulators and legislators alike, regarding allied "professions" impacting the business of insurance to ensure that consumers are properly protected. A copy of this discussion will, therefore, be forwarded to both the CDI and the ABAC for their consideration.

Many fee-only planners offer **"comprehensive"** financial planning services that, by definition, include risk management analysis and recommendations as part of the planning process. These recommendations include calculations regarding the amounts and types of life insurance, recommendations with regard to the benefits and disadvantages of various individual and/ or group health insurance plans, disability and long term care plans etc. In some cases advice is provided on a fee basis regarding homeowners, auto and other types of property, casualty and general liability coverage.

To avoid real and "perceived" conflicts of interest, many fee-only financial planners choose **not** to maintain affiliations or representation agreements with any insurer and, therefore, are unable to license themselves as LX's or FX's. Some let their LX or FX licenses lapse when they transition to fee-only planning. In both these cases, California law is clear. Any person accepting fees for insurance related matters from any third party other than an insurer, unless otherwise exempt, must be licensed as a LA.[9] In an attempt to circumvent the law, other planners obtain a LX and / or FX license to create the appearance of legal compliance, but never have any intention of actually "transacting business" or utilizing the license for the purpose for which it was originally issued or intended. This practice is prohibited under CA law,[10] because it is the fee-only planner's true intention to **charge the consumer** for

insurance advice rather than to be compensated by an “insurer” as CA Insurance Code Sections 32 & 1622 (supra) require.

Many fee-only planners quote an often-abused section of California's Insurance code, Section 1831(e), which provides a limited exemption from insurance licensing for Registered Investment Advisers to justify their unlawful behavior. The following is an excerpt from a letter originally addressed to Errold Moody, CFP™, (A California Life & Disability Analyst who has concerned himself with the illegal activities of fee-only financial planners in insurance matters for over 10 years in California) on July 27, 1995, by Patricia Staggs the then Assistant General Counsel and Chief, Compliance Bureau of the Legal Division, Compliance Bureau of the California Department of Insurance, who wrote regarding the Investment Adviser exemption:

*"That exemption appears at Insurance Code Section 1831(e) and provides an exemption to the chapter regarding life and disability analysts for "an investment adviser as defined in section 25009 of the Corporations Code**, "when acting in that capacity."** (Emphasis added) Section 25009 of the Corporations Code provides as follows:*

"Investment adviser means any person who, for compensation, engages in the business of advising others, either directly or through publications or writings, as to the value of securities or as to the advisability of investing in, purchasing or selling securities, or who, for compensation and as part of regular business, publishes analyzes or reports concerning securities. "Investment Adviser" does not include (a) a bank, trust company or savings and loan association; (b) an attorney law, accountant, engineer or teacher whose performance of these services is solely incidental to the practice of his profession; (c) a broker-dealer whose performance of the services is solely incidental to the conduct of his business as a broker-dealer and who receives no special compensation for them; or (d) a publisher of any bona fide newspaper, news magazine or business or financial publication of general, regular and paid circulation and the agents and servants thereof, but this clause (d) does not exclude any person who engages in any other activity which would constitute him as an investment adviser within meaning of this section.

A life and disability insurance analyst is defined in insurance code 32.5 as follows:

"Life and disability insurance analyst" means a person who, for a fee or compensation, paid by or derived from any person or source other than an insurer, advises, purports to advise, or offers to advise any person insured under, named as a beneficiary of, or having any interest in, a life or disability insurance contract, in any manner concerning that contract or his or her rights in respect thereto."

*The Department's view to that exemption set forth in insurance code 1831(e) is that an investment adviser need not submit to regulation by the Department of Insurance so long as the activities engaged in by the investment adviser fall within the defined activities of an investment advisor as set forth in Corporations Code section 25009. It is noteworthy that the definition of an investment **adviser contains no reference to insurance related activities.***

(Emphasis Added) Therefore, any activities included within the definition of life and disability analyst, such as advising as the life insurance products, are clearly outside the "capacity" of an investment adviser, and would subject the person to the provisions of law relating to life and disability insurance analysts.

Very Truly Yours,
Patricia Staggs

Since as early as 1995, the CDI has taken the documented position that the Investment Advisor exemption applies ONLY when a Registered Investment Advisor acts "in that capacity" and, as defined in section 25009 of the Corporations code. It is the author's conclusion based on conversations with CDI staff counsel Jody Miller, therefore, that the only time a Registered Investment Advisor in the State of California may lawfully provide "insurance" related advice to a consumer for a fee would be, **for example**, if he were advising a client as to the allocation of sub accounts containing regulated securities within an already existing variable life insurance or variable annuity policy.

This exemption does **NOT**, however, permit a Registered Investment Advisor to discuss the merits or disadvantages of any type of insurance including Life, Health, Disability, Long Term Care, Property / Casualty, Homeowners, General Liability, Auto insurance etc. that do not contain any elements related to the provision of investment advisory services. Under current law then, any Registered Investment Advisor who provides such advice and is compensated directly by the consumer without having first obtained a LA license, is guilty of a misdemeanor.[11]

The position of the CDI was illuminated in a letter addressed to representatives of the financial services sector who attended a series of meetings held with the Dept. of Insurance in late 1997. In as letter dated February 3, 1998, Assistant Ombudsman and Legislative Liaison Jeffrey Kenny wrote:

February 3, 1998

On July 30, 1997, a discussion concerning the life and disability insurance analyst license was held between the California Department of Insurance (CDI) and members of the financial planning industry. As you participated in this dialog, I am writing to communicate CDI's policy on this matter.

The focal point for this issue is consumer protection, not the interests of the individual factions. With all parties based in customer service, it is sad that this detail has been lost in much of the discussion. As defined by insurance code Section 32.5, a life and disability insurance analyst is

"... a person who, for a fee or compensation of any kind, paid by or derived from any person or source other than the insurer, advises, purports to advise, or offers to advise any person

insured under, named as beneficiary of, or have any interest in, a life or disability insurance contract, in any manner concerning that contract or his or her rights in respect thereto."

The fact that there are only 46 life and disability analyst in California is not a valid argument for repealing this code. In fact, the limited number of licensees and population in noncompliance begs for increased education and enforcement. While the easy solution for those in noncompliance may be to repeal this law, consumers who pay for fee advise on insurance matters deserve an analyst educated in insurance per CDI standards. The current licensing requirements ensure that relationship. Any legislative effort to repeal this law will likely be opposed, on the basis that such action is harmful to consumers, by consumer groups, insurers, agents and brokers, and the California Department of Insurance.

At the July 30, 1997 meeting, representatives from the financial planning industry raised two additional suggestions concerning CDI's examination requirement. The first seeks to allow issuance of a Life and Disability Analyst license to Certified Financial Planners and Certified Public Accountants following the successful completion of their own professional examinations. Again, this is an idea that requires legislation and will certainly face opposition. CDI's position remains at only those individuals who pass CDI's exam are to be issued a life and disability analyst license. CDI is the agency charged with enforcing this license and will remain, via its examination and related or regulatory functions, the authorizing agency for this license.

The final suggestion request a waiver of the requirement than an examinee must have five (5) years experience as a life licensee, or employment experience under said licensee, to sit for CDI's examination. Again, this is an idea that requires legislation. CDI will reserve judgment until the full breadth of this proposal has been introduced to the state legislature.

Despite some groups interest in changing current law, there is an existing law which is, and has always been, quite clear. While a financial planner may be illegally engaging in insurance analyst activities and may not be aware of their violation, it is my hope that this the explanation of policy will provide them with the impetus to come into compliance or cease the illegal activity immediately. Per insurance code Section 1844, " any person who acts, offers to acts, assumes to act, as a life and disability insurance analyst when not licensed by the commissioner per this article..... is guilty of a misdemeanor." Consistent with current practice, information obtained on individuals in noncompliance will be aggressively pursued.

Sincerely,

Jeffrey Kenny
Assistant Ombudsman and Legislative Liaison

However, successful criminal prosecutions for a violation of CIC §1844 are apparently rare because the CDI must turn these matters over to local district attorney's offices Statewide. Their failure to enforce the law is probably attributable to a lack of funding to prosecute

non-violent, misdemeanor counts of this nature where no victim can be produced. Unfortunately and to the detriment of California's consumers, this lack of enforcement has had the effect of creating a Cavalier attitude towards compliance with State law that, essentially, seems to tolerate this unlawful activity, permitting fee-only planners to operate almost with impunity.

There are a number of fee-only financial planners who claim in their firm's disclosure form that they have no affiliations or representation agreements with any insurance carriers and, that they do not represent or offer for sale, any kind of insurance products. However, in reality, they maintain LX or FX licenses and have contracts with life insurance carriers who do not require a minimum annual production level **without any intention** of "transacting" on behalf of an insurer, (a violation of CA Insurance code section 1668 sub. (c) & (g) supra) while making no disclosures anywhere on their disclosure statements or advertising materials as to their active insurance licenses, which is in and of itself a violation of Section 1725.5 of the Insurance Code.[12]

Other fee-only financial planners claim that any insurance advice given by them to their clients as part of a comprehensive financial plan is given "free of charge". They claim that a fee is charged for all the other elements (investment, tax, retirement & estate planning), but **not** for the risk management portion of the plan. They point to the fact that they never "act in any of the capacities defined in Article 1 (commencing with Section 1621)" because they do not appoint themselves with, or represent an insurance company or any particular insurance product and, do not actually "transact" insurance business. (Thereby avoiding, in their minds, a licensing requirement under CIC Sections 32 & 1622) Furthermore they claim, they **do not** charge the consumer a fee for the advice they provide, regardless of the complexity of that advice. (Charging a fee would trigger a licensing requirement under section 32.5, Insurance Code) The result, if the courts upheld this logic, would be that the Dept. of Insurance would lose all control and authority for the provision of insurance advice to consumers by fee-only financial planners in California to the California Dept. of Corporations. Worse still, the only recourse damaged consumers would then have against fee-only financial planners in the business of insurance would be the California Dept. of Corporations, a state agency woefully equipped to enforce state insurance laws.

One problem that requires statutory revision is the lack of a suitable definition for "transacting" in the business of insurance. While the Dept. of Insurance has considerable leeway in determining what constitutes "transacting", the code itself provides little or no useful information or guidance for fee-only planners who often feel, based on the wording of the current definition, that they acting inside the law when performing certain services. Transaction is defined under §35 of the Insurance code as:

35. "Transact" as applied to insurance includes any of the following:
    a) Solicitation.
    b) Negotiations preliminary to execution.
    c) Execution of a contract of insurance.
    d) Transaction of matters subsequent to execution of the contract and arising out of it.

While the requirements under sub(s) b, c, & d, is self-explanatory, "Solicitation" (sub. A) Is not defined and the legislature has, to date, been loathe to define it, leaving the interpretation to the CDI and creating a "fact at issue" that requires administrative or judicial interpretation and determination in cases where fee-only planners dispute their activities as "transacting". This is not the first time the issue of defining "solicitation" has been brought to the attention of the Department of Insurance. In a discussion paper dated September 25, 1998, the Producer Licensing Working Group recommended defining "solicitation" in the following manner:

Solicitation: ***Any oral or written statement or image (1) made by any person, either directly or by another person acting pursuant to the first person's authorization, direction, or control; (2) which statement is made with the intention or likely effect of provoking, directly or indirectly, a recipient's interest in potentially purchasing an insurance product.***

This author believes a clarification of what constitutes Solicitation under the Insurance Code will assist Registered Investment Advisors, fee-only financial planners and others in assessing which license, if any, would be appropriate given their particular facts and circumstances. If the legislature decides not to act, the Dept. of Insurance should issue authoritative guidelines or advisory opinions, similar to those of other regulatory agencies such the SEC, NASD and IRS in an effort to bolster compliance. This is extremely important given recent trends and developments in the delivery methods and current practices of individuals providing insurance services in California.

The issue of "transacting" and what constitutes "solicitation" aside and with regard to the practice of giving advice in insurance for free; CIC Section 1631 does not mention compensation as a criteria for triggering a licensing requirement.[13] Even setting aside the current CDI determination of what constitutes "transacting" which is ambiguous, California's Insurance code, for purposes of interpretation, is also governed by Section 1858 of the California code of Civil Procedure (CCCP)[14]. There is voluminous precedent under CCCP section 1858 supporting the author's opinion that the interpretation of a statute that produces an absurd or anomalous result will not prevail when used as a defense. ***In interpreting a statute, Supreme Court avoids any construction that would produce absurd consequences.[15] In construing statute, state Supreme Court will not parse each literal phrase of statute if doing so contravenes obvious underlying intent, or leads to absurd or anomalous result[16]***

Since it is already well settled in law that, "The business of Insurance is a business affected with a public interest,"[17] this author believes the circumvention of State Insurance licensing laws by fee-only financial planners in **any** manner, irrespective of compensation or level of competence, presents a clear and present danger to California's consumers and is contrary to the public interest. The intent and desire of the Legislature to require State licensure for insurance professionals is clearly set forth in CA Insurance Code Sections 1631, 1633 & 1633.5[18], and is unambiguous in the author's opinion.

UNLICENSED INSURANCE ADVICE, CURRENT REMEDIES

CA Insurance Code Section 1668 applies in the case of fee only planners who maintain a license but do not intend to actively transact business as LX's. The sole remedy for such conduct is that under this section; ***" the commissioner may deny an application for any license issued pursuant to this chapter if:***

……. (c) The applicant does not intend actively and in good faith to carry on as a business with the general public the transactions which would be permitted by the issuance of the license applied for;
……. (g) The applicant seeks the license for the purpose of avoiding or preventing the operation or enforcement of the insurance laws of this state;"

CA Insurance Code Section 1668 is problematic in that; it is difficult if not impossible to enforce unless insurers are "required" to terminate **all** LX's & FX's not actively "transacting" insurance business, and, unless the Dept. of Insurance requires proof be provided to the department by the insurer that a LX or FX **is**, in fact, actively transacting business. The code could require insurers to review commissions paid to appointed agents on an annual basis and terminate the appointments of all agents who do not "transact" over a period of 12 months unless valid cause can be shown. Exceptions could be made for salaried employee of insurers and persons engaged in the regulation of insurance business in whatever form.

CA Insurance Code Section 1844 is applicable to fee only planners who provide insurance advice for a fee, or, "for free" and provides that; ***any person who acts, offers to act, or assumes to act, as a life and disability insurance analyst when not licensed by the commissioner as provided by this article, or after the license granted to him or her has been suspended or revoked, unless proceedings are pending in the courts to review the act of the commissioner, is guilty of a misdemeanor, punishable by a fine of not more than one thousand dollars ($1,000) or by imprisonment for not more than one year or by both such fine and imprisonment.***

Again, this is difficult if not impossible to enforce because the Dept. of Insurance must rely on local district attorney's offices, most of which have no funds to prosecute non-violent misdemeanor counts, particularly when most D.A.'s offices consider this a matter for the Insurance Commissioner in the first place. Therefore, rather than seek prosecution under this section, the Dept. of Insurance should actively enforce State law against violators under the recently introduced CIC section 12921.8. (discussed below) It makes no sense for the Dept. to refer these cases to local district attorney's offices if their decision to prosecute under the State's criminal statutes is based on "financial considerations", rather than the evidence of malfeasance.

There are two other remedies available to the Dept. of Insurance. The first is California Insurance Code (CIC) 790 et. Seq., The Unfair and Deceptive Trade Practices Act. The second is the aforementioned and recently introduced CIC Section 12921.8.

Prosecution under CIC 790 et. Seq does not require compensation because, under section 790.01, the Insurance Code applies to all persons engaged in the "business" of insurance.[19] Under section 790.04, the Dept. of Insurance is authorized to investigate any person engaged in the business of Insurance in California.[20] Transacting in the business of insurance without a valid license with or without compensation is clearly an unfair and deceptive, competitive practice because violators seek to avoid and evade ascertainable standards in training, examination, licensing and continuing education required by the State for agents and brokers appointed by insurers who are performing, essentially, the same tasks, while at the same time claiming to take the "ethical high ground" in terms of the advice given. State licensing places the agent at a competitive disadvantage because a licensed agent can only accept compensation from an insurer unless that agent is also a Life and disability Analyst. Section 790.035 provides substantial administrative penalties including fines and restraining orders for persons violating this Act.[21] The provision of unlicensed insurance advice, whether for a fee or "free of charge" by fee-only planners is detrimental to the consumers of California because there is no ascertainable standard of education, or requirement to keep current present unless such planners are subjected to the licensing requirements of the CA Dept. of Insurance.

The second remedy available is authorized under CIC Section 12921.8[22], which provides for greater administrative remedies against those individuals who transact the business of insurance without proper licensure. A CA Life & Disability analyst whose business has been severely impacted filed complaints in early 2002 against prominent California fee-only planners who are flagrantly violating the law. To date, the CDI has taken no action against these planners and it remains unclear whether these new powers will be utilized on a **proactive** basis to seek out fee-only financial planners offering insurance advice, or, whether the Dept. of Insurance will remain **reactive** to "consumer" complaint only in the enforcement of California's insurance laws

On a final note, the CDI is considering proposed regulations pursuant to the authority granted to the Insurance Commissioner under the provisions of in SEC. 8 of Assembly Bill 393, Chapter 321, Statutes of 2000 that, among other things, address the necessity for licensing. These new regulations include a proposed section 2192.3

Draft

Section 2192.3 - Necessity of License

The following activities are not exempt from licensure under ~~CIC~~ Insurance Code Section 1631, because they are directly related to solicitation, negotiation, or effecting the sale of insurance:

(a) Explanations, discussions, or interpretations of, and offering of opinions or recommendations on, insurance coverages, exposures,

limits, premiums, rates, deductibles, payment plans, or any other insurance contract, or potential insurance contract, terms.

(b) Recommending ~~and/or~~ advising, or urging ~~applicants/potential applicants/policyholders~~ applicants for insurance coverage, potential applicants for insurance coverage, or policyholders to buy particular insurance policies or to insure with particular companies or insurers.

(c) Binding of insurance coverages.

Note: Authority ~~cited~~: Section 8 of AB 393, Chapter 321, States of 2000. Reference: Insurance Code Section 1631 ~~of the Insurance Code~~.

Should section 2192.3 be enacted, any perceived ambiguities associated with the giving of "unlawful" advice by fee-only planners would be eliminated. While the author applauds all these efforts to increase compliance through enforcement and regulation, the consumer's total ignorance of California Insurance law and the reactive nature of insurance enforcement will bring few, if any, real-world changes for consumers. There have, to date, been few complaints regarding the illegal practices of fee-only financial planners by consumers because, a) a licensed life insurance agent is always eventually involved in the "sale" of a specific product to the consumer, and b) the client has already received a written affirmation from the fee-only planner that he is acting in a fiduciary capacity as their trusted advisor. The client, therefore, places greater value on the fee advice given by a fee-only planner, than the advice of a licensed life agent "selling" the same product the fee-only planner recommends, simply because the licensed individual is an agent of the insurer.

Of course, the consumer is paying twice for the same advice, once in the form of fees and a second time in the form of commissions to a licensed "agent". Providing there is no relationship between the fee-only planner and the insurance agent and no referral fee is payable by the agent to the planner, this fact is never disclosed to the client. It is the author's personal experience that many fee-only financial planners refer these clients to out-of-state insurance agencies who have declared themselves willing to provide substantial discounts from their commissions. While the author views these discounts are "only fair in light of the circumstances", it does not excuse the illegal conduct and the fact that the client is not receiving any favorable **contractual** benefits on their insurance policy such as; shorter exclusion periods, shorter surrender penalties, lower mortality and expense fees or lower percentage monetary penalties for early termination of the product.

The already established fiduciary relationship between a fee-only financial planner and his / her client creates a bond of trust that implies, by its very nature that the planner is fully complying with all federal and state laws. In fact, many fee-only planners subscribe to written codes of ethics established by credentialing bodies and professional membership organizations such as the CFP Board of Standards, the Financial Planning Association and the National Association of Personal Financial Advisors (NAPFA), which demand their members comply with all federal and state licensing laws. However, the aforementioned

professional membership and regulatory bodies are conflicted in their response to the problem of illegal activity because both organizations, as mentioned previously on page 5 & 6 of this report, are lobbying for a change in the law that will allow such fee-only planners, particularly those holding the CFP® Certificate, to qualify for a waiver from licensing. These professional membership and regulatory bodies refuse to investigate or discipline such planners unless the State first prosecutes them. The State of California, for reasons stated elsewhere in this report, have been loathe to take action against these fee-only planners despite repeated complaint filings by life and disability analysts over the most recent ten year period, whose income is being severely impacted by such illegal activities.

From a consumer's perspective, there would be absolutely no reason to question the integrity of their fee-only financial planner. In fact, organizations such as the National Association of Personal Financial Advisors (NAPFA) have marketed their fee-only planner members as the "only" planners capable of providing clear, untainted, unbiased advice on all financial matters including insurance and have disseminated brochures since the 1980's claiming that commissioned based advice is somehow tainted and a totally flawed delivery method that could harm consumers. NAPFA's position has been supported and publicized to a great extent by the media, including magazines such as Bloomberg and Money, to newspapers such as the Los Angeles Times, which requires "fee-only" as a pre-requisite "method of compensation" for any planner participating in it's popular "Money Makeover" series of consumer assistance feature articles. It has also been supported by non-profit organizations such as the Consumer Federation of America. Negative consumer perceptions of insurance licensed individuals, has to a great extent, been unfairly tainted by such media hype and marketing tactics.

The recent introduction of section 12921.8[22] coupled with an acceptance of proposed section 2192.3 would, absolutely, provide the CDI with additional needed powers to regulate the business of insurance. It will not in the author's opinion, however, increase compliance in any meaningful manner. Continued consumer ignorance of State insurance laws and reactive rather than pro-active enforcement by the CDI will almost certainly maintain the current status quo.

This author applauds the sentiment of the recently introduced statute, but believes it has no real-world practical value. This license requirement will continue to be ignored by most fee-only planners because of the incredible burden it places on them in terms of initial compliance and qualification. In addition, the statute, to date, remains un-enforced because the CDI lacks the manpower and funding within the civil enforcement division to even begin to attack this widespread problem. Simply stated, this recently introduced legislation demands aggressive investigation, large fines and numerous prosecutions to achieve even partial compliance. The CA Department of Insurance has instigated a consumer-complaint driven "reactive" role, rather than a consumer-protective "proactive" enforcement campaign even after the introduction of CIC section 12921.8.

One major reason for continued non-compliance is the requirement that applicants be registered as LX agents for five years preceding their examination and licensure as LA's.

(Fee-only planners view this as being forced to move back into a house they have already sold) Secondary reasons include, fee-only planners view the LA license as an over-qualification to perform the tasks they desire to perform, there are no schools or colleges currently teaching the course work required to become LA's because a total lack of enforcement by the CDI of this statute has created a total lack of interest on the part of fee-only planners. Also, there are no teaching materials or publications available for purchase to prepare for the examination. These problems and potential solutions are discussed in more detail in the section below.

Finally, it is fascinating and significant to note that, while many fee-only planners firmly believe State and SEC investment adviser regulations are outdated, irrelevant and sorely in need of a complete revision and overhaul if they permit planners to "perform comprehensive financial planning", few if any fee-only financial planners actually violate the Investment advisory statutes. One major reason for this almost total compliance is because of the rigorous enforcement efforts of the Dept. of Corporations, the NASD and the SEC in regards to the Investment Adviser Act of 1940, and the severe penalties including imprisonment it imposes for offenders.

In light of the foregoing, this author has concluded that, the only way consumers will be substantially protected from unlicensed insurance activities is if; (a) meaningful reforms are enacted that make statutory compliance desirable, and, (b) cooperation is sought with other State agencies such as the Dept. of Corporations and private, professional regulatory organizations such as the CFP Board of Standards (discussed later) who regulate activities in related financial service categories, to facilitate the sharing of information crucial in establishing which activities fee-only financial planners are engaging in.

RECOGNIZING NEW DELIVERY METHODS IN THE BUSINESS OF INSURANCE

It is the author's belief that licensing compliance in the business of insurance will only become a reality when States recognize the recent, rapid developments in the "methods of delivery" of insurance advice nationwide, particularly those associated with the emerging profession of financial planning. More and more consumers have recognized the advantages of employing **one** trusted advisor for all their financial affairs and view insurance advice as part of an overall financial plan. California's consumers are cognizant that conflicts of interest exist in insurance planning because LX & FX agents are only compensated by insurers and represent the insurer's interests to the client, not the client's interests to the insurer. Such agency relationships impact the fee-only planner's ability to honor his/her fiduciary obligation to act in the client's best interests at all times.

Fee-only planners desire to perform the tasks and functions of an LX & FX licensee. Few, if any, desire to perform the more complex tasks and analysis normally expected of a Life and Disability Analyst. Fee-only planners are committed to eliminating the conflicts of interests associated with representing an insurer, and many consumers in California desire to employ one fee-only planner to handle all their affairs, including the insurance planning portion of their financial plan, rather than multiple professionals. The net effect of this is that many

consumers seek out fee-only planners to reduce conflicts, while ostensibly obtaining objective and untainted advice. Unfortunately, they are instead, often given incompetent advice by unlicensed individuals. In order, then, to benefit and protect consumers, substantial but beneficial reform is necessary.

Fee-only planners with established financial planning credentials equate obtaining the LA license with "moving back into a house they are trying to sell". They feel competent and qualified to assist consumers in insurance planning and may have held insurance licenses for years prior to allowing them to lapse. State law, however, demands they be licensed for five years preceding their application for licensing as Analysts and, during that time they would need to "transact" insurance as a licensed LX agent, something they do not feel they can do.

As the author sees it, the State has two choices in this matter. It can either; crack down on fee-only planners and others offering unlicensed insurance advice for a fee, (hardly feasible based on lack of funding, staffing or voluminous consumer complaints) or, seek ways to legalize, regulate and supervise these planner's activities. Currently, financial planners are regulated at the state level under Section 25009(b) of California's Corporations Code. Which states;

Section 25009 (b) (b) "Investment adviser" also includes any person who uses the title "financial planner" and who, for compensation, engages in the business, whether principally or as part of another business, of advising others, either directly or through publications or writings, as to the value of securities or as to the advisability of investing in, purchasing or selling securities, or who, for compensation and as part of a regular business, publishes analyses or reports concerning securities……..."

While consumers nationwide have embraced the concept of comprehensive financial planning, California, along with most other States, has been slow to recognize that financial planning has developed far beyond the simple giving of "investment" advice. Financial planners in California are still regulated, supervised and audited by the Dept. of Corporations which, while skilled in terms of overseeing regulated securities transactions, is woefully under equipped to supervise the activities of a planner engaging in insurance, investment, tax, retirement, estate and asset protection planning. The Series 65 Investment Advisor Examination is the only legal requirement for those who desire to use the term "financial planner" in California. However, as the Series 65 training and education requirements[23] illustrate, the current State educational requirements for "financial planners" are far removed from the level of competency actually required to practice "financial planning".

RECOGNITION OF "FINANCIAL PLANNING" AS A PROFESSION

The State of California is well known for its innovative and forward thinking and has a unique opportunity, as the bell-weather State of this nation, to lead the way for other States to follow. It is time for California's regulatory and licensing bodies such as the Dept. of Insurance and Dept. of Corporations to recognize "financial planning" as an **"emerging**

allied profession" that is having a significant impact on the provision of services traditionally regulated by their agencies. Recognizing the emerging profession of financial planning and, recommending to the legislature the necessity of developing regulations that will govern professionals who desire to practice the profession of financial planning, is the only viable, sensible and logical long-term solution for protecting California's consumers from harm.

As with any other emerging profession the State, in developing any such regulations, should recognize and seek the counsel of long established national and international organizations that have developed, rules, guidelines, ethics, and ascertainable standards of education, examination criteria, credentialing and continuing education requirements. Consideration should also be given as to whether a new or existing State agency should regulate the activities of financial planners, or, whether these activities should be regulated independent of agencies in allied professions such as those agencies governing insurance and securities. As an example, lawyers, accountants and bank employees etc. are provided limited exemptions from registration under insurance and securities laws because the State has concluded that their existing professional State licensing requirements contained in the Business and Professions Code, established standards of practice and a written codes of ethics and professional responsibility, provide sufficient protection to consumers without requiring multiple State licensure.

Regulations governing investment advisers are inadequate to address the multitude of tasks performed by comprehensive financial planners. The question therefore arises as to whether a separate state license and new regulations should be developed within the Business & Professions Code to govern comprehensive financial planners, that is separate and distinct from investment advisory services, in order to adequately protect California's consumers. **Should the use of the commonly touted investment industry term "financial planner" be reserved for individuals who have been State certified as competent to perform comprehensive financial planning?** The greatest obstacle to the recognition of financial planning as an emerging profession requiring some form of licensure is; by what standards should such a profession be measured? Many fee-only financial planners have no professional accreditation whatsoever, other than the investment adviser registration overseen by the CA Dept. of Corporations. Have ascertainable and acceptable standards been developed?

FINANCIAL PLANNING AND THE CERTIFIED FINANCIAL PLANNER® CERTIFICANT

The most widely recognized professional financial planning designation worldwide is the CFP® Certificate. The CERTIFIED FINANCIAL PLANNER BOARD OF STANDARDS, INC.[24] (Hereafter, CFP Board) has licensed its CFP® and CERTIFIED FINANCIAL PLANNER® trademarks to over 67,000 individuals in 19 countries. There are currently 4,578 CERTIFIED FINANCIAL PLANNER® Certificants licensed in California.[25] Most CFP® Certificants hold multiple State or federal licenses (insurance, securities, Registered Investment Advisor etc.) and are already supervised in their professional activities by

multiple federal and / or state agencies. Sadly, not one auditor of any supervising federal or state agency possesses the knowledge base or skill sets to supervise the overall activities of a comprehensive, fee-only financial planner. It should be stated that while the CFP Board has established a code of ethics and uniform standards of practice for CFP® Certificants that could be used as a yardstick by legislators, the CFP Board does not currently supervise, investigate or audit any CFP® Certificant's activities, unless a formal complaint is filed against a Certificant with the Board.

The CFP Board, defines a **"financial planner"** as a person; "who is capable and qualified to offer objective, integrated comprehensive financial advice to or for the benefit of individuals to help them achieve their financial objectives." A financial planning professional must have the ability to provide competent financial planning services to the client utilizing the **"financial planning process"[26], which** covers basic "**financial planning subject areas"**.[27]

With specific regard to the business of insurance, it is important to understand the benefits provided by the CFP® Certificate course of education, as well as its shortcomings. The CFP Board has developed a course curriculum (Attached as Exhibit IV) in insurance planning as an integral part of the CFP® Certificate examination requirement. This educational requirement exceeds the training currently required by the California Department of Insurance on all levels. There are, however, shortcomings to the CFP Board's program that cannot be overlooked. There is no training in State insurance regulations or any State's insurance code provisions governing the business of insurance. Furthermore, while there is a mandatory requirement that each CFP® Certificant complete 30 hours of continuing education for each two year certification period, there is currently no requirement that all of these hours be approved by the CDI for insurance continuing education credits.

The CFP Board of Standards is willing to cooperate with the CDI to address and correct the shortcomings in its program. Once these problems have been corrected, there are two potential solutions that, if implemented, could encourage full compliance with State licensing laws, certainly on the part of CFP® Certificant, fee-only planners not currently licensed.

SOLUTION 1: PROVIDE A FULL EXEMPTION FROM INSURANCE EXAMINATION AND LICENSING TO CFP® CERTIFICANTS WHO ARE LICENSED AS REGISTERED INVESTMENT ADVISORS

Currently, section 1831(e) provides a limited exemption from insurance licensing for Registered Investment Advisors, (RIA's) but **only** ***"when acting in that capacity"***. (Discussed in detail earlier) This suggestion would expand the relevant code section and remove any limitation from RIA's performing the tasks of a LX or FX agent providing the following conditions are met;

1. The person is and remains a licensed Registered Investment Advisor either with the State or by the S.E.C., AND,

2. The person remains a CFP® Certificant in good standing, AND,

3. The person, in addition to any continuing education requirements of the CFP Board of Standards in other areas of financial planning, completes no less than 30 hours of continuing education in each two-year period that is approved by the CA Dept. of Insurance, 8 hours of which must be a qualified and state approved long-term-care planning course, AND,

4. The person provide to the CA Dept. of Insurance proof of his current licensing status as a Registered Investment Advisor and CFP® Certificant, together with a list of all approved continuing education courses completed for each two year period, or whenever required to do so by the Dept. of Insurance, AND,

5. Obtain a surety bond to protect consumers in the amount of $100,000 (one hundred thousand dollars), AND,

6. Carry at least $2,000,000 (two million dollars) of errors and omissions insurance, proof of which must be submitted annually, or whenever required to do so by the CA Dept. of Insurance.

EFFECT OF THIS EXEMPTION

As previously illustrated, the Registered Investment Advisor license **alone** does not qualify a person to offer insurance advice for a fee. The CFP® Certificate alone, even once enhanced to provide training in statutory law and the regulation of the business of insurance in California, would be insufficient because the CFP® Certificate is not an official **State regulated** license. However, a combination of the CFP™ Certificate and the Registered Investment Advisor license, coupled with the other suggestions made above, will provide a sound, educational basis for any person desiring to offer insurance advice for a fee, while protecting the public from harm to a **far greater degree** than they are protected under current law. In addition, this proposed exemption would alleviate the need for fee-only CFP® Certificants to become licensed LA's in order to be compensated by the consumer, thereby eliminating the requirement that they license themselves as LX's for 5 years before meeting licensing qualification requirements. By NOT forcing fee-only planners to move into a house they've already moved out of, BUT RATHER, demanding competence in return for a waiver from LA licensing requirements, the CA Dept. of Insurance would protect the consumer while facilitating an opportunity for immediate compliance without expensive investigation of illegal activities, prosecution and supervision of future activities. Compliance would go up, the cost of supervision, investigation and prosecution would go down.

It is important to note that any advice given would be limited under this proposed change, to the typical advice offered by LX or FX licensees, who generally provide explanations, discussions, or interpretations of, and offering of opinions or recommendations on, insurance coverages, exposures, limits, premiums, rates, deductibles, payment plans, and

insurance contract, or potential insurance contract, terms, as well as recommending and/or advising potential applicants/policyholders on insurance coverage to buy particular insurance policies or to insure with particular companies or insurers. **The advice given should not be allowed to encroach on the more complex tasks a Life & Disability Analyst provides.**

This exemption will:

- Permit Registered Investment Advisors with a CFP® Certificate to offer insurance advice without the need for appointment by an insurer, and allow them to be compensated by a third party other than the insurer for that advice. (A Variant of this model already exists in Connecticut and New Hampshire. A very POORLY structured derivative (that this author does **NOT** support) has just been signed into law in Idaho. The Idaho statute gives a Registered Investment Advisor carte blanche to offer insurance advice for a fee without any training, examination or continuing education requirement in insurance planning, a clear violation of the public trust. In addition, CFP® Certificants will shortly be given an exemption from registration as Insurance Counselors (LA equivalent license for Texas) in Texas. The author finds this unacceptable because, again, no instruction will be mandatory in insurance regulation and insurance law)

- Require the candidate to complete a comprehensive course of education in, among other things, all aspects of insurance planning, and, demand state licensing (as an investment adviser) before qualifying for the exemption.

- Require continuing education of 30 hours in insurance planning, a significant improvement over the LA license which requires **NO** continuing education currently

- Leaves intact, the State Insurance Commissioner's authority (under CIC§790 et. Seq. And CIC§12921.8 (supra)) to supervise, audit, fine, punish and bar from the business of insurance in CA, any person who violates the public's trust

COMPARISON OF THE "CFP® PLUS REGISTERED INVESTMENT ADVISOR" EXEMPTION, TO THE LIFE AND DISABILITY ANALYST LICENSE REQUIREMENT

There will still be a need for the Life & Disability Analyst license in California. LA's provide a valuable service to the public by:

- **Offering expert testimony in court regarding all insurance related matters**

- **Providing complex, expert comparative analysis and interpretation of the terms and conditions of various insurance contracts to consumers, accountants and lawyers**

- **Explanation of the rights of the parties under an insurance contract, a service otherwise reserved exclusively to members of the Bar.**

The proposed exemption would not obviate the need for LA licensees. It will provide a means for fee-only, Registered Investment Advisor financial planners who have earned the CFP® Certificate, a professional financial planning credential that has course work superior to the current minimum standard requirement by the CA Dept. of Insurance, (with the noted exceptions listed above, which must be addressed ***before*** an exemption would be granted) to serve their clients basic insurance needs without appointment by an insurer and the inherent conflicts of interest this may represent.

EFFECT OF THIS PROPOSED EXEMPTION ON CONSUMERS

This proposed exemption would have a substantially positive effect on consumers, with no negative impact whatsoever. They will be able to seek out a professional on a fee basis that has complied with an ascertainable standard in terms of education, licensing, examination, competency and continuing education. It will further provide greatly enhanced protections for the public against wrongdoing by requiring a bond in the amount of $100,000 (one hundred thousand dollars) **and** mandatory Errors and Omissions insurance in the amount of $2,000,000 (two million dollars), neither of which is currently required under law for LX, FX or LA licensees licensed by the CA Department of Insurance. (It should, however be noted that most if not all CFP® Certificants meet all the above criteria already in terms of E&O insurance etc., and obtaining a $100,000 bond would not place an undue burden on any fee-only, CFP® Certificant planner) Finally, it recognizes the fact that most consumers do not require the sophisticated level of assistance offered by an LA in planning their insurance matters.

POTENTIAL PROBLEMS ASSOCIATED WITH THE GRANTING OF AN EXEMPTION FOR CFP® CERTIFICANTS MEETING THE ABOVE CRITERIA

One possible problem would, of course, be that other financial service professionals with professional insurance or financial planning credentials would seek to block any such legislation unless their credential were to be included. Some other designations worthy of exemption would be:

The Chartered Life Underwriter (CLU)
The Chartered Financial Consultant (ChFC)

The author, based on the knowledge and skill sets required to hold such designations, has no objections to the inclusion of these designations for purposes of the aforementioned suggested exemption, providing these professionals meet **ALL** the other criteria.

SOLUTION 2: PERMIT STATE LICENSING AS A LX OR FX WITHOUT INSURANCE COMPANY APPOINTMENT AND AUTHORIZE PLANNERS TO BILL CLIENTS DIRECTLY.

Under California law, a person who "for a fee or compensation of any kind, ***paid by or derived from any person or source other than an insurer,***"(emphasis added) must register a Life and Disability Insurance Analyst under CIC Section 32.5. As previously illustrated in this discussion, however, Life and Disability Insurance Analysts are required to

- Pass an antiquated examination that has not been substantially revised since 1983
- Self-Study, in some cases, already repealed statutes because no examination revisions have been undertaken since 1983. Furthermore, no educational courses are available from any college, school or professional educational institution because there is simply no demand for the license, due to a complete lack of enforcement of LA laws by the CDI
- Self Study to familiarize themselves with many topics including Long Term Care and other more recently introduced exotic and hybrid insurance products because candidates are not tested on these products due to lack of LA examination revision

Oddly, once licensed, Life and Disability Insurance Analysts are **NOT** required to complete **any** continuing education requirements of any kind. There is no requirement, other than one imposed by "potential liability" through civil action, for a LA to "remain current" as a LA licensee.

In light of the foregoing, a far more sensible alternative and second potential solution would be; to allow all LX & FX agents to be licensed with the CDI without the requirement for appointment to transact on behalf of an insurer. LX or FX agents desiring to be compensated directly from the consumer, (for purposes of this discussion, the author will refer to such agents as FLX & FFX agents) would subject themselves to the same CDI licensing and examination requirements as traditional LX & FX agents. FLX & FFX agents would also be subject to the same continuing education requirements as traditional LX & FX agents. The function of FLX & FFX licensed individuals would be to act "quasi" in the capacity of a personal representative of the client with the authority to negotiate and effect all insurance coverages on their behalf, at the best possible terms, with any company they choose. (As fiduciaries, such FLX &FFX licensees would be subject to regulations similar to the NASD's "best execution" rules. They would be required to perform extensive due diligence and seek the best coverages at the most reasonable prices on behalf of their clients)

Currently, such activities allowed under CIC §33 are restricted to "***a person who, for compensation and on behalf of another person, transacts insurance other than life with, but not on behalf of, an insurer."*** (Emphasis added) In essence then, a similar but new and distinct section would be created, expanding the role of an "insurance broker" as defined under CIC §33 to that of a FLX & FFX, who would be authorized to solicit and negotiate all forms of insurance including property / casualty, life, health, disability, long-term-care and other forms of insurance.

This new Code section would make additional demands on any person seeking to license him/herself as a FLX & FFX licensee to protect consumers from harm. Among other things such licensees would be required to;

- Complete ***BOTH*** LX and FX courses of education and the appropriate licensing examinations. (Based on the CFP Board's program of education in insurance planning, fee-only comprehensive financial planners provide information regarding all aspects of a consumer's risk management needs.

- Be a licensed Registered Investment Advisor with the State, AND,

- Complete no less than 30 hours of continuing education in each two-year period that is approved by the CA Dept. of Insurance, 8 hours of which must be a qualified and state approved long-term-care planning course, AND,

- Provide to the CA Dept. of Insurance proof of current licensing status as a Registered Investment Advisor, together with a list of all approved continuing education courses completed each two year period, or whenever required to do so by the Dept. of Insurance, AND,

- Obtain a surety bond to protect consumers in the amount of $100,000 (one hundred thousand dollars), AND,

- Carry at least $2,000,000 (two million dollars) of errors and omissions insurance, proof of which must be submitted annually, or whenever required to do so by the CA Dept. of Insurance.

EFFECT OF THIS NEW LICENSE

This proposed license would have a substantially positive effect on consumers, with no negative impact whatsoever. Consumers will be able to seek out a "licensed" professional on a fee basis that has complied with an ascertainable standard in terms of education, licensing, examination, competency and continuing education. The examination requirement supports the CDI's position as stated in the February 8, 1998 letter written by Jeffrey Kenny (Supra) that only those individuals who pass CDI's exams are to be issued licenses and, that the CDI will remain, ***"via its examination and related or regulatory functions, the authorizing agency……"*** in the business of insurance. It will further provide greatly enhanced protections for consumers against wrongdoing by requiring a California surety bond in the amount of $100,000 (one hundred thousand dollars) **in addition to** mandatory Errors and Omissions insurance in the amount of $2,000,000 (two million dollars), neither of which is currently required under law for LX, FX or LA licensees licensed by the CDI. Finally, it recognizes the fact that most consumers do not require the sophisticated level of assistance offered by an LA in planning their basic insurance needs on a fee-only basis.

SUMMARY AND CONCLUSIONS

The California Dept. of Insurance has, essentially, four choices.

1. Maintain a Status Quo approach, do nothing to address the illegal activities of fee-only financial planners, remaining a reactive, rather than proactive regulator of the business of insurance.

2. Implement a program of rigorous investigation and enforcement of illegal activities in the business of insurance utilizing current and newly introduced sections of the California Insurance Code, to stamp out the widespread and growing problem of illegal activities on the part of fee-only financial planners offering advice in insurance matters for a fee in California.

3. Consider implementation of one or more of the solutions suggested in this discussion

4. Develop meaningful initiatives such as those suggested herein, to combat and/or provide solutions to illegal activities in the business of insurance.

Maintaining the status quo and doing nothing to address the illegal activities of fee-only planners will eventually cause the CDI to lose control and regulatory authority over the business of providing insurance advice to consumers to other state agencies such as the Dept of Corporations, an agency ill equipped and hardly qualified to supervise and monitor such activities. More and more broker-dealer registered financial planners and life agents are transitioning to the more profitable fee-only model. Without aggressive enforcement of the law, many of these planners may eventually surrender their insurance licenses to avoid multiple state licensure, layering of regulation, supervision and audit. The current lack of any enforcement by the CDI against prominent planners who have already been reported to CDI's investigations division by Errold Moody, CFP® and others over the past ten years is an encouragement to other transitioning planners to ignore and violate State law. Inaction equates to state condoned tolerance and silent approval in the eyes and minds of many fee-only financial planners.

Rigorous investigation and enforcement, while preferable, is also the most difficult policy to enforce. The CDI has neither the manpower, nor the consumer driven complaints necessary to actively enforce insurance laws against fee-only planners violating state law. Simply put, these planners are "off the radar" and rarely generate complaints. Since they are not licensed, they do not fall under the authority of the CDI and, unless they are brought to the attention of the CDI by virtue of consumer complaints, these planners will continue to remain extremely difficult to find. Additionally, the CDI lacks proper funding and manpower to effectively enforce Insurance laws in California at this time. Therefore, any consideration for rigorous investigation and enforcement must be viewed as impractical, given the current budget deficit and the apparent lack of will on the part of the CDI and local district attorney's offices to prosecute violators when they are reported.

By implementing one or more of the suggestions contained in this discussion, the CDI will facilitate voluntary and willing compliance with state law, while ensuring that their mandate to protect consumers from harm by insisting that CDI established examination, licensing and continuing education requirements, would be met. Fee-only planners would be able to offer the advice they desire to offer on a fee basis with direct client billing, the CDI would be in a far better position to supervise, control, audit and discipline these planners if and when the need arises. More importantly, consumers would be able to turn to the CDI for assistance without hearing the phrase; "I'm sorry, that individual is not licensed and does not fall under our jurisdiction".

In conclusion, the CDI has the opportunity to solicit opinions and suggestions from state sponsored agencies and boards such as the CA Agent and Broker Advisory Commission to the Dept. of Insurance. Some members of the CDI Agent and Broker Advisory committee are fee-only CFP® Certificants and have an understanding of the issues involved. These professionals and other insurance professionals, whose livelihoods also depend, in part, on ethical conduct in the business of insurance are in a position to provide valuable input to the CDI regarding these suggestions.

It is hoped that this discussion will generate concern and renewed scrutiny of the illegal activities of fee-only planners in California and that this, in turn, will lead to a necessary, beneficial and long overdue overhaul of California's insurance licensing laws for the benefit of not only California's consumers, but eventually Consumers nationwide who reside in States with similar insurance advisory statutes.

Respectfully submitted.

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[1] *CA Insurance Code Sections 32 & 1622*
[2] Source, Dept. of Insurance Annual Report 2000
[3] Source, Dept. of Insurance Annual Report 2000
[4] *CA Insurance Code Section 32.5*
[5] *CA Insurance Code Sections 1849*
[6] *Source. CA Dept. of Insurance, March 2002*
[7] *Source, CA Dept. of Corporations, March 2002*
[8] *25009. (b) "Investment adviser" also includes any person who uses the title "financial planner" and who, for compensation, engages in the business, whether principally or as part*

of another business, of advising others, either directly or through publications or writings, as to the value of securities……(Excerpt)

[9] *CA Insurance Code Section 32.5*

[10] *CA Insurance Code Section 1668: The commissioner may deny an application for any license issued pursuant to this chapter if:*

……. (c) The applicant does not intend actively and in good faith to carry on as a business with the general public the transactions which would be permitted by the issuance of the license applied for;

……. (g) The applicant seeks the license for the purpose of avoiding or preventing the operation or enforcement of the insurance laws of this state;

[11] *CA Insurance Code Section 1844. Any person who acts, offers to act, or assumes to act, as a life and disability insurance analyst when not licensed by the commissioner as provided by this article, or after the license granted to him or her has been suspended or revoked, unless proceedings are pending in the courts to review the act of the commissioner, is guilty of a misdemeanor, punishable by a fine of not more than one thousand dollars ($1,000) or by imprisonment for not more than one year or by both such fine and imprisonment.*

[12] *CA Insurance Code 1725.5. (a) For purposes of Sections 32.5, 1625, 1626, 1724.5, 1758.1, 1765, 1800, 14020, 14021, and 15006, every licensee shall prominently affix, type, or cause to be printed on business cards, written price quotations for insurance products, and print advertisements distributed exclusively in this state for insurance products its license number in type the same size as any indicated telephone number, address, or fax number.*

CIC 1725.5 (c) Any person in violation of this section shall be subject to a fine levied by the commissioner in the amount of two hundred dollars ($200) for the first offense, five hundred dollars ($500) for the second offense, and one thousand dollars ($1,000) for the third and subsequent offenses. The penalty shall not exceed one thousand dollars ($1,000) for any one offense. These fines shall be deposited into the Insurance Fund.

[13] *1631. Unless exempt by the provisions of this article, a person shall not solicit, negotiate, or effect contracts of insurance, or act in any of the capacities defined in Article 1 (commencing with Section 1621) unless the person holds a valid license from the commissioner authorizing the person to act in that capacity.*

[14] *1858. In the construction of a statute or instrument, the office of the Judge is simply to ascertain and declare what is in terms or in substance contained therein, not to insert what has been omitted, or to omit what has been inserted; and where there are several provisions or particulars, such a construction is, if possible, to be adopted as will give effect to all.*

[15] *Flannery v. Prentice (2001) 110CalRptr.2d 809, 26Cal 4th 572, 28P.3d 860*

[16] *People v. Martinez (1995) 45CalRptr.2d 905, 11Cal.4th 434, 903P.2d 1037*

[17] Caminetti v. State Mut. Life Ins. Co. (1942) 126P.2d.809,26Cal 4th 572, 28P3d, 860.

[18] *1631. Unless exempt by the provisions of this article, a person shall not solicit, negotiate, or effect contracts of insurance, or act in any of the capacities defined in Article 1 (commencing with Section 1621) unless the person holds a valid license from the*

commissioner authorizing the person to act in that capacity. The issuance of a certificate of authority to an insurer does not exempt an insurer from complying with this article.

1633. Any person who acts, offers to act, or assumes to act in a capacity for which a license is required without a valid license so to act is guilty of a misdemeanor.

1633.5. It is hereby declared to be the intent of the Legislature in enacting this chapter that the regulations prescribed herein be the exclusive regulations relating to the conduct of insurance business by persons licensed to act in any of the capacities defined hereunder, any local regulations or ordinances notwithstanding.

[19] *790.01. This article applies to reciprocal and interinsurance exchanges, Lloyds insurers, fraternal benefit societies, fraternal fire insurers, grants and annuities societies, insurers holding certificates of exemptions, motor clubs, nonprofit hospital associations, life agents, broker-agents, surplus line brokers and special lines surplus line brokers* ***as well as all other persons engaged in the business of insurance****. (color & emphasis added)*

[20] *790.04. The commissioner shall have power to examine and investigate into the affairs of every person engaged in the business of insurance in the State in order to determine whether such person has been or is engaged in any unfair method of competition or in any unfair or deceptive act or practice prohibited by Section 790.03 or determined pursuant to this article to be an unfair method of competition or an unfair or deceptive practice in the business of insurance. Such investigation may be conducted pursuant to Article 2 (commencing at Section 11180) of Chapter 2, Part 1, Division 3, Title 2 of the Government Code.*

[21] *790.035. (a) Any person who engages in any unfair method of competition or any unfair or deceptive act or practice defined in Section 790.03 is liable to the state for a civil penalty to be fixed by the commissioner, not to exceed five thousand dollars ($5,000) for each act, or, if the act or practice was willful, a civil penalty not to exceed ten thousand dollars ($10,000) for each act. The commissioner shall have the discretion to establish what constitutes an act. However, when the issuance, amendment, or servicing of a policy or endorsement is inadvertent, all of those acts shall be a single act for the purpose of this section.*

[22] *12921.8. (a) The commissioner shall have the authority to issue a cease and desist order against any person acting as, or holding himself, herself, or itself out as, an insurance agent or broker without being so licensed, and against any person holding out that person as transacting, or transacting, the business of insurance without having been issued a certificate of authority. The commissioner may issue a cease and desist order without holding a hearing prior to issuance of the order. The commissioner may impose a fine of up to five thousand dollars ($5,000) for each day the order is violated.*

[22] Supra
[23] See Exhibit III of this memorandum

[24] ***CFP Board, a 501(c)(3) certifying organization, fosters professional standards in personal financial planning so that the public values, has access to and benefits from competent financial planning. CFP Board owns the certification marks CFP™, CERTIFIED FINANCIAL PLANNER™ and federally registered CFP (with flame) logo, which it awards to individuals who successfully complete initial and ongoing certification requirements. CFP Board has currently authorized more than 39,214 individuals to use these marks in the United States and 27,343 individuals outside the United States. For more about CFP Board, visit www.CFP.net.***

[25] Source. CFP Board of Standards, Inc. Colorado

[26] *Financial Planning Process denotes the process which typically includes, but is not limited to, the six elements of; establishing and defining the client-planner relationship, gathering client data including goals, analyzing and evaluating the client's financial status, developing and presenting financial planning recommendations and monitoring the financial planning recommendations. (CFP™ Board Code of Ethics – Definitions)*

[27] *Financial planning subject areas denotes the basic subject fields covered in the financial planning process which typically include, but are not limited to; financial statement preparation and analysis (including cash flow analysis / planning and budgeting), investment planning, (Including portfolio design i.e. asset allocation and portfolio management), income tax planning, education planning,* ***Risk Management*** *(emphasis added), retirement planning and estate planning. (CFP™ Board Code of Ethics – Definitions)*

EXHIBIT I

LIFE AGENT (LX)

Licensing Information

TABLE OF CONTENTS

APPLICABLE FORMS

Individual Application for Insurance License (Form 441-9)
Application for Business Entity License (Form 441-11)
Action Notice of Appointment* (Form 447-54)
Organization Endorsement* (Form 411-8A)
Non-Resident Insurance License Stipulation and Agreement (Form 447-68)

*These forms are also included in the Individual and Business Entity applications.

AUTHORIZING ACT

California State Insurance Code Chapter 5, Part 2, Division 1.

A life agent (LX) is a person authorized by and on behalf of a life, disability, or life and disability insurer to transact life, disability or life and disability insurance.

QUALIFICATIONS

Minimum Age: 18 years

Residency: California residency is not required

Entity Types: Individual, corporation, partnership, nonprofit corporation, unincorporated association, limited liability company.

Prelicensing Experience/Education:

1) Require a minimum of 40 hours of approved prelicensing classroom study. A new California resident applicant who had a current life license in another state and completed 40 hours of prelicensing education for life insurance in order to obtain that license, or an applicant holding either a Life Underwriter Training Council Fellowship (LUTCF) or Chartered Life Underwriter (CLU) designation is exempt from the 40 hours of prelicensing education.

2) Require 12 hours of approved prelicensing classroom study on ethics and the California Insurance Code. Where an applicant seeks both the Fire and Casualty broker-agent license and the Life agent license, the applicant shall only be required to complete one 12-hour course on ethics and the California Insurance Code.

Continuing Education:

1) During each of the first four 12-month periods following the date of original issue of license, satisfactorily complete approved courses or programs of instruction or attend seminars equivalent to a minimum of 25 hours.

2) Any licensee who has complied with the above or was licensed as of 12/31/91, shall satisfactorily complete approved courses or programs of instruction or attend seminars equivalent to 30 hours of instruction during each two-year license period.

3) Any agent that markets long-term care insurance must complete an 8-hour California specific long-term care continuing education course. Check with your insurer regarding long-term care insurance requirements.

4) Effective January 01, 1998, any person who is 70 years of age or older **and** who has been licensed for 30 continuous years as a licensee in good standing in this state, may be exempt from continuing education requirement. Any licensee that markets individual long-term care contracts is still required to meet the specific education requirements for marketing such contracts.

The agent who is limited by the terms of a written agreement with the insurer to transact only specific life insurance policies or annuities having an initial face amount of $10,000 or less that are designated by the purchaser for the payment of funeral or burial expenses will be exempted from the prelicensing and continuing education requirements. The commissioner may require the insurer appointing those life agents to certify as to the limitation of the agents' representations.

FILING REQUIREMENTS: INDIVIDUAL - RESIDENTS

Application: Application for Insurance License, form 441-9

Action Notice: Action Notice of Appointment, form 447-54, completed by the sponsoring insurance company admitted to California.This form is also included in the Individual and Business Entity applications.

AND/OR

Organization Endorsement, form 411-8A, completed by the sponsoring organization licensed in California.

Fingerprint Impressions: Fingerprint impressions are required for unlicensed applicants. If an examination is required, fingerprint impressions will be taken at the California examination sites.

Additional Documents: The Insurance Commissioner may require such other documents as will aid in determining whether the applicant meets the qualifications for a license.

Prelicensing Certificate Of Completion: Original certificate(s) of completion signed by both classroom instructor/provider director and applicant for life agent course and/or Ethics and Code course.

Examination: Applicants who do not hold an active Life (LX) California resident license and whose eligibility for that license without examination has expired must pass the written examination prepared and administered by the Department.

Fees - Individual Resident:

- **License filing:** $124 (2-year term)
- **Action Notice fee:** $21 per action notice ***or*** an **Organization Endorsement:** $21 per notice
- **Examination:** $35 per scheduled examination date
- **Fingerprint Processing:** $74 **Effective October 2, 2000**, all applicants must appear at the designated exam site with a check in the amount of $74 made payable to **"SIFC". VISA/MASTERCARD WILL ALSO BE ACCEPTED. CASH WILL NOT BE ACCEPTED.**
- **Renewal Fee:** $124 (2-year term)

FILING REQUIREMENTS: ORGANIZATION - RESIDENTS

Organization Application:

- Corporation, partnership, unincorporated association, limited liability company or nonprofit corporation applicants must submit the Application for Organization License, form 441-11.

NOTE: The organization must have at least one California resident LX endorsee to establish and maintain the license.

Natural Person Named On Organization:

- Organization Endorsement, form 411-8A, must be completed for each endorsee who holds an active California non-resident LX license.
- Application for insurance license, form 441-9, and Organization Endorsement, form 411-8A, (this form is also included in the Individual and Business Entity applications) must be completed by each natural person who does not hold an active California non-resident LX license (individual filing requirements must be met).

Action Notice: Action Notice of Appointment, form 447-54, must be completed in the organization name by the sponsoring insurance company admitted to California. This form is also included in the Individual and Business Entity applications.

Additional Documents: The Insurance Commissioner may require such other documents as will aid in determining whether the applicant meets the qualifications for a license.

Fees - Organization Resident:

- **License filing:** $124 (2-year term)
- **Action Notice fee:** $21 per action notice
- **Organization Endorsement:** $21 per notice
- **Renewal Fee:** $124 (2-year term) Must have 1 natural person currently named on organization

Note: Natural persons filing form 441-9, refer to individual filing fees.

FILING REQUIREMENTS: INDIVIDUAL - NON-RESIDENTS

Application: Application for Insurance License, form 441-9, must be completed by applicants who do not hold an active California LX license.

NOTE: Licensed non-resident agents whose state of residence does not have continuing education must meet the same requirements as a California resident in order to renew their license. Licensed non-resident agents who comply with the continuing education requirements of their state of residence are exempt from California continuing education requirements. If licensees transact long term care products, they must meet California specific long term care education requirements.

Action Notice: Action Notice of Appointment, form 447-54, completed by the sponsoring insurance company admitted to California This form is also included in the Individual and Business Entity applications;

AND/OR

Organization Endorsement, form 411-8A, completed by the sponsoring organization licensed in California. This form is also included in the Individual and Business Entity applications.

Stipulation and Agreement: Non-resident Insurance Licensee Stipulation and Agreement, form 447-68.

Certification Of License Status From Resident State

Additional Documents: The Insurance Commissioner may require such other documents as will aid in determining whether the applicant meets the qualifications for a license.

Examination: Not required except if the applicant's state, commonwealth or Canadian province of residence has no reciprocal agreement for waiving of examination.

Fees - Individual Non-Resident:

- **License filing:** $124 (2-year term) subject to retaliatory provisions
- **Action Notice fee:** $21 per action notice
- **Organization Endorsement:** $21 per notice
- **Renewal Fee:** $124 (2-year term)

Note: Natural persons filing form 441-9, refer to individual filing fees.

FILING REQUIREMENTS: ORGANIZATION - NON-RESIDENTS

Organization Application:

- Corporation, partnership, unincorporated association, or nonprofit corporation applicants must submit the Application for Business Entity License, form 441-11.

Note: A California resident cannot be endorsed on a non-resident organization.

Action Notice: Action Notice of Appointment, form 447-54, must be completed in the organization name by the sponsoring insurance company admitted to California. This form is also included in the Individual and Business Entity applications.

Natural Person Named On Organization:

- Organization Endorsement, form 411-8A, must be completed for each natural person who holds an active California non-resident LX license. This form is also included in the Individual and Business Entity applications.
- Application for insurance license, form 441-9, and Organization Endorsement, form 411-8A (this form is also included in the Individual and Business Entity applications), must be completed by each natural person who does not hold an active California non-resident LX license (individual filing requirements must be met).

Stipulation and Agreement: Non-resident Insurance License Stipulation and Agreement as required by law, form 447-68, signed by an officer or partner of the organization.

Certification Of License Status From Resident State: Must be in the organization name.

Fees - Organization Non-resident:

- **License filing:** $124 (2-year term) subject to retaliatory provisions
- **Action Notice fee:** $21 per action notice
- **Organization Endorsement:** $21 per notice
- **Renewal Fee:** $124 (2-year term) Must have 1 natural person currently named on organization

Note: Natural persons filing form 441-9, refer to individual filing fees.

LICENSE TERM:

The term of the first license begins the date the license is issued and ends the last day of that same calendar month two years later. All additional licenses are issued for the balance of the established term.

RENEWAL OF LICENSE:

Renewal notification is mailed to the mailing address of record approximately 90 days prior to the expiration date of the license. Individuals will receive a renewal application showing total fees due for all license types held and the total number of continuing education hours completed at the time the renewal form is printed. If the continuing education requirement has not been met, the renewal will indicate how many hours are needed. If renewal application is not received, refer to the back of the permanent license for renewal instructions.

All licensees that renew their licenses late will be required to file new company appointments, organization endorsements, or solicitor appointments. "Late" is defined as any renewal for which the requirements to renew (this includes completing the continuing education hours) are not met until after the expiration date of the previous license term.

ADDITIONAL INFORMATION:

The Commissioner may grant authority to transact variable contracts to a person or an organization licensed as a Life Agent which is appointed by an admitted insurer which is required to register itself or to register a separate account or fund with the United States Securities and Exchange Commission or to register its variable policies or contracts with the Securities and Exchange Commission. The person must submit acceptable proof of registration with NASD or SECO before authority to transact variable contracts can be granted.

If currently licensed as a resident of another state, upon becoming a California resident, a clearance letter from the former state of residence is required.

Limited liability company applicants are required to submit the following information to demonstrate compliance with Section 1647.5 of the California Insurance Code:

1. A statement as to the number of licensees rendering professional services on behalf of the Limited Liability Company.

2. The aggregate dollar amount of E & O Liability Insurance, Cash, Bonds, Bank Certificates of Deposit, U.S. Treasury obligations, etc. held to provide security for claims against the Limited Liability Company. (The amount required over the minimum of $500,000, is at least $100,000 multiplied by the number of licensees rendering professional services on behalf of the company; however, the maximum amount is not required to exceed $5,000,000).

3. For purposes of satisfying the security requirements of California Insurance Code Section 1647.5, we will require one or more of the following:

   (A) A copy of the declaration page for each liability insurance policy used to satisfy the minimum security requirement.

   (B) Verification by the bank or escrow holder listing the type and current dollar value of the assets used to satisfy the minimum security requirements.

Limited liability company licensees must file at least once each year, an "annual confirmation" with the commissioner in the above format, to demonstrate continuing compliance with the financial security requirements of Section 1647.5. of the California Insurance Code.

To obtain insurance licensing forms by mail, send request to: Department of Insurance, 320 Capitol Mall, Sacramento, CA 95814, or you may phone Sacramento at (800) 967-9331 or (916) 322-3555, press 4.

To obtain insurance licensing information, you may phone our Sacramento office at (800) 967-9331 or (916) 322-3555.

ALL FEES MAILED TO THE DEPARTMENT MUST BE ADDRESSED TO:

DEPARTMENT OF INSURANCE
P.O. BOX 1139
SACRAMENTO, CA 95812-1139

ALL FILING FEES SUBMITTED ARE NOT REFUNDABLE OR TRANSFERABLE, WHETHER OR NOT THE APPLICATION IS ACTED UPON OR THE EXAMINATION TAKEN.

Form 644A (Rev. 11/2000)

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EXHIBIT II

LIFE AND DISABILITY INSURANCE ANALYST (LA)

License Information

APPLICABLE FORMS

Application for Insurance License (Form 441-9)
Application for Business Entity License (Form 441-11)
Organization Endorsement* (Form 441-8A)
Request For Live Scan Service (form 442-39A)

*This form is also included in the Individual and Business Entity applications.

AUTHORIZING ACT: California State Insurance Code Chapter 8, Part 2, Division 1

A Life and Disability Insurance Analyst is a person who, for a fee or compensation of any kind, paid by or derived from any person or source other than an insurer, advises, purports to advise, or offers to advise any person insured under, named as beneficiary of, or having any interest in, a life or disability insurance contract, in any manner concerning that contract or his or her rights in respect thereto.

QUALIFICATIONS:

Minimum Age: 18 years

Residency: California residency is required

Prelicensing Experience/Education: Must have worked as a life licensee as defined under Chapter 5, Part 2, Division 1 of the Insurance Code, for five years preceding the date of the examination or as an employee of such a licensee.

Continuing Education:

Not required

Entity Types: Individual, corporation, partnership, nonprofit corporation, unincorporated association, limited liability company.

FILING REQUIREMENTS - INDIVIDUAL:

Application: Application for Insurance License, form 441-9

Fingerprint Impressions: Fingerprint impressions are required for unlicensed applicants. You must call **SYLVAN/IDENTIX at 1-(800) 315-4507** to schedule an appointment to have your fingerprint impressions taken **prior** to submitting your application. Fingerprint impressions will not be accepted from any other source. A copy of your Request For Live Scan Service (form 442-39A) must be submitted with your application verifying your prints were taken by **SYLVAN/IDENTIX.**

Additional Documents: The Insurance Commissioner may require such other documents as will aid in determining whether the applicant meets the qualifications for a license.

FEES - Individual:

- **License Filing:** $418 (2-year term)
- **Examination:** $103 per scheduled examination date
- **Fingerprint Processing:** $74 **Effective October 2, 2000,** this fee must be paid at the designated site when the fingerprint impressions are taken. You may pay by check made payable to **"SIFC". VISA/MASTERCARD WILL ALSO BE ACCEPTED. CASH WILL NOT BE ACCEPTED.**
- **Renewal:** $418 (2-year term)

EXAMINATION:

The applicant must pass the written examination prepared and administered by the Department.

STUDY MATERIAL:

Although the Department does not recommend any particular text, method or course of study, listed below is a study guide to assist in the preparation for the examination.

1) The life and disability laws of this state are contained in the California Insurance Code. Those sections on which an applicant might be tested are:

General Provisions Sections 1 - 46
Division 1, Part 1, Chapter 1 Sections 100 - 123
Division 1, Part 1, Chapter 2, Article 1 Sections 150 - 151
Division 1, Part 1, Chapter 2, Article 3 Sections 250 - 252
Division 1, Part 1, Chapter 2, Article 4 Sections 280 - 287
Division 1, Part 1, Chapter 2, Article 5 Sections 300 - 305
Division 1, Part 1, Chapter 3, Article 1 Sections 330 - 339
Division 1, Part 1, Chapter 3, Article 2 Sections 350 - 361
Division 1, Part 1, Chapter 4, Article 1 Sections 380 - 393
Division 1, Part 1, Chapter 4, Article 3 Section 430
Division 1, Part 1, Chapter 4, Article 4 Sections 440 - 449
Division 1, Part 1, Chapter 4, Article 5 Section 460
Division 1, Part 1, Chapter 5 Sections 480 - 489
Division 1, Part 1, Chapter 6, Article 3 Sections 550 - 557.5
Division 1, Part 2, Chapter 1, Article 1 Section 680
Division 1, Part 2, Chapter 1, Article 3 Sections 669 - 726
Division 1, Part 2, Chapter 1, Article 5 Sections 750 - 767
Division 1, Part 2, Chapter 1, Article 5.5 Sections 770 - 776
Division 1, Part 2, Chapter 1, Article 5.7 Sections 777.1 - 777.3
Division 1, Part 2, Chapter 1, Article 6 Sections 780 - 784
Division 1, Part 2, Chapter 1, Article 6.5 Sections 790 - 790.10
Division 1, Part 2, Chapter 1, Article 7.5 Sections 815 - 816
Division 1, Part 2, Chapter 2, Article 5 Sections 1220 - 1221
Division 1, Part 2, Chapter 4, Article 2 Sections 1580 - 1599
Division 1, Part 2, Chapter 5 Sections 1621 - 1758.5
Division 1, Part 2, Chapter 5A Sections 1759 - 1759.10
Division 1, Part 2, Chapter 8 Sections 1831 - 1849

Division 2, Part 2, Chapters 1-13 Sections 10110 - 11533
Division 2, Part 6.1 Sections 12670 - 12691

Division 3 Chapters 1 and 2 Sections 12900 - 12977

2) The provisions, terms and conditions of a life and disability insurance contract that might be tested are, but not limited to, the following:

Life Insurance	Disability Insurance
Insuring Agreement	Insurance Clause
Reinstatement	Schedule
Incontestability	Renewal Provisions
Settlement Options	Benefit Provisions
Dividend Options	Co-Insurance
Ownership Provisions	Waiting Periods
Nonforfeiture Provisions	Elimination Periods
Grace Periods	Deductibles
Loan Provisions	Waivers
Suicide	Exclusions
Assignments of Transfers	Restrictions
Aviation Clause	Pre-existing Conditions
Beneficiaries Provisions	Other Insurance

Additionally, the applicants are expected to be thoroughly familiar with the types of contracts being issued in this state, including, but not necessarily limited to:

Life	Disability
Individual Contracts	Individual Contracts
Group Contracts	Group Contracts
Industrial Contracts	Blanket Contracts
Ordinary Life	Basic Hospital Expense
Limited Payment Life	Basic Medical-Surgical Expense
Modified and Graded Premium	Basic Hospital and Medical-Surgical Expense
Endowment Insurance	Hospital Confinement Indemnity
Immediate Annuities	Major Medical Expense
Deferred Annuities	Comprehensive Major Medical Expense
Variable Annuities	Disability Income Protection
Level Term Life	Accident Only
Increasing Term Life	Specified Disease
Decreasing Term Life	Specified Accident
Re-entry Term Life	Medicare Supplement
Universal Life	

3) A thorough and complete knowledge of life and disability insurance may include:

a. Application and consequences of various policies.
b. Applications and consequences of federal and estate taxes.
c. Interrelationship with other investment vehicles.
d. Interrelationship with other regulatory agencies including, but not limited to SEC, RIA, etc.
e. Interrelationship with contract, business, probate and investment laws in California.
f. Insurance company's financial and organization analysis.
g. Rate calculations and risk transfer.

FILING REQUIREMENTS - ORGANIZATION:

Organization Application:

- Corporation, partnership, nonprofit corporation or unincorporated association applicants must submit the Application for Business Entity License, form 441-11.

Natural Person Named On Organization:

- Application for insurance license, form 441-9, and Organization Endorsement, form 411-8A, must be completed by each natural person who does **not** hold an active California LX license (individual filing requirements must be met).

- Organization Endorsement, form 441-8A, (this form is also included in the Business Entity application) must be completed for each natural person who holds an active California LX license.

FEES - ORGANIZATION:

Fees are not required for the organization license. Each natural person named on the organization must pay individual fees.

- **License filing:** $418 (2-year term)
- **Renewal Fee:** $418 (2-year term)

Note: Natural persons filing form 441-9, refer to individual filing fees.

LICENSE TERM:

The term of the first license begins the date the license is issued and ends the last day of that same calendar month two years later. All additional licenses are issued for the balance of the established term.

RENEWAL OF LICENSE:

Renewal notification is mailed approximately 60 days prior to the expiration date of the license and will show total fees due for all license types held. If this application is not received, refer to the back of the permanent license for renewal instructions.

ADDITIONAL INFORMATION:

The following persons are exempt from the requirements of this license:

a. Active members of the State Bar of California.

b. Any person who has passed all of the qualifying examinations necessary to become an Associate of the Society of Actuaries.

c. An officer or employee of any bank or trust company who receives no compensation from sources other than the bank or trust company for activities connected with his employment which would otherwise subject him to licensing requirements.

d. Any person employed by an employer who on behalf of his or her employer or any employee of his or her employer transacts life or disability insurance with, but not on behalf of, an insurer; or advises his or her employer or any employee of his or her employer in any manner concerning life or disability insurance; if:

1. the employer receives no compensation by reason of such transactions or advice; and
2. such person receives no compensation from any source other than his or her employer for such transactions or advice.

e. An investment advisor, as defined in Section 25009 of the Corporations Code, when acting in that capacity.

NOTE: An employee or officer of any insurer is not eligible for a license as a Life and Disability Insurance Analyst.

To obtain insurance licensing forms by mail, send request to: Department of Insurance, 320 Capitol Mall, Sacramento, CA 95814, or you may phone Sacramento at (800) 967-9331 or (916) 322-3555, press 4.

To obtain insurance licensing information, you may phone our Sacramento office at (800) 967-9331 or (916) 322-3555.

ALL FEES MAILED TO THE DEPARTMENT MUST BE ADDRESSED TO:

DEPARTMENT OF INSURANCE
P.O. BOX 1139
SACRAMENTO, CA 95812-1139

ALL FILING FEES SUBMITTED ARE NOT REFUNDABLE OR TRANSFERABLE, WHETHER OR NOT THE APPLICATION IS ACTED UPON OR THE EXAMINATION TAKEN.

Form 765A (Rev. 11/2000)

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EXHIBIT III

Series 65 Exam

The Uniform Investment Adviser Law Examination and the available study outline were developed by the North American Securities Administrators Association, Inc. ("NASAA"). The examination, called the Series 65 exam, is designed to qualify candidates as investment adviser representatives. The exam covers topics that have been determined to be necessary to understand in order to provide investment advice to clients. The study outline is designed to provide an overview of the exam's general content and format.

The study outline is divided into corresponding sections to aid in preparing for the examination.

The Uniform Investment Adviser Law Examination consists of 130 questions plus 10 pretest questions covering the materials outlined in the following study outline. Applicants are allowed 180 minutes to complete the examination. At least 89 (68.5%) of the questions must be answered correctly for an individual to pass the Series 65 exam.

The examination is conducted as a closed book test. Upon completion of the examination, the score for each section and the overall test score will immediately be made available to the candidate.

The examination is administered by the National Association of Securities Dealers, Inc. ("NASD"). To schedule a candidate for the examination, an individual's firm should file a Form U-4 or the individual should file a Form U-10 and pay the $110.00 examination fee to the NASD at the following address:

NASD Regulation, Inc.
Attention: Exams Dept.
9509 Key West Avenue
Rockville, MD 20850
301/590-6500

Once registered, NASD will open a 120-day window within which an individual may schedule the exam. A link to the NASD Forms can be found at http://www.nasdr.com/3400.asp. More information on exam sites can be found at http://www.nasdr.com/2630.asp.

The questions in the examination, the examination study outline, and the method by which the examination is administered have been designed by Chauncey Group International for NASAA and approved by NASAA and the Competency Exam Project Group. In addition, each examination question is statistically analyzed to insure reliability.

Any attempt to compromise the examination may serve to destroy its validity and usefulness. Therefore, NASAA intends to bring appropriate action against persons who attempt to compromise the examination in whole or in part. In addition, such conduct may subject a candidate to further action by state administrators.

Successful completion of the Uniform Investment Adviser Law Examination does not relieve a candidate of the personal responsibility to know and to abide by the specific requirements of the securities laws and regulations of the states in which the candidate transacts business. Furthermore, although successful completion of the examination may satisfy a portion of the requirements of a particular state, it does not convey the right to transact business prior to being granted a license or registration by that state.

NASAA believes that the Uniform Investment Adviser Law Examination will significantly benefit the industry and state regulators alike by such uniformity. The investing public will be afforded a greater degree of protection through enhanced uniform qualification standards.

NASAA Uniform Investment Adviser Law Exam (Series 65) Exam Specifications	
CONTENT AREA	**# OF ITEMS**
I. **Economics and Analysis**	**20**
A. B. **Understand basic economic concepts** 1. Inflation/deflation a. Definitions b. Causes of inflation/deflation 2. Interest rates and yield curves a. Graphs b. Definitions c. Interest rate = cost of money 3. Basic economic indicators a. GDP b. Employment indicators c. Trade deficit d. Balance of payments e. CPI	
A. **B. Identify components of a business's financial statements to**	

determine investment merits A. Income statement a. Revenues b. Cost of goods sold c. Pre-tax margins d. Cash flow B. Balance sheet a. Assets b. Liabilities c. Working capital d. Owner's equity e. Footnotes	
A. C. **Demonstrate understanding of quantitative methods to evaluate investments** A. Time value of money B. Expected return C. Net present value D. Internal rate of return E. Inflation-adjusted return (real return) F. After-tax return/yield G. Risk-adjusted return H. Total return I. Holding period return J. Yield-to-maturity K. Yield-to-call L. Current yield M. Risk measurements (e.g., Beta, standard deviation, duration) N. Valuation ratios (e.g., P/E, price-to-book) O. Benchmark portfolios P. Annualized return	
D. E. **Identify risks (i.e. definitions, impact on the market, companies, and personal investments)** D. Business E. Market F. Interest rate G. Inflation H. Regulatory (e.g., tax law changes) I. Liquidity	

J. Opportunity cost	
II. Investment Vehicles	**26**
A. B. **Evaluate cash and cash equivalents** A. Types and characteristics of cash and cash equivalents a. Certificates of deposit b. Money market funds c. Treasury bills B. Benefits/risks of owning cash and cash equivalents	
B. C. **Evaluate fixed income securities** B. Types and characteristics of fixed income securities a. U.S. government and agency securities b. Mortgage-backed securities c. Corporate bonds (i.e., investment grade and high yield) d. Convertible bonds e. Municipal bonds f. Zero-coupon bonds C. Benefits/risks of owning fixed income securities	
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b. Closed-end investment companies c. Classes of shareholders, expense ratios, sales load, breakpoints, 12b-1 fees E. Benefits/risks of owning investment company securities	
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G. H. **Understand real estate partnerships and investment trusts (REITs) and variable annuities** G. Definitions H. Benefits/risks	
III. Investment Recommendations and Strategies	**39**
A. B. **Determine and analyze the financial profile of the client to develop a suitable investment policy and strategy** A. Type of client a. Individual b. Sole proprietorship c. General partnership d. Limited partnership (including family limited partnership) e. Limited liability company f. C corporation g. S corporation h. Trust i. Estate B. Financial goals C. Current financial status (e.g., cash flow, balance sheet) D. Capital needs (e.g., current, retirement, death, disability)	

E. Current investments and strategies F. Time horizon G. Non-financial investment considerations (e.g., values, attitudes, experience, demographic characteristics) H. Risk tolerance I. Tax situation	
B. C. **Understand portfolio management strategies, styles, and techniques (fixed income and equities)** B. Portfolio management styles and strategies a. Strategic and tactical asset allocation (e.g., style, asset class, rebalancing) b. Active vs. passive c. Growth vs. value d. Market capitalization (micro, small, mid, large) e. Buy/hold f. Indexing g. Diversification C. Funding techniques a. Dollar-cost averaging b. Income reinvestment (e.g., dividend, interest, cap gain)	
C. D. **Recognize fundamental taxation issues** C. Individual income tax (e.g., capital gains, tax basis, retirement distribution, alternative minimum tax) D. Corporate, trust, and estate income tax E. Estate and gift tax	
D. E. **Recognize types of retirement plans and related issues** D. Retirement plans a. Individual Retirement Arrangements (IRA) b. 403(b) plans c. Qualified retirement plans (e.g., pension and profit sharing, 401(k)) d. Nonqualified retirement plans E. Important ERISA issues a. Fiduciary responsibility (e.g., 404(c)) b. Investment policy statement	

c. Prohibited transactions	
E. F. **Define the fundamental terms and concepts of trading securities** E. Terminology (e.g., bids, offers, quotes) F. Role of broker-dealers, specialists, market-makers G. Types of orders (e.g., market, limit, stop, short sale) H. Types of accounts (e.g., cash, margin, option) I. Commissions, markups, spread	
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B. Fiduciary responsibility C. Conflict of interest D. Prudent Investor standards E. Limitations on advice and activities (i.e., when to consult other professionals)	

EXHIBIT IV

CFP Board Curriculum Requirements for the "Insurance Planning And Risk Management" Module of the CFP Certification Course of Education*

CFP Required subject matter for "Insurance Planning and Risk Management"

CFP® Candidates must complete comprehensive training in the following subject areas at a college or university whose program has been inspected and approved by the CFP Board. This course represents approximately 20% of the educational requirement for CFP Candidates. Other courses include "Financial Planning Fundamentals", "Investment Planning", "Tax Planning", "Retirement Planning & Qualified Plans" and "Estate Planning".

Principles of insurance

A. Definitions and application of principles

1) Risk
2) Peril
3) Hazard
4) Law of large numbers
5) Adverse selection

B. Response to risk
1) Retain
2) Transfer
3) Control
4) Reduce
5) Avoid

C. Mortality vs. morbidity

Analysis and evaluation of risk exposures

A. Personal Insurance lines

1) Death
2) Disability
3) Poor health
4) Unemployment
5) Outliving one's capital

B. Property Insurance lines
1) Real
2) Personal
3) Auto

C. Liability Issues

1) Negligence
2) Libel
3) Slander
4) Malpractice

D. Business-related risks

E. Calculation of benefits

23. Legal aspects of insurance

A. Indemnity

**** Source: CFP Board of Standards, Inc. Denver, CO.***

B. Insurable interest

C. Contract requirements

D. Contract characteristics

Property and casualty insurance (individual and business)

A. Real property

B. Automobile and recreational vehicles

C. Business

D. Business activity

E. Personal property

F. Umbrella liability

General business liability

A. Professional liability

B. Errors and omissions

C. Directors and officers

D. Product liability

Health insurance (individual)

A. Hospital-surgical

B. Major medical

C. Traditional indemnity

D. Preferred Provider Organization (PPO)

E. Health Maintenance Organization (HMO)

F. Medicare supplemental insurance

G. Other

Disability income insurance (individual)

A. Occupational definitions and application

1) Total
2) Partial
3) Residual

**** Source: CFP Board of Standards, Inc. Denver, CO.***

B. Benefit period

C. Elimination period

D. Benefit amount

E. Riders

F. Taxation of benefits

Long-term care insurance (individual and joint)

A. Basic provisions

B. Eligibility

C. Benefit amount and period

D. Elimination period

E. Inflation protection

F. Nursing home and in-home care

G. Comparing and selecting policies

H. Tax implications and qualification

I. Appropriateness of coverage

Life insurance

A. Fundamentals

B. Types

C. Contractual provisions

D. Dividend options

E. Non-forfeiture and other options

F. Settlement options

G. Policy replacement

H. Tax issues and strategies

I. Policy ownership issues and strategies, including split-dollar

Viatical settlements

A. Legal principles

B. Requirements

C. Tax implications

D. Planning

E. Ethical concepts and planning

Insurance needs analysis and rationale

A. Life insurance amount required

1) Liquidity and survivor income needs

2) Human life value

3) Capital retention

B. Disability insurance

C. Long-term care insurance

D. Health insurance

**** Source: CFP Board of Standards, Inc. Denver, CO.***

E. Property insurance

F. Liability insurance

Taxation of life, disability and long-term care insurance

A. Income

B. Gift

C. Estate

D. Generation-Skipping Transfer Tax (GSTT)

E. Ownership issues

F. Beneficiary issues

G. Withdrawals

Insurance policy selection

A. Purpose of coverage

B. Length of time required

C. Risk tolerance

D. Cash flow constraints

Insurance company selection and due diligence

A. Financials

B. Ratios

C. Ratings

D. Mutual vs. stock

E. Reinsurance

F. Investments

G. Underwriting

H. Federal and state law

**** Source: CFP Board of Standards, Inc. Denver, CO.***

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November 23, 2011

SEC OFFICIAL SCRUTINIZED FOR 'CRASH-PROOF RETIREMENT' INTERVIEW WITH ADVISOR

(Bloomberg News) The U.S. Securities and Exchange Commission's internal watchdog has come under scrutiny for comments he made in a 75-minute videotaped interview about the agency and the stock market to a man who markets a "crash-proof retirement" plan through the Internet and a paid radio program.

SEC Inspector General H. David Kotz has been contacted about the matter by the agency's general counsel's office, which also has briefed the SEC's commissioners over concerns the interview could be construed as investment advice or an endorsement of financial services.

Phillip Cannella III, chief executive officer of First Senior Financial Group in King of Prussia, Pennsylvania, edited the interview he conducted at SEC headquarters in late July into more than a dozen video segments. He posted them on YouTube and his website, www.crashproofretirement.com, and plays them on the radio as well as during his seminars about insurance products for retirees.

The SEC doesn't ban its employees from interviews with people connected to commercial ventures. Kotz said he cleared the matter in advance with the SEC's internal ethics counsel. He told SEC officials he would ask an outside group, the Council of Inspectors General on Integrity and Efficiency, to look into whether he said or did anything improper in the interview, according to two people briefed on the situation.

The Federal Bureau of Investigation, which oversees the panel within the inspector general's group that deals with integrity matters, doesn't comment on its inquiries, said William Carter, an FBI spokesman.

'Appropriate Caveats'

Kotz said in an e-mailed statement to Bloomberg News that he provided "all the appropriate caveats and disclaimers" to Cannella and "specifically stated in the radio interview that I was not in a position to, nor was I, providing investment advice."

SEC Chairman Mary Schapiro said in a statement that she appreciated that Kotz requested an independent review.

"David Kotz is an experienced professional with expertise in the ethics rules who I

believe would not intentionally create an appearance issue," Schapiro said.

The SEC didn't say if it was taking further action on the matter. The agency's ethics counsel, Shira Pavis Minton, didn't respond to a request for comment.

In the interview segments posted on the website, Kotz discusses issues ranging from the Bernard Madoff fraud to the difficulties the SEC faces policing Wall Street. A press release issued by Cannella's company headlined Kotz's suggestion that retirees consider cutting their investments in stocks.

'Turbulent Times'

"So much money is in the stock market where people's lives are so affected by it, that sometimes it may make sense to take things out in turbulent times to ensure that you're not living and dying, so to speak, by the Dow Jones going up and down," Kotz told Cannella as the two sat in the agency's Washington offices in front of the SEC seal. "Particularly with what's occurred over the last several years."

Kotz also discusses the SEC's past shortcomings and says the agency has improved, being a "fundamentally different place now than when I first started at the SEC and before we issued our Madoff report."

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10 Ways To Stronger Client Connections

Tips on how to create stronger bonds with clients capped off IMCA's Winter Specialty Conference in Vail, Colo.,with speaker Jamie Ziegler, founder of AUMPartners, telling attendees, "Trust is the single most important factor in building lasting relationships."

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Cannella said in a phone interview that he was contacted by an SEC attorney several weeks ago asking that he put a disclaimer on the videos to make clear that neither the agency nor Kotz endorse, sponsor or promote his firm. Cannella said he quickly complied. Kotz said he supported efforts by the SEC's general counsel's office "to ensure that my interview is not being used to endorse any product."

'Not a Journalist'

Cannella said he was pleased to be able to interview a high-level government official like Kotz -- a man he said he greatly respects. While it costs him $12,000 a week to air the radio show on two Philadelphia area stations, Cannella said he treats it like a consumer advocacy program, not an infomercial.

"I can't believe myself," Cannella said. "I'm not a journalist, and I got over a 75-minute interview with Kotz inside the SEC building."

Besides the radio program, Cannella said, he holds "educational events" in restaurants where he teaches people in their 50s and older about "safe investment alternatives in the insurance industry." His website has clips of prospective clients being asked about their reaction to watching the Kotz interview.

One woman, who wasn't identified in the video, said that Cannella's interview with the inspector general shows that the host is "standing up for the little people, and very admirable, and that's one of the reasons that I'm very anxious to proceed with Phil."

Probes

In another clip, an unidentified man said, "It was incredible to find out that the SEC feels like it can't police the securities industry because it doesn't have the funding or the manpower."

The fracas adds a new chapter to Kotz's contentious four-year tenure at the SEC. In recent months, current and former officials have spoken out about what they say are his overly aggressive probes and their negative impact on the agency's ability to police the markets. Earlier this month, the Justice Department declined to open an investigation into Kotz's allegations that former SEC General Counsel David Becker violated ethics laws.

Kotz and his supporters have dismissed the complaints, saying his oversight has done much to help the SEC burnish its image after it was widely attacked for missing massive frauds like Madoff's and the alleged Ponzi scheme run by R. Allen Stanford.

Commissions

In his interview with Cannella, Kotz said victims of investment schemes "deserve a strong, vibrant, effective, aggressive SEC that goes after those people, gets their money back as possible and puts them in jail."

Because he doesn't sell securities, Cannella isn't regulated by the SEC. He said he is licensed to sell insurance in over 40 states. His company puts together individual plans for clients and then earns commission on products they buy from an insurance company. He described the investments as "guaranteed, tax-deferred contractual agreements with income options from a statutory corporation."

The investments are "outside of the securities industry" and "many of them have outperformed the markets since their inception with no market risk, no market fees, no upfront commissions or sales costs," he added.

The trade magazine *Senior Market Advisor* in January 2008 reported that Cannella said he wrote about $25 million in premiums in 2007 for fixed index annuities. Cannella said he didn't want to put a specific name on the investments he sells because he thinks the media has misreported on the products.

"I'm not well-liked among securities guys because I am speaking truth and logic to a deceptive industry," Cannella said. "You can't beat the sword of truth."

Techniques for gaining more business through client referrals were among the topics broached at the IMCA 2011 Winter Specialty Conference in Vail, Colo.

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United States Government Accountability Office

GAO

Report to Congressional Addressees

January 2011

CONSUMER FINANCE

Regulatory Coverage Generally Exists for Financial Planners, but Consumer Protection Issues Remain

GAO-11-235

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Highlights

Highlights of GAO-11-235, a report to congressional addressees

CONSUMER FINANCE

Regulatory Coverage Generally Exists for Financial Planners, but Consumer Protection Issues Remain

Why GAO Did This Study

Consumers are increasingly turning for help to financial planners—individuals who help clients meet their financial goals by providing assistance with such things as selecting investments and insurance products, and managing tax and estate planning. The Dodd-Frank Wall Street Reform and Consumer Protection Act mandated that GAO study the oversight of financial planners. This report examines (1) how financial planners are regulated and overseen at the federal and state levels, (2) what is known about the effectiveness of this regulation, and (3) the advantages and disadvantages of alternative regulatory approaches. To address these objectives, GAO reviewed federal and state statutes and regulations, analyzed complaint and enforcement activity, and interviewed federal and state government entities and organizations representing financial planners, various other arms of the financial services industry, and consumers.

What GAO Recommends

GAO recommends that (1) NAIC assess consumers' understanding of the standards of care associated with the sale of insurance products, (2) SEC assess investors' understanding of financial planners' titles and designations, and (3) SEC collaborate with the states to identify methods to better understand problems associated specifically with the financial planning activities of investment advisers. NAIC said it would consider GAO's recommendation and SEC provided no comments.

View GAO-11-235 or key components.
For more information, contact Alicia Puente Cackley at (202) 512-8678 or cackleya@gao.gov.

What GAO Found

There is no specific, direct regulation of "financial planners" *per se* at the federal or state level, but various laws and regulations apply to most of the services they provide. Financial planners are primarily regulated as investment advisers by the Securities and Exchange Commission (SEC) and the states, and are subject to laws and regulation governing broker-dealers and insurance agents when they act in those capacities. Federal and state agencies have regulations on marketing and the use of titles and designations that also can apply to financial planners.

The regulatory structure applicable to financial planners covers the great majority of their services, but the attention paid to enforcing existing regulation can vary and certain consumer protection issues remain. First, consumers may be unclear about when a financial planner is required to serve the client's best interest, particularly when the same financial planner provides multiple services associated with different standards of care. SEC is studying these issues with regard to securities transactions, but no complementary review is under way by the National Association of Insurance Commissioners (NAIC) related to the sale of high-risk insurance products. Second, financial planners can adopt numerous titles and designations, which vary greatly in the expertise or training that they signify, but consumers may not understand or be able to distinguish among them. SEC has a mandated review under way on financial literacy among investors and incorporating this issue into that review could assist in assessing further changes that may be needed. Finally, the extent of problems related to financial planners is not fully known because SEC generally does not track data on complaints, examination results, and enforcement activities associated with financial planners specifically, and distinct from investment advisers as a whole. A regulatory system should have data to identify risks and problem areas, and given that financial planning is a growing industry that has raised certain consumer protection issues, regulators could benefit from better information on the extent of problems specifically involving financial planning services.

A number of stakeholders have proposed different approaches to the regulation of financial planners, including (1) creation of a federally chartered board overseeing financial planners as a distinct profession; (2) augmenting oversight of investment advisers with a self-regulatory organization; (3) extending the fiduciary standard of care to more financial services professionals; and (4) specifying standards for financial planners and the designations that they use. While the views of stakeholder interests vary, a majority of the regulatory agencies and financial services industry representatives GAO spoke with did not favor significant structural change to the overall regulation of financial planners because they said existing regulation provides adequate coverage of most financial planning activities. Given available information, an additional layer of regulation specific to financial planners does not appear to be warranted at this time.

Contents

Abbreviations

Advisers Act	Investment Advisers Act of 1940
Dodd-Frank Act	Dodd-Frank Wall Street Reform and Consumer Protection Act
FINRA	Financial Industry Regulatory Authority
Form ADV	Uniform Application for Investment Adviser Registration
FTC	Federal Trade Commission
NAIC	National Association of Insurance Commissioners
NASAA	North American Securities Administrators Association
SEC	Securities and Exchange Commission

GAO
Accountability * Integrity * Reliability

United States Government Accountability Office
Washington, DC 20548

January 18, 2011

Congressional Addressees

Consumers are increasingly turning for help to professionals who describe themselves as financial planners for assistance with a broad range of services, such as selecting the right balance of stocks and bonds for an investment portfolio, choosing among insurance products, and tax and estate planning. Although there is no statutory or single definition of financial planning, it can be broadly defined as a systematic process that individuals use to achieve their financial goals. Between 2000 and 2008, the number of financial planners more than doubled and may continue to climb as more individuals are asked to take responsibility for their retirement savings and must choose among a growing array of investment options.

Some financial planning organizations have raised concerns that no single law governs providers of financial planning services, broadly describing this situation as a regulatory gap. Concerns also exist that financial planners may have an inherent conflict of interest in recommending products they may stand to benefit from selling. In addition, some consumer advocates believe consumers may be confused by the numerous titles and designations that financial planners can use. This report responds to a mandate included in Section 919C of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) that directed GAO to conduct a study on the oversight and regulation of financial planners. Our objectives are to address (1) how financial planners are regulated and overseen at the federal and state levels, (2) what is known about the effectiveness of regulation of financial planners and what regulatory gaps or overlap may exist, and (3) alternative approaches for the regulation of financial planners and the advantages and disadvantages of these approaches.

To address these objectives, we reviewed federal and selected state statutes and regulations applicable to financial planners. We also reviewed regulations issued by the Securities and Exchange Commission (SEC) and the Financial Industry Regulatory Authority (FINRA), and model laws developed by the National Association of Insurance Commissioners (NAIC) and by the North American Securities Administrators Association (NASAA). In addition, we reviewed applicable securities and insurance laws and regulations of five states—California, Illinois, North Carolina, Pennsylvania, and Texas. We also interviewed representatives of, and

gathered documentation from, SEC, FINRA, the Federal Trade Commission (FTC), NAIC, and organizations representing the interests of consumers, financial planners, and various arms of the financial services industry. In addition, we gathered information on complaints and enforcement activity, as available, from SEC, FINRA, FTC, and selected state regulators and organizations. A more extensive discussion of our scope and methodology appears in appendix I.

We conducted this performance audit from June 2010 to January 2011 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Background

Financial planning typically involves a variety of services, including preparing financial plans for clients based on their financial circumstances and objectives and making recommendations for specific actions clients may take. In many cases, financial planners also help implement these recommendations by, for example, providing insurance products, securities, or other investments. Individuals who provide financial planning services may call themselves a variety of different titles, such as financial planner, financial consultant, financial adviser, trust advisor, or wealth manager. In addition, many financial planners have privately conferred professional designations or certifications, such as Certified Financial Planner®, Chartered Financial Consultant®, or Personal Financial Specialist.

The number of financial planners in the United States rose from approximately 94,000 in 2000 to 208,400 in 2008, according to the Bureau of Labor Statistics. The bureau projects the number will rise to 271,200 by 2018 because of the need for advisers to assist the millions of workers expected to retire in the next 10 years.[1] According to the bureau, 29 percent of financial planners are self-employed and the remaining 71

[1]While the Bureau of Labor Statistics reports these statistics using the term "financial adviser," bureau officials said that this term could be used interchangeably with financial planner. The bureau broadly defined a "personal financial adviser" as an individual who provides financial planning services and that private bankers or wealth managers would also be categorized as financial advisers.

percent are employees of firms, some of them large entities with offices nationwide that provide a variety of financial services. The median annual wage for financial planners was $68,200 in May 2009.

According to an analysis of the 2007 Survey of Consumer Finances, the most recent year for which survey results are available, in 2007 about 22 percent of U.S. households used a financial planner for investment and saving decisions and about 12 percent of U.S. households used a financial planner for making credit and borrowing decisions. Those households most likely to use a financial planner were those with higher incomes. For example, 37 percent of households in the top income quartile used a financial planner to make investment and saving decisions compared to 10 percent of households in the bottom quartile.[2]

Various Federal and State Laws and Regulations Apply to Financial Planners and Their Activities

Financial planners are primarily regulated by federal and state investment adviser laws, because planners typically provide advice about securities as part of their business. In addition, financial planners that sell securities or insurance products are subject to applicable laws governing broker-dealers and insurance agents. Certain laws and regulations can also apply to the use of the titles, designations, and marketing materials that financial planners use.

Financial Planners Are Primarily Regulated by Federal and State Investment Adviser Laws

There is no specific, direct regulation of "financial planners" *per se* at the federal or state level. However, the activities of financial planners are primarily regulated under federal and state laws and regulations governing investment advisers—that is, individuals or firms that provide investment advice about securities for compensation. According to SEC staff, financial planning normally includes making general or specific recommendations about securities, insurance, savings, and anticipated retirement.[3] SEC has issued guidance that broadly interprets the Investment Advisers Act of 1940 (Advisers Act) to apply to most financial planners, because the advisory services they offer clients typically include

[2]Our percentage estimates based on the 2007 Survey of Consumer Finances have 95 percent confidence intervals of +/- 2.5 percentage points or less. For example, we are 95 percent confident that between 8.2 and 11.8 percent of households in the bottom quartile used financial planners for investment decisions. See appendix I for additional information.

[3]Investment Adviser Act Release No. 1092, 52 Fed. Reg. 38400, 38401 (Oct. 16, 1987) (IA Rel. No. 1092).

providing advice about securities for compensation.[4] Similarly, NASAA representatives told us that states take a similar approach on the application of investment adviser laws to financial planners and, as a result, generally register and oversee financial planners as investment advisers. As investment advisers, financial planners are subject to a fiduciary standard of care when they provide advisory services, so that the planner "[is] held to the highest standards of conduct and must act in the best interest of [the adviser's] clients."[5]

SEC and state securities departments share responsibility for the oversight of investment advisers in accordance with the Advisers Act.[6] Under that act, SEC generally oversees investment adviser firms that manage $25 million or more in client assets, and the states that require registration oversee those firms that manage less.[7] However, as a result of section 410 of the Dodd-Frank Act, as of July 2011 the states generally will have registration and oversight responsibilities for investment adviser firms that manage less than $100 million in client assets, instead of firms that manage less than $25 million in assets as under current law.[8] This will result in the states gaining responsibility for firms with assets under management between $25 million and $100 million. As shown in figure 1, as of October 2010, of the approximately 16,000 investment adviser firms providing

[4]The Advisers Act defines an investment adviser as any person (i.e., individual or firm) who is in the business of providing advice, or issuing reports or analyses, regarding securities, for compensation. 15 U.S.C. § 80b-2(a)(11); IA Rel. No. 1092. In addition to applicable securities law, investment advice related to a retirement savings plan, such as a 401(k) plan, may also be subject to the Employee Retirement Income Security Act. The requirements under that act are outside the scope of this study. A forthcoming GAO report, GAO-11-119, will provide more information on investment advice in 401(k) plans.

[5]In *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 189-192 (1963), the U.S. Supreme Court recognized that the Advisers Act imposes a fiduciary duty on investment advisers. This standard imposes an affirmative duty to act solely in the best interests of the client. The investment adviser also must eliminate or disclose all conflicts of interest.

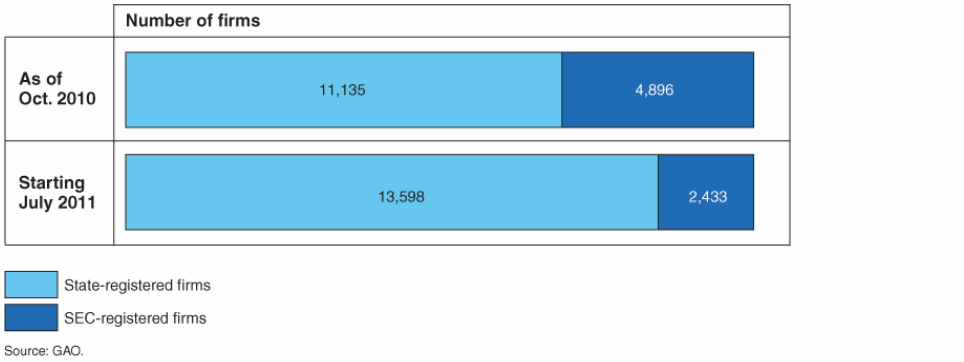
[6]15 U.S.C. § 80b-3a. The term investment adviser can refer to a person or firm. Investment adviser firms generally register with SEC or state securities departments as registered investment advisers. According to NASAA, certain natural persons that are employed by firms generally register with the state securities departments as investment adviser representatives.

[7]*Id.* Under 17 C.F.R. § 275.203A-1, SEC registration has been optional for certain investment advisers having assets under management between $25 and $30 million. Firms also may have a different basis for registering with SEC (other than the amount of client assets the firm has under management), such as whether the principal office and place of business are within a state that has no registration requirement.

[8]Pub. L. No. 111-203, § 410, 124 Stat. 1376, 1576-77 (2010).

financial planning services, the states were overseeing about 11,100 firms and SEC was overseeing about 4,900 such firms.[9] However, in July 2011 about 2,400 of investment adviser firms that provided financial planning services (15 percent of the 16,000 firms) may shift from SEC to state oversight.[10]

Figure 1: Change in Regulatory Oversight of Investment Adviser Firms Providing Financial Planning Services as a Result of the Dodd-Frank Act



Source: GAO.

SEC's supervision of investment adviser firms includes evaluating their compliance with federal securities laws by conducting examinations of firms—including reviewing disclosures made to customers—and investigating and imposing sanctions for violations of securities laws. According to SEC staff, in its examinations, the agency takes specific steps to review the financial planning services of investment advisers. For example, SEC may review a sample of financial plans that the firm prepared for its customers to check whether the firm's advice and investment recommendations are consistent with customers' goals, the contract with the firm, and the firm's disclosures.

[9]In registering with SEC or a state, investment adviser firms are required to report whether they provide financial planning services in Part 1A of the Uniform Application for Investment Adviser Registration, Item 5 G(1). SEC does not provide a definition of financial planning services for firms to use when completing the registration form. The total number of investment adviser firms overseen—including both those that do and do not provide financial planning services—is 15,016 for the states and 11,873 for SEC. For data on investment adviser firms, firms that were registered with both SEC and the states were counted with SEC-registered investment adviser firms.

[10]See 75 Fed. Reg. 77052 (Dec. 10, 2010) (SEC proposed rule, which, if finalized, would give advisers until August 20, 2011, to report the market value of their assets under management to the SEC as the first step in the process).

However, the frequency with which SEC conducts these examinations varies, largely because of resource constraints faced by the agency.[11] SEC staff told us that the agency examined only about 10 percent of the investment advisers it supervises in 2009. In addition, they noted that generally an investment adviser is examined, on average, every 12 to 15 years, although firms considered to be of higher risk are examined more frequently. In 2007, we noted that harmful practices could go undetected because investment adviser firms rated lower-risk are unlikely to undergo routine examinations within a reasonable period of time, if at all.[12]

According to NASAA, state oversight of investment adviser firms generally includes activities similar to those undertaken by SEC, including taking specific steps to review a firm's financial planning services. According to NASAA, states generally register not just investment adviser firms but also investment adviser representatives—that is, individuals who provide investment advice and work for a state- or federally registered investment adviser firm.[13]

Financial Planners Are Subject to Broker-Dealer and Insurance Laws When Acting in Those Capacities

In addition to providing advisory services, such as developing a financial plan, financial planners generally help clients implement the plan by making specific recommendations and by selling securities, insurance products, and other investments. SEC data show that, as of October 2010, 19 percent of investment adviser firms that provided financial planning

[11]GAO, *Securities and Exchange Commission: Steps Being Taken to Make Examination Program More Risk-Based and Transparent*, GAO-07-1053 (Washington, D.C.: Aug. 14, 2007). As we noted, since the detection of mutual fund trading abuses in late 2003, in light of limited resources, SEC has shifted its approach to examinations of investment advisers from one that focused on routinely examining all registered firms, regardless of risk, to one that focuses on more frequently examining those firms and industry practices at higher risk for compliance issues.

[12]GAO-07-1053. SEC reported in February 2010 that it is now placing a greater emphasis on fraud detection, in addition to identifying potential violations of securities laws and rules, strengthening procedures and internal controls to maximize limited resources, recruiting examiners with specialized skills, and increasing expertise through enhanced training.

[13]According to NASAA, New York, Minnesota, and Wyoming do not register investment adviser representatives, although New York and Minnesota do have certain examination and other requirements that must be met.

services also provided brokerage services, and 27 percent provided insurance.[14]

Financial planners that provide brokerage services, such as buying or selling stocks, bonds, or mutual fund shares, are subject to broker-dealer regulation at the federal and state levels. At the federal level, SEC oversees U.S. broker-dealers, and SEC's oversight is supplemented by self-regulatory organizations (SRO).[15] The primary SRO for broker-dealers is FINRA. State securities offices work in conjunction with SEC and FINRA to regulate securities firms. Salespersons working for broker-dealers are subject to state registration requirements, including examinations. About half of broker-dealers were examined in 2009 by SEC and SROs. Under broker-dealer regulation, financial planners are held to a suitability standard of care when making a recommendation to a client to buy or sell a security, meaning that they must recommend those securities that they reasonably believe are suitable for the customer.[16]

Financial planners that sell insurance products, such as life insurance or annuities, must be licensed by the states to sell these products and are subject to state insurance regulation. In contrast to securities entities (other than national banks) that are subject to dual federal and state oversight, the states are generally responsible for regulating the business of insurance. When acting as insurance agents, financial planners are

[14]The brokerage and insurance services provided by these investment adviser firms are not necessarily a part of their financial planning services. In addition, many financial planners may sell securities- or insurance-related products through affiliated brokers or agents.

[15]The primary law for regulating broker-dealers is the Securities Exchange Act of 1934, codified at 15 U.S.C. §§ 78a-78oo. Brokers effect transactions for the account of others, while dealers buy and sell securities for their own accounts. 15 U.S.C. § 78c. The term registered representative is generally used to refer to certain employees of a broker-dealer firm who are engaged in providing securities recommendations. Broker-dealers must be members of a qualifying self-regulatory organization (either a national exchange or a registered securities association). 15 U.S.C. § 78o(b)(8).

[16]Under NASD Conduct Rule 2310, a FINRA member making an investment recommendation to a customer must have grounds for believing that the recommendation is suitable for that customer's financial situation and needs. In November 2010, SEC approved FINRA's proposed new consolidated rules governing the suitability obligations of its members. 75 Fed. Reg. 71479 (Nov. 23, 2010). This rule, proposed FINRA Rule 2111, requires salespersons to have a reasonable basis for believing, based on adequate due diligence, that a recommendation of a transaction or strategy is suitable for at least some investors; that the recommendation is suitable for a specific customer, based on that customer's profile; and that a series of recommended transactions is not excessive and unsuitable for the customer.

subject to state standard of care requirements, which can vary by product and by state. As of October 2010, 32 states had adopted a previous version of the NAIC Suitability in Annuities Transactions Model Regulation, according to NAIC.[17] In general, this regulation requires insurance agents to appropriately address consumers' insurance needs and financial objectives at the time of an annuity transaction.[18] Thirty-four states had also adopted the Life Insurance Disclosure Model Regulation in a uniform and substantially similar manner as of July 2010, according to NAIC. This regulation does not include a suitability requirement, although it does require insurers to provide customers with information that will improve their ability to select the most appropriate life insurance plan for their needs and improve their understanding of the policy's basic features.

Financial planners that sell variable insurance products, such as variable life insurance or variable annuities, are subject to both state insurance regulation and broker-dealer regulation, because these products are regulated as both securities and insurance products. When selling variable insurance, financial planners are subject to FINRA sales practice standards requiring that such sales be subject to suitability standards.[19] In addition, other FINRA rules and guidance, such as those governing standards for communication with the public, apply to the sale of variable insurance products.[20] In addition, as previously discussed, 32 states also generally require insurance agents and companies to appropriately address a consumer's insurance needs and financial objectives at the time of an annuity transaction. However, in the past, we have reported that the effectiveness of market conduct regulation—that is, examination of the sales practices and behavior of insurers—may be limited by a lack of

[17]NAIC amended this model regulation in March 2010; according to NAIC, one state has adopted the updated model and additional states are expected to do so.

[18]According to NAIC, in 4 of these 32 states the regulation applies only when the consumers are senior citizens.

[19]NASD Notice to Members 96-86 outlines that variable contracts for insurance products are subject to suitability requirements.

[20]NASD Interpretive Material 2210-2 outlines guidance concerning communications with the public about variable life insurance and variable annuities. FINRA has proposed that this guidance be replaced by a separate new FINRA Rule 2211. See FINRA Rule Filing No. SR-FINRA-2009-070.

reciprocity and uniformity, which may lead to uneven consumer protection across states.[21]

Federal and State Laws and Regulations Can Apply to the Use of Marketing Materials and Financial Planning Titles and Designations

At the federal level, SEC and FINRA have regulations on advertising and standards of communication that apply to the strategies investment adviser firms and broker-dealers use to market their financial planning services. For example, SEC-registered investment advisers must follow SEC regulations on advertising and other communications, which prohibit false or misleading advertisements, and these regulations apply to investment advisers' marketing of financial planning services.[22] FINRA regulations on standards for communication with the public similarly prohibit false, exaggerated, unwarranted, or misleading statements or claims by broker-dealers, and broker-dealer advertisements are subject to additional approval, filing, and recordkeeping requirements and review procedures.[23] According to many company officials we spoke with, their companies responded to these requirements by putting procedures in place to determine which designations and titles their registered representatives may use in their marketing materials, such as business cards.

SEC and state securities regulators also regulate information that investment advisers are required to disclose to their clients. In the Uniform Application for Investment Adviser Registration (Form ADV), regulators have typically required investment adviser firms to provide new and prospective clients with background information, such as the basis of the advisory fees, types of services provided (such as financial planning services), and strategies for addressing conflicts of interest that may arise

[21]GAO, *Insurance Reciprocity and Uniformity: NAIC and State Regulators Have Made Progress in Producer Licensing, Product Approval and Market Conduct Regulation, but Challenges Remain*, GAO-09-372 (Washington, D.C.: Apr. 6, 2009). Reciprocity refers to the extent to which state regulators accept other states' regulatory actions. Uniformity refers to the extent to which states have implemented either the same, or substantially similar, regulatory standards and procedures.

[22]17 C.F.R. § 275.206(4)-1.

[23]NASD Rule 2210.

from their business activities.[24] Recent changes to Form ADV are designed to improve the disclosures that firms provide to clients. For example, firms must now provide clients with information about the advisory personnel on whom they rely for investment advice, including the requirements and applicability of any professional designations or certifications advisers may choose to include in their background information.

Most states regulate the use of the title "financial planner," and state securities and insurance laws can apply to the misuse of this title and other titles. For example, according to NASAA, at least 29 states specifically include financial planners in their definition of investment adviser.[25] According to NAIC, in many states, regulators can use unfair trade practice laws to prohibit insurance agents from holding themselves out as financial planners when in fact they are only engaged in the sale of life or annuity insurance products. However, as noted earlier, the effectiveness of the regulation of insurers' market conduct varies across states. In particular, in 2010 we noted inconsistencies in the state regulation of life settlements, a potentially high-risk transaction in which financial planners may participate.[26]

In addition, we were told some states had adopted regulations limiting the use of "senior-specific designations"—that is, designations that imply expertise or special training in advising senior citizen or elderly investors. According to NAIC, as of December 2010, 25 states had adopted in a uniform and substantially similar manner the NAIC Model Regulation on the Use of Senior-Specific Certifications and Professional Designations in the Sale of Life Insurance and Annuities, which limits the use of senior-specific designations by insurance agents. According to NASAA, as of December 2010, 31 states had adopted—and at least 9 other states were

[24]SEC and the states use Form ADV to register investment adviser firms and collect information from them. Part 2 of Form ADV provides information about the investment adviser and its business for use of the clients and is publicly available on the Investment Adviser Public Depository Web site. The SEC adopted amendments to Form ADV that were effective October 12, 2010, requiring Part 2 of Form ADV be written in a plain English narrative format. *See* Amendments to Form ADV, 75 Fed. Reg. 49,234 (Aug. 12, 2010) (to be codified at 17 C.F.R. pt. 275 and 279).

[25]The District of Columbia and Puerto Rico also include financial planners in their definitions of investment adviser, according to NASAA.

[26]GAO, *Life Insurance Settlements: Regulatory Inconsistencies May Pose a Number of Challenges*, GAO-10-775 (Washington, D.C.: July 9, 2010).

planning to adopt—the NASAA Model Rule on the Use of Senior-Specific Certifications and Professional Designations, which prohibits the misleading use of senior-specific designations by investment adviser representatives and other financial professionals.

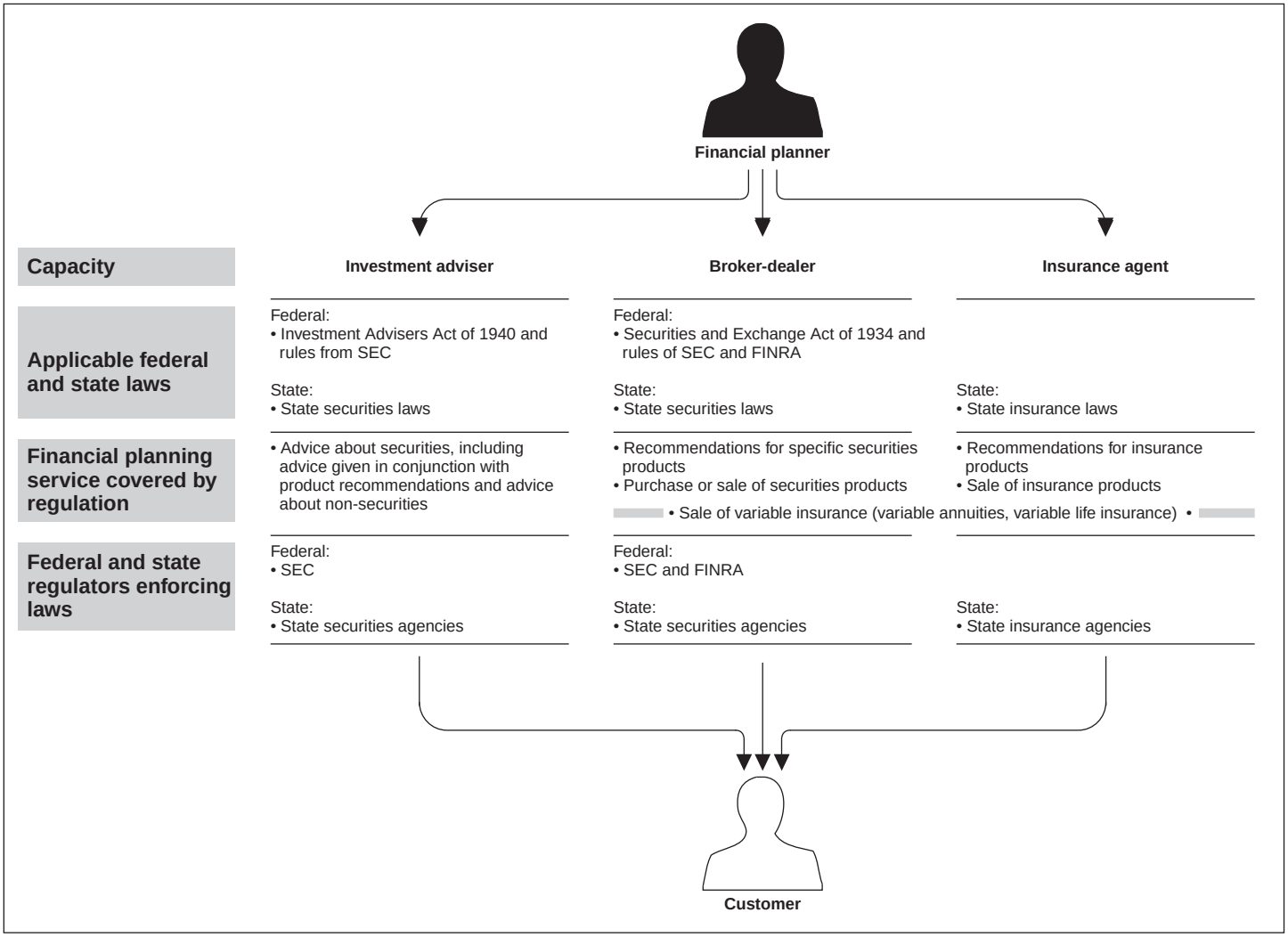
Regulatory Structure for Financial Planners Covers Most Activities, but Some Consumer Protection Issues Exist, and Data Tracking Complaints and Regulatory Actions against Planners Are Limited

The regulatory system for financial planners covers most activities in which they engage. However, enforcement of regulation may be inconsistent and some questions exist about consumers' understanding of the roles, standards of care, and titles and designations that a financial planner may have. The ability of regulators to identify potential problems is limited because they do not specifically track complaints, inspections, and enforcement actions specific to financial planning services.

Existing Regulation Covers Most Financial Planning Services

Although there is no single stand-alone regulatory body with oversight of financial planners, the regulatory structure for financial planners covers most activities in which they engage. As discussed earlier, and summarized in figure 2, the primary activities a financial planner performs are subject to existing regulation at the federal or state level, primarily through regulation pertaining to investment advisers, broker-dealers, and insurance agents. As such, SEC, FINRA, and NASAA staff, a majority of state securities regulators, financial industry representatives, consumer groups, and academic and subject matter experts with whom we spoke said that, in general, they believe the regulatory structure for financial planners is comprehensive, although, as discussed below, the attention paid to enforcing existing regulation has varied.

Figure 2: Summary of Key Statutes and Regulations That Can Apply to Financial Planners



Source: GAO.

Note: This figure highlights three major areas of regulatory oversight but is not comprehensive and does not include other regulatory regimes or practice standards that may be applicable to financial planners. In addition, not all investment advisers, broker-dealers, or insurance agents are financial planners.

As noted earlier, the activities a financial planner normally engages in generally include advice related to securities—and such activities make financial planners subject to regulation under the Advisers Act. One industry association and an academic expert noted that it would be very difficult to provide financial planning services without offering investment

advice or considering securities. SEC staff told us that financial planners holding even broad discussions of securities—for example, what proportion of a portfolio should be invested in stocks—would be required to register as investment advisers or investment adviser representatives. In theory, a financial planner could offer only services that do not fall under existing regulatory regimes—for example, advice on household budgeting—but such an example is likely hypothetical and such a business model may be hard to sustain. SEC and NASAA staff, a majority of the state securities regulators we spoke with, and many representatives of the financial services industry told us that they were not aware of any individuals serving as financial planners who were not regulated as investment advisers or regulated under another regulatory regime. Some regulators and industry representatives also said that, to the extent that financial planners offered services that did not fall under such regulation, the new Bureau of Consumer Financial Protection potentially could have jurisdiction over such services.[27]

However, not everyone agreed that regulation of financial planners was comprehensive. One group, the Financial Planning Coalition, has argued that a regulatory gap exists because no single law governs the delivery of the broad array of financial advice to the public.[28] According to the coalition, the provision of integrated financial advice—which would cover topics such as selecting and managing investments, income taxes, saving for college, home ownership, retirement, insurance, and estate planning—is unregulated. Instead, the coalition says that there is patchwork regulation of financial planning advice, and it views having two sets of laws—one regulating the provision of investment advice and another regulating the sale of products—as problematic.

[27]Section 1011 of the Dodd-Frank Act established the Bureau of Consumer Financial Protection to regulate "the offering and provision of consumer financial products or services under the Federal consumer financial laws." A financial product or service is defined in section 1002(15)(A)(viii) of the act to include financial advisory services to consumers on individual financial matters, with the exception of advisory services related to securities provided by a person regulated by SEC or a state securities commission to the extent that such person acts in a regulated capacity. Accordingly, it appears that the bureau may have jurisdiction over financial planners to the extent that they may offer services that would not be under the jurisdiction of SEC or a state securities commission.

[28]The members of this coalition include the Certified Financial Planner Board of Standards, Inc.; the Financial Planning Association; and the National Association of Personal Financial Advisors.

In addition, although the regulatory structure itself for financial planners may generally be comprehensive, attention paid to enforcing existing statute and regulation has varied. For example, as noted earlier, due to resource constraints, the examination of SEC-supervised investment advisers is infrequent. Further, as also noted earlier, market conduct regulation of insurers—which would include the examination of the sales practices and behavior of financial planners selling insurance products—has been inconsistent. Some representatives of industry associations told us that they believed that a better alternative to additional regulation of financial planners would be increased enforcement of existing law and regulation, particularly related to fraud and unfair trade practices.

Certain professionals—including attorneys, certified public accountants, broker-dealers, and teachers—who provide financial planning advice are exempt from regulation under the Advisers Act if such advice is "solely incidental" to their other business activities.[29] According to an SEC staff interpretation, this exemption would not apply to individuals who held themselves out to the public as providing financial planning services, and would apply only to individuals who provided specific investment advice on anything other than "rare, isolated and non-periodic instances."[30] Banks and bank employees are also excluded from the Advisers Act and are subject to separate banking regulation.[31] The American Bankers Association told us that the financial planning activities of bank employees such as trust advisors or wealth managers were typically utilized by clients with more than $5 million in investable assets. The association noted that these activities were subject to a fiduciary standard and the applicable supervision of federal and state banking regulators.

Most regulators and academic experts and many financial services industry representatives we spoke with told us that there is some overlap in the regulation of individuals who serve as financial planners because

[29]15 U.S.C. § 80b-2(a)(11); IA Rel. No. 1092(II)(B), at 38403. Under 15 U.S.C. § 80b-2(a)(11)(C), brokers and dealers also cannot receive any special compensation for their services in order to be exempt from registration as an investment adviser.

[30]*Id.*

[31]*Id.* The Advisers Act excludes bank and bank holding companies from the definition of investment adviser. Further, a bank and a bank holding company is an investment adviser under the act to the extent that the bank or bank holding company serves or acts as an adviser to a registered investment company. If such services are performed in a separate department or division of a bank, the department or division and not the bank itself is the investment adviser.

such individuals might be subject to oversight by different regulatory bodies for the different services they provide. For example, a financial planner who recommends and sells variable annuities as part of a financial plan is regulated as a registered representative of a broker-dealer as well as an insurance agent under applicable federal and state laws. However, some state regulators we spoke with told us that such overlap may be appropriate since the regulatory regimes cover different functional areas.

Consumers May Not Understand That Financial Planners Have Potential Conflicts of Interest When Selling Products

As seen in figure 3, financial planners are subject to different standards of care in their capacities as investment advisers, broker-dealers, and insurance agents.

- *Fiduciary Standard of Care*: As noted earlier, investment advisers are subject to a fiduciary standard of care—that is, they must act in their client's best interest, ensure that recommended investments are suitable for the client, and disclose to the client any material conflicts of interest.[32] According to SEC and NASAA representatives, the fiduciary standard applies even when investment advisers provide advice or recommendations about products other than securities, such as insurance, in conjunction with advice about securities.

- *Suitability Standard of Care When Recommending Security Products*: FINRA regulation requires broker-dealers to adhere to a suitability standard when rendering investment recommendations—that is, they must recommend only those securities that they reasonably believe are suitable for the customer.[33] Unlike the fiduciary standard, suitability rules do not necessarily require that the client's best interest be served. According to FINRA staff, up-front general disclosure of a broker-dealer's business activities and relationships that may cause conflicts of interest is not

[32]The SEC has, in effect, established rules of conduct for investment advisers, including requirements for disclosing conflicts of interest, obtaining the best execution on behalf of clients, allocating investments among clients fairly, ensuring that investments are suitable for clients, and ensuring that there is a reasonable basis for recommendations. SEC also requires investment advisers to maintain records pertaining to client accounts and business operations.

[33]A broker-dealer must have an adequate and reasonable basis for any recommendation and must make recommendations based on a customer's financial situation, needs and other securities holdings.

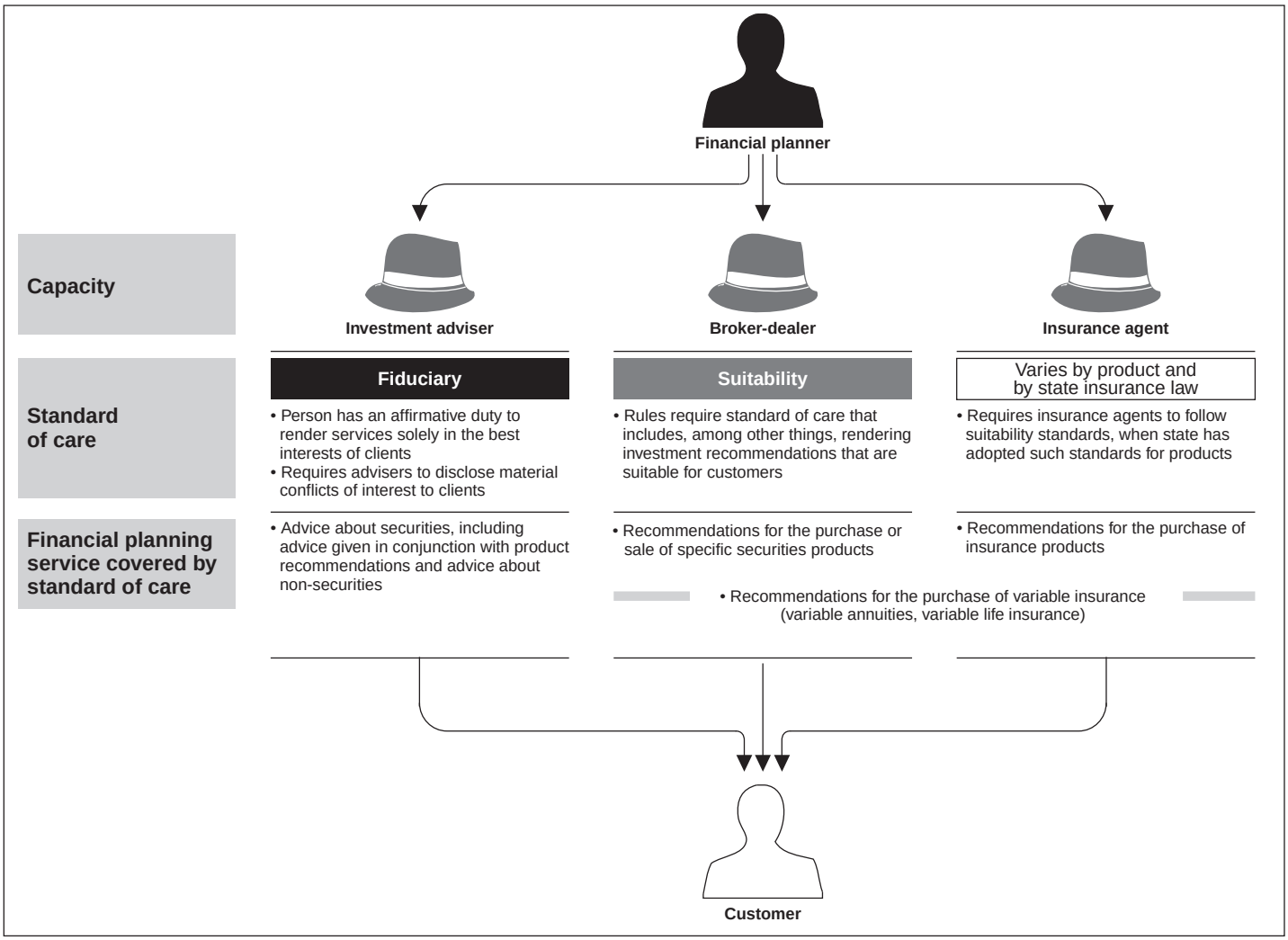
required.[34] However, according to SEC, broker-dealers are subject to many FINRA rules that require disclosure of conflicts in certain situations, although SEC staff also note that those rules may not cover every possible conflict of interest, and disclosure may occur after conflicted advice has already been given.[35]

- *Suitability Standard of Care When Recommending Insurance Products*: Standards of care for the recommendation and sale of insurance products vary by product and by state. For example, as seen earlier, NAIC's model regulations on the suitability standard for annuity transactions, adopted by some states but not others, require consideration of the insurance needs and financial objectives of the customer, while NAIC's model regulation for life insurance does not include a suitability requirement *per se*.

[34]Letter from Marc Menchel, Executive Vice President and General Counsel, FINRA, to Elizabeth M. Murphy, Secretary, SEC 4 (Aug. 25, 2010), available at http://www.finra.org/web/groups/industry/@ip/@reg/@guide/documents/industry/p121983.pdf.

[35]The standards of conduct for broker-dealers may also be based on antifraud provisions of the securities law and agency principles. Broker-dealers also have a duty of fairness in their contracts with a customer, which requires them to disclose material information that the customer would consider important as an investor. In addition, broker-dealers that handle discretionary accounts are generally thought to owe fiduciary obligations to their customers.

Figure 3: Differences in the Standards of Care Required of Financial Planners



Source: GAO.

Note: This figure is illustrative and is not comprehensive: financial planners may serve in capacities other than those shown here, and not all investment advisers, broker-dealers, and insurance agents serve as financial planners.

Conflicts of interest can exist when, for example, a financial services professional earns a commission on a product sold to a client. Under the fiduciary standard applicable to investment advisers, financial planners must mitigate any potential conflicts of interest and disclose any that remain. But under a suitability standard applicable to broker-dealers, conflicts of interest may exist and generally may not need to be disclosed

up-front.[36] For example, as confirmed by FINRA, financial planners functioning as broker-dealers may recommend a product that provides them with a higher commission than a similar product with a lower commission, as long as the product is suitable and the broker-dealer complies with other requirements. Because the same individual or firm can offer a variety of services to a client—a practice sometimes referred to as "hat switching"—these services could be subject to different standards of care. As such, representatives of consumer groups and others have expressed concern that consumers may not fully understand which standard of care, if any, applies to a financial professional. As shown above, the standards of care—and the extent to which conflicts of interest must be disclosed—can vary depending on the capacity in which the individual serves.[37] A 2007 report by the Financial Planning Association stated that "it would be difficult, if not impossible, for an individual investor to discern when the adviser was acting in a fiduciary capacity or in a non-fiduciary capacity."[38] A 2008 SEC study conducted by the RAND Corporation, consisting of a national household survey and six focus group discussions with investors, found that consumers generally did not understand not only the distinction between a suitability and fiduciary standard of care but also the differences between broker-dealers and investment advisers.[39] Similarly, a 2010 national study of investors found that most were confused about which financial professionals are required to operate under a fiduciary standard that requires professionals to put their client's interest ahead of their own.[40]

[36]FINRA officials have stated that they believe that the regulation of broker-dealers—while lacking an express fiduciary duty—prescribes in great detail the conduct and supervision of broker-dealers who provide investment advice to retail customers.

[37]Black's Law Dictionary (9th ed. 2009) defines the term "conflict of interest" as a "real or seeming incompatibility between one's private interests and one's public or fiduciary duties."

[38]*Final Report on Financial Planner Standards of Conduct*, FPA Fiduciary Task Force, June 2007.

[39]Angela A. Hung et al., RAND Institute for Civil Justice, *Investor and Industry Perspectives on Investment Advisers and Broker-Dealers* (2008).

[40]Infogroup, Opinion Research Corporation, *U.S. Investors & The Fiduciary Standard: A National Opinion Survey*, September 15, 2010. The survey was conducted among a sample of 2,012 adults living in the continental United States, including 1,319 who identified themselves as investors. The survey was sponsored by AARP, the Consumer Federation of America, NASAA, the Investment Adviser Association, the Certified Financial Planner Board of Standards, the Financial Planning Association, and the National Association of Personal Financial Advisors.

Representatives of financial services firms that provide financial planning told us they believe that clients are sufficiently informed about the differing roles and accompanying standards of care that a firm representative may have. They noted that when they provide both advisory and transactional services to the same customer, each service—such as planning, brokerage, or insurance sales—is accompanied by a separate contract or agreement with the customer. These agreements disclose that the firm's representatives have different obligations to the customer depending on their role. In addition, once a financial plan has been provided, some companies told us that they have customers sign an additional agreement stating that the financial planning relationship with the firm has ended.

Recent revisions by SEC to Form ADV disclosure requirements were designed to address, among other things, consumer understanding of potential conflicts of interest by investment advisers and their representatives. Effective October 12, 2010, SEC revised Form ADV, Part 2, which financial service firms must provide to new and prospective clients.[41] The new form, which must be written in plain English, is intended to help consumers better understand the activities and affiliations of their investment adviser. It requires additional disclosures about a firm's conflicts of interest, compensation, business activities, and disciplinary information that is material to an evaluation of the adviser's integrity. Similarly, in October 2010 FINRA issued a regulatory notice requesting comments on a concept proposal regarding possible new disclosure requirements that would, among other things, detail for consumers in plain English the conflicts of interest that broker-dealers may have associated with their services.[42]

Section 913 of the Dodd-Frank Act requires SEC to study the substantive differences between the applicable standards of care for broker-dealers and investment advisers; the effectiveness of the existing legal or regulatory standards of care for brokers, dealers, and investment advisers; and consumers' ability to understand the different standards of care. SEC

[41]Amendments to Form ADV, 75 Fed. Reg. 49234 (Aug. 12, 2010) (requires investment advisers registered with SEC to provide new and prospective clients with a brochure and brochure supplements clearly setting forth a meaningful, current disclosure of the business practices, conflicts of interest and background of the investment adviser and its advisory personnel; and requires the brochures to be filed with SEC electronically, which will make them available to the public through its Web site).

[42]FINRA Regulatory Notice 10-54.

will also consider the potential impact on retail customers of imposing the same fiduciary standard that now applies to investment advisers on broker-dealers when they provide personalized investment advice. Under the act, SEC may promulgate rules to address these issues and is specifically authorized to establish a uniform fiduciary duty for broker-dealers and investment advisers that provide personalized investment advice about securities to customers. As a result, further clarification of these standards may be forthcoming. FINRA officials told us that they support a fiduciary standard of care for broker-dealers when they provide personalized investment advice to retail customers.

Consumer confusion on standards of care may also be a source of concern with regard to the sale of some insurance products. A 2010 national survey of investors found that 60 percent mistakenly believed that insurance agents had a fiduciary duty to their clients.[43] Some insurance products, such as annuities, are complex and can be difficult to understand, and annuity sales practices have drawn complaints from consumers and various regulatory actions from state regulators as well as SEC and FINRA for many years.[44] According to NAIC, many states have requirements that insurance salespersons sell annuities only if the product is suitable for the customer. However, NAIC notes that some states do not have a suitability requirement for annuities. Consumer groups and others have stated that high sales commissions on certain insurance products, including annuities, may provide salespersons with a substantial financial incentive to sell these products, which may or may not be in the consumer's best interest. As a result of section 989J of the Dodd-Frank Act, one type of annuity—the indexed annuity—is to be regulated by states as an insurance product, rather than regulated by SEC as a security, under certain conditions.[45]

SEC's pending study related to the applicable standards of care for broker-dealers and investment advisers will not look at issues of insurance that

[43]Infogroup, Opinion Research Corporation, *U.S. Investors & The Fiduciary Standard: A National Opinion Survey*, September 15, 2010.

[44]See, for example, Securities and Exchange Commission Rule 151A and Annuities: Issues and Legislation, CRS Report for Congress 7-7500 (July 29, 2010).

[45]State regulation applies so long as a state has adopted NAIC's Suitability in Annuity Transactions model regulation or if an insurance company adopts and implements practices on a nationwide basis that meet or exceed the minimum requirements established by NAIC's model regulation. Indexed annuities are products that guarantee a purchaser's principal and a certain rate of return, and offer a chance for additional returns linked to a securities index or indices.

fall outside of SEC's jurisdiction. NAIC has not undertaken a similar study regarding consumer understanding of the standard of care for insurance agents. As we reported in the past, financial markets function best when consumers understand how financial service providers and products work and know how to choose among them.[46] Given the evidence of consumer confusion about differing standards of care and given the increased risks that certain insurance products can pose, there could be benefits to an NAIC review of consumers' understanding of standards of care for high-risk insurance products.

Consumers May Be Confused about the Ways Financial Professionals Present Themselves to the Public

Individuals who provide financial planning services may use a variety of titles when presenting themselves to the public, including financial planner, financial consultant, and financial adviser, among many others. However, evidence suggests that the different titles financial professionals use can be confusing to consumers. The 2008 RAND study found that even experienced investors were confused about the titles used by broker-dealers and investment advisers, including financial planner and financial adviser. Similarly, in consumer focus groups of investors conducted by SEC in 2005 as part of a rulemaking process, participants were generally unclear about the distinctions among titles, including broker, investment adviser, and financial planner.[47] In addition, a representative of one consumer advocacy group has expressed concern that some financial professionals may use as a marketing tool titles suggesting that they provide financial planning services, when in fact they are only selling products. One industry group, the Financial Planning Coalition, also has noted that some individuals may hold themselves out as financial planners without meeting minimum training or ethical requirements. Federal and state regulators told us they generally focused their oversight and enforcement actions on financial planners' activities rather than the titles they use. Moreover, NASAA has said that no matter what title financial planners use, most are required to register as investment adviser representatives and must satisfy certain competency requirements,

[46]GAO, *Financial Regulation: A Framework for Crafting and Assessing Proposals to Modernize the Outdated U.S. Financial Regulatory System*, GAO-09-216 (Washington, D.C.: Jan. 8, 2009).

[47]*Results of Investor Focus Group Interviews About Proposed Brokerage Account Disclosures.* Report to the Securities and Exchange Commission by Siegel & Gale LLC and Gelb Consulting Group, Inc., Mar. 10, 2005.

including passing an examination or obtaining a recognized professional designation.[48]

Financial planners' professional designations are typically conferred by a professional or trade organization. These designations may indicate that a planner has passed an examination, met certain educational requirements, or had related professional experience. Some of these designations require extensive classroom training and examination requirements and include codes of ethics with the ability to remove the designation in the event of violations. State securities regulators view five specific designations as meeting or exceeding the registration requirements for investment adviser representatives, according to NASAA, and allow these professional designations to satisfy necessary competency requirements for prospective investment adviser representatives.[49] For example, one of these five designations requires a bachelor's degree from an accredited college or university, 3 years of full-time personal financial planning experience, a certification examination, and 30 hours of continuing education every 2 years.

The criteria used by organizations that grant professional designations for financial professionals vary greatly. FINRA has stated that while some designations require formal certification procedures, including examinations and continuing professional education credits, others may merely signify that membership dues have been paid. The Financial Planning Coalition and The American College, a nonprofit educational institution that confers several financial designations, similarly told us that privately conferred designations range from those with rigorous competency, practice, and ethical standards and enforcement to those that can be obtained with minimal effort and no ongoing evaluation.

[48]According to NASAA, all but three states—New York, Minnesota, and Wyoming—register investment adviser representatives and require that they pass either the Series 65 (Uniform Investment Adviser Law Examination) or the Series 66 (Uniform Combined State Law Examination), or obtain a recognized professional designation. While New York and Minnesota do not register individual investment adviser representatives, their state laws require that the representatives meet other requirements, such as passing certain examinations or obtaining a professional designation accepted by the state.

[49]The five designations recognized as such are Certified Financial Planner®, Chartered Financial Consultant®, Personal Financial Specialist, Chartered Financial Analyst, and Chartered Investment Counselor.

As noted earlier, designations that imply expertise or special training in advising senior citizen or elderly investors have received particular attention from regulators. A joint report of SEC, FINRA, and NASAA described cases in which financial professionals targeted seniors by using senior-specific designations that implied that they had a particular expertise for senior investors, when in fact they did not; as noted earlier, NASAA and NAIC have developed a model rule to address the issue.[50] The report also noted these professionals targeted seniors through the use of so-called free-lunch seminars, where free meals are offered in exchange for attendance of a financial education seminar. However, the focus of the seminars was actually on the sale of products rather than the provision of financial advice.

Given the large number of designations financial planners may use, concerns exist that consumers may have difficulty distinguishing among them. To alleviate customer confusion, FINRA has developed a Web site for consumers that provides the required qualifications and other information about the designations used by securities professionals. The site lists more than 100 professional designations, 5 of which include the term "financial planner," and 24 of which contain comparable terms such as financial consultant or counselor.[51] The American College told us that it had identified 270 financial services designations. Officials from NASAA, NAIC, and a consumer advocacy organization told us that consumers might have difficulty distinguishing among the various designations. Officials from The American College told us that the number of designations itself was not necessarily a cause for concern, but rather consumers' broadly held misperception that all designations or credentials are equal.

To help address these concerns, FINRA plans to expand its Web site on professional designations to include several dozen additional designations related to insurance. However, FINRA officials noted that consumers' use of this tool has been limited. For example, in 2009, the site received only 55,765 visits. A recent national study of the financial capability of American adults sponsored by FINRA found that only 15 percent of adults

[50]*Protecting Senior Investors: Report of Examinations of Securities Firms Providing "Free Lunch" Sales Seminars* by the Office of Compliance Inspections and Examination, Securities and Exchange Commission; North American Securities Administrators Association; and the Financial Industry Regulatory Authority, September 2007.

[51]See http://apps.finra.org/DataDirectory/1/prodesignations.aspx.

who had used a financial professional in the last 5 years claimed to have checked the background, registration, or license of a financial professional.[52] In addition, SEC staff acknowledged that there have been concerns about confusing designations, and SEC's October 2010 changes to investment adviser disclosure requirements mandate that investment adviser representatives who list professional designations and certifications in their background information also provide the qualifications needed for these designations, so that the consumer can understand the value of the designation for the services being provided.

Section 917 of the Dodd-Frank Act includes a requirement that SEC conduct a study identifying the existing level of financial literacy among retail investors, including the most useful and understandable relevant information that they need to make informed financial decisions before engaging a financial intermediary. While the section does not specifically mention the issue of financial planners' titles and designations, the confusion we found to exist could potentially be addressed or mitigated if SEC incorporated this issue into its overall review of financial literacy among investors. SEC staff told us that at this time its review would not likely address this issue, although it would address such things as the need for conducting background checks on financial professionals. Financial markets function best when consumers have information sufficient to understand and assess financial service providers and products.[53] Including financial planners' use of titles and designations in SEC's financial literacy review could provide useful information on the implications of consumers' confusion on this issue.

Consumer Complaints and Enforcements Actions Appear to Be Relatively Limited, but Regulators Generally Do Not Track Data Specific to Financial Planners

Available data do not show a large number of consumer complaints and enforcement actions involving financial planners, but the exact extent to which financial planners may be a source of problems is unknown. We were able to find limited information on consumer complaints from various agencies. For example, representatives of FTC and the Better Business Bureau said that they had received relatively few complaints related to financial planners. FTC staff told us that a search in its Consumer Sentinel Network database for the phrase "financial planner"

[52]Applied Research & Consulting LLC, *Financial Capability in the United States: Initial Report of the Research Findings from the 2009 National Survey*, prepared for the FINRA Investor Education Foundation (New York: December 2009).

[53]GAO-09-216.

found 141 complaints in the 5-year period from 2005 through 2010 but that only a handful of these appeared to actually involve activity connected to the financial planning profession.[54] The staff added that additional searches on other titles possibly used by financial planners, such as financial consultant and personal financial adviser, did not yield significant additional complaints. In addition, a representative of the Better Business Bureau told us that it had received relatively few complaints related to financial planners, although the representative noted that additional complaints might exist in broader categories, such as "financial services."

Consumer complaint data may not be an accurate gauge of the extent of problems. Complaints may represent only a small portion of potential problems and complaints related to "financial planners" may not always be recorded as such. As we have previously reported, consumers also may not always know where they can report complaints.[55] At the same time, some complaints that are made may not always be valid.

SEC has limited information on the extent to which the activities of financial planners may be causing consumers harm. The agency does record and track whether federally and state-registered investment adviser firms provide financial planning services, but its data tracking systems for complaints, examination results, and enforcement actions are not programmed to readily determine and track whether the complaint, result, or action was specifically related to a financial planner or financial planning service. For example, SEC staff told us the number of complaints about financial planners would be undercounted in their data system that receives and tracks public inquiries, known as the Investor Response Information System, because this code would likely be used only if it could not be identified whether the person (or firm) was an investment adviser or broker-dealer. In addition, the data system that SEC uses to record examination results, known as the Super Tracking and Reporting System,

[54]The Consumer Sentinel Network database is a secure online database of millions of consumer complaints available only to law enforcement. In addition to storing complaints received by FTC, the Consumer Sentinel Network also includes complaints filed with the Internet Crime Complaint Center, Better Business Bureaus, Canada's PhoneBusters, the U.S. Postal Inspection Service, the Identity Theft Assistance Center, and the National Fraud Information Center, among others.

[55]GAO, *Telecommunications: FCC Needs to Improve Oversight of Wireless Phone Service*, GAO-10-34 (Washington, D.C.: November 2009), p. 18.

does not allow the agency to identify and extract examination results specific to the financial planning services of investment advisers.

However, SEC staff told us that a review of its Investor Response Information System identified 51 complaints or inquiries that had been recorded using their code for issues related to "financial planners" between November 2009 and October 2010. SEC staff told us that the complaints most often involved allegations of unsuitable investments or fraud, such as misappropriation of funds.[56] A review of a separate SEC database called Tips, Complaints, and Referrals—an interim system that was implemented in March 2010—found 124 allegations of problems possibly related to financial planners from March 2010 to October 2010.[57]

SEC staff told us that they did not have comprehensive data on the extent of enforcement activities related to financial planners *per se*. In addition, NASAA said that states generally do not track enforcement data specific to financial planners. At our request, SEC and NASAA provided us with examples of enforcement actions related to individuals who held themselves out as financial planners. Using a keyword search, SEC identified 10 such formal enforcement actions between August 2009 and August 2010. According to SEC documents, these cases involved allegations of such activities as defrauding clients through marketing schemes, receiving kickbacks without making proper disclosures, and misappropriation of client funds. Although NASAA also did not have comprehensive data on enforcement activities involving financial planners, representatives provided us with examples of 36 actions brought by 30 states from 1986 to 2010. These cases involved allegations of such things as the sale of unsuitable products, fraudulent misrepresentation of qualifications, failure to register as an investment adviser, and misuse of client funds for personal expenses.

[56]Of these 51 complaints or inquiries, 29 involved allegations of fraud, 9 involved allegations of unsuitable investments, and the remaining 13 represented questions on a variety of topics.

[57]Of these 124 allegations, 13 were coded as "fraudulent or unregistered offer or sale of securities, including Ponzi schemes, high yield investment programs or other investment programs"; 12 as "manipulation of a security's price or volume"; 6 as "theft or misappropriation of funds or securities"; 5 as "false or misleading statements about a company"; 3 as "problems with my brokerage or advisory account"; and 2 as "insider trading." An additional 14 were coded as "other fraudulent conduct" and 69 were coded simply as "other."

Because of limitations in how data are gathered and tracked, SEC and state securities regulators are not currently able to readily determine the extent to which financial planning services may be causing consumers harm. NASAA officials told us that, as with SEC, state securities regulators did not typically or routinely track potential problems specific to financial planners. SEC and NASAA representatives told us that they had been meeting periodically in recent months to prepare for the transition from federal to state oversight of certain additional investment adviser firms, as mandated under the Dodd-Frank Act, but they said that oversight of financial planners in particular had not been part of these discussions. SEC staff have noted that additional tracking could consume staff time and other resources. They also said that because there are no laws that directly require registration, recordkeeping, and other responsibilities of "financial planners" *per se*, tracking such findings relating to those entities would require expenditure of resources on something that SEC does not have direct responsibility to oversee. Yet as we have reported in the past, while we recognize the need to balance the cost of data collection efforts against the usefulness of the data, a regulatory system should have data sufficient to identify risks and problem areas and support decisionmaking.[58] Given the significant growth in the financial planning industry, ongoing concerns about potential conflicts of interest, and consumer confusion about standards of care, regulators may benefit from identifying ways to get better information on the extent of problems specifically involving financial planners and financial planning services.

[58]GAO, *Managing for Results, Using GPRA to Help Congressional Decisionmaking and Strengthen Oversight*, GAO/T-00-95 (Washington, D.C.: March 2000), p. 13. GAO, *Executive Guide, Effectively Implementing the Government Performance and Results Act*, GAO/GGD-96-118 (Washington, D.C.: June 1996), p. 27.

Some Changes in the Oversight of Financial Planners Could Be Beneficial, but Most Stakeholders Believe Substantial Overhaul Is Not Needed

Stakeholders Have Suggested a Variety of Approaches to the Regulation of Financial Planners

Over the past few years, a number of stakeholders—including consumer groups, FINRA, and trade associations representing financial planners, securities firms, and insurance firms—have proposed different approaches to the regulation of financial planners. Following are four of the most prominent approaches, each of which has both advantages and disadvantages.

Creation of a Board to Oversee Financial Planners

In 2009, the Financial Planning Coalition—comprised of the Certified Financial Planner Board of Standards, Financial Planning Association, and the National Association of Personal Financial Advisors—proposed that Congress establish a professional standards-setting oversight board for financial planners. According to the coalition, its proposed legislation would establish federal regulation of financial planners by allowing SEC to recognize a financial planner oversight board that would set professional standards for and oversee the activities of individual financial planners, although not financial planning firms. For example, the board would have the authority to establish baseline competency standards in the areas of education, examination, and continuing education, and would be required to establish ethical standards designed to prevent fraudulent and manipulative acts and practices. It would also have the authority to require registration or licensing of financial planners and to perform investigative and disciplinary actions. Under the proposal, states would retain antifraud authority over financial planners as well as full oversight for financial planners' investment advisory activity. However, states would not be allowed to impose additional licensing or registration requirements for financial planners or set separate standards of conduct. Supporters of a new oversight board have noted that its structure and governance would be analogous to the Public Company Accounting Oversight Board, a private nonprofit organization subject to SEC oversight that in turn oversees the audits of public companies that are subject to securities laws.

According to the Financial Planning Coalition, a potential advantage of this approach is that it would treat financial planning as a distinct profession and would regulate across the full spectrum of activities in which financial planners may engage, including activities related to investments, taxes, education, retirement planning, estate planning, insurance, and household budgeting. Proponents argue that a financial planning oversight board would also help ensure high standards and consistent regulation for all financial planners by establishing common standards for competency, professional practices, and ethics.

However, many securities regulators and financial services trade associations with whom we spoke said that they believe such a board would overlap with and in many ways duplicate existing state and federal regulations, which already cover virtually all of the products and services that a financial planner provides. Some added that the board would entail unnecessary additional financial costs and administrative burdens for the government and regulated entities. In addition, some opponents of this approach question whether "financial planning" should be thought of as a distinct profession that requires its own regulatory structure, noting that financial planning is not easily defined and can span multiple professions, including accounting, insurance, investment advice, and law. One consumer group also noted that the regulation of individuals and professions is typically a state rather than a federal responsibility. Finally, we note that the analogy to the Public Company Accounting Oversight Board may not be apt. That board was created in response to a crisis involving high-profile bankruptcies and investor losses caused in part by inadequacies among public accounting firms. In the case of financial planners, there is limited evidence of an analogous crisis or, as noted earlier, of severe harm to consumers.

Augmenting Oversight of Investment Advisers with an SRO

A number of proposals over the years have considered having FINRA or a newly created SRO supplement SEC oversight of investment advisers. These proposals date back to at least 1963, when an SEC study recommended that all registered investment advisers be required to be a

member of an SRO.[59] In 1986, the National Association of Securities Dealers, a predecessor to FINRA, explored the feasibility of examining the investment advisory activities of members who were also registered as investment advisers. The House of Representatives passed a bill in 1993 that would have amended the Advisers Act to authorize the creation of an "inspection only" SRO for investment advisers, although the bill did not become law.[60] In 2003, SEC requested comments on whether one or more SROs should be established for investment advisers, citing, among other reasons, concerns that the agency's own resources were inadequate to address the growing numbers of advisers.[61] However, SEC did not take further action. Section 914 of the Dodd-Frank Act required SEC to issue a study in January 2011 on the extent to which one or more SROs for investment advisers would improve the frequency of examinations of investment advisers.[62]

According to FINRA, the primary advantage of augmenting investment adviser oversight with an SRO is that doing so would allow for more frequent examinations, given the limited resources of states and SEC. The Financial Services Institute, an advocacy organization for independent broker-dealers and financial advisers, has stated that an industry-funded SRO with the resources necessary to appropriately supervise and examine all investment advisers would close the gap that exists between the regulation of broker-dealers and investment advisers. FINRA said that it finds this gap troubling given the overlap between the two groups (approximately 88 percent of all registered advisory representatives are also broker-dealer representatives). FINRA adds that any SRO should operate subject to strong SEC oversight and that releasing SEC of some of its responsibilities for investment advisers would free up SEC resources for other regulatory activities.

[59]See Securities and Exchange Commission, News Digest Issue No. 63-4-3, 8 (1963), which describes SEC's report to Congress, regarding the adequacy of the rules of national securities exchanges and national securities associations, pursuant to Pub. L. No. 87-196, 75 Stat. 465 (1961), wherein SEC points out that the framework of industry self-regulation permitted many broker-dealer firms and registered investment advisers to remain outside of any official self-regulatory group. According to the SEC News Digest, the report suggested that membership in an SRO should be a prerequisite to registration with SEC as a broker-dealer or investment adviser.

[60]H.R. 578, 103rd Cong. (1993).

[61]Investment Advisers Act Release No. 2107, 68 Fed. Reg. 7038 (Feb. 11, 2003).

[62]SEC is required to report the results of its study within 180 days of enactment of the Dodd-Frank Act.

However, NASAA, some state securities regulators, and one academic with whom we spoke opposed adding an SRO component to the regulatory authority of investment advisers. NASAA said it believed that investment adviser regulation is a governmental function that should not be outsourced to a private, third-party organization that lacks the objectivity, independence, expertise, and experience of a government regulator. Further, NASAA said it is concerned with the lack of transparency associated with regulation by SROs because, unlike government regulators, they are not subject to open records laws through which the investing public can obtain information. Two public interest groups, including the Consumer Federation of America, have asserted that one SRO—FINRA—has an "industry mindset" that has not always put consumer protection at the forefront. In addition, the Investment Adviser Association and two other organizations we interviewed have noted that funding an SRO and complying with its rules can impose additional costs on a firm.[63]

Extending Coverage of the Fiduciary Standard

Proposals have been made to extend coverage of the fiduciary standard of care to all those who provide financial planning services. Some consumer groups and others have stated that a fiduciary standard should apply to anyone who provides personalized investment advice about securities to retail customers, including insurance agents who recommend securities. The Financial Planning Coalition has proposed that the fiduciary standard apply to all those who hold themselves out as financial planners. Proponents of extending the fiduciary standard of care, which also include consumer groups and NASAA, generally maintain that consumers should be able to expect that financial professionals they work with will act in their best interests. They say that a fiduciary standard is more protective of consumers' interests than a suitability standard, which requires only that a product be suitable for a consumer rather than in the consumer's best interest. In addition, the Financial Planning Coalition notes that extending a fiduciary standard would somewhat reduce consumer confusion about financial planners that are covered by the fiduciary standard in some capacities (such as providing investment advice) but not in others (such as selling a product).

However, some participants in the insurance and broker-dealer industries have argued that a fiduciary standard of care is vague and undefined. They say that replacing a suitability standard with a fiduciary standard could

[63]The Investment Adviser Association is a not-for-profit association that represents the interests of SEC-registered investment adviser firms.

actually weaken consumer protections since the suitability of a product is easier to define and enforce. Opponents also have argued that complying with a fiduciary standard would increase compliance costs that in turn would be passed along to consumers or otherwise lead to fewer consumer choices.

Clarifying Financial Planners' Credentials and Standards

The American College has proposed clarifying the credentials and standards of financial professionals, including financial planners. In particular, it has proposed creating a working group of existing academic and practice experts to establish voluntary credentialing standards for financial professionals. As noted previously, consumers may be unable to distinguish among the various financial planning designations that exist and may not understand the requirements that underpin them. Clarifying the credentials and standards of financial professionals could conceivably take the form of prohibiting the use of certain designations, as has been done for senior-specific designations in some states, or establishing minimum education, testing, or work experience requirements needed to obtain a designation. The American College has stated that greater oversight of such credentials and standards could provide a "seal of approval" that would generally raise the quality and competence of financial professionals, including financial planners, help consumers distinguish among the various credentials, and help screen out less qualified or reputable players.

However, the ultimate effectiveness of such an approach is not clear, since the extent to which consumers take designations into account when selecting or working with financial planners is unknown, as is the extent of the harm caused by misleading designations. In addition, implementation and ongoing monitoring of financial planners' credentials and standards could be challenging. Further, the issue of unclear designations has already been addressed to some extent—for example, as noted earlier, some states regulate the use of certain senior-specific designations and allow five professional designations to satisfy necessary competency requirements for prospective investment adviser representatives. State securities regulators also have the authority to pursue the misleading use of credentials through their existing antifraud authority.

Most Stakeholders Saw Little Need for an Additional Oversight Body Governing Financial Planners

In general, a majority of the regulatory agencies, consumer groups, academics, trade associations, and individual financial services companies with which we spoke did not favor substantial structural change in the regulation of financial planners. In particular, few supported an additional oversight body, which was generally seen as duplicative of existing regulation. Some stakeholders in the securities and insurance industries

noted that given the dynamic financial regulatory environment under way as a result of the Dodd-Frank Act—such as creation of a new Bureau of Consumer Financial Protection—more time should pass before additional regulatory changes related to financial planning services were considered. Several industry associations also noted that opportunities existed for greater enforcement of existing law and regulation, as discussed earlier.

Conclusions

Existing statutes and regulations appear to cover the great majority of financial planning services, and individual financial planners nearly always fall under one or more regulatory regimes, depending on their activities. While no single law governs the broad array of activities in which financial planners may engage, given available information, it does not appear that an additional layer of regulation specific to financial planners is warranted at this time. At the same time, as we have previously reported, more robust enforcement of existing laws could strengthen oversight efforts. In addition, there are some actions that can be taken that may help address consumer protection issues associated with the oversight of financial planners.

First, as we have reported, financial markets function best when consumers understand how financial providers and products work and know how to choose among them. Yet consumers may be unclear about standards of care that apply to financial professionals, particularly when the same individual or firm offers multiple services that have differing standards of care. As such, consumers may not always know whether and when a financial planner is required to serve their best interest. While SEC is currently addressing the issue of whether the fiduciary standard of care should be extended to broker-dealers when they provide personalized investment advice about securities, the agency is not addressing whether this extension should also apply to insurance agents, who generally fall outside of SEC's jurisdiction. Sales practices involving some high-risk insurance products, such as annuities, have drawn attention from federal and state regulators. A review by NAIC of consumers' understanding of the standards of care with regard to the sale of insurance products could provide information on the extent of consumer confusion in the area and actions needed to address the issue.

Second, we have seen that financial planners can adopt a variety of titles and designations. The different designations can imply different types of qualifications, but consumers may not understand or distinguish among these designations, and thus may be unable to properly assess the qualifications and expertise of financial planners. SEC's recent changes in this area—requiring investment advisers to disclose additional information

on professional designations and certifications they list—should prove beneficial. Another opportunity lies in SEC's mandated review of financial literacy among investors. Incorporating issues of consumer confusion about financial planners' titles and designations into that review could assist the agency in assessing whether any further changes are needed in disclosure requirements or other related areas.

Finally, SEC has limited information about the nature and extent of problems specifically related to financial planners because it does not track complaints, examination results, and enforcement activities associated with financial planners specifically, and distinct from investment advisers as a whole. However, a regulatory system should have data sufficient to identify risks and problem areas and support decisionmaking. SEC staff have noted that additional tracking could require additional resources, but other opportunities may also exist to gather additional information on financial planners. Because financial planning is a growing industry and has raised certain consumer protection issues, regulators could potentially benefit from better information on the extent of problems specifically involving financial planners and financial planning services.

Recommendations

We recommend that the National Association of Insurance Commissioners, in concert with state insurance regulators, take steps to assess consumers' understanding of the standards of care with regard to the sale of insurance products, such as annuities, and take actions as appropriate to address problems revealed in this assessment.

We also recommend that the Chairman of the Securities and Exchange Commission direct the Office of Investor Education and Advocacy, Office of Compliance Inspections and Examinations, Division of Enforcement, and other offices, as appropriate, to:

- Incorporate into SEC's ongoing review of financial literacy among investors an assessment of the extent to which investors understand the titles and designations used by financial planners and any implications a lack of understanding may have for consumers' investment decisions; and

- Collaborate with state securities regulators in identifying methods to better understand the extent of problems specifically involving financial planners and financial planning services, and take actions to address any problems that are identified.

Agency Comments

We provided a draft of this report for review and comment to FINRA, NAIC, NASAA, and SEC. These organizations provided technical comments, which we incorporated, as appropriate. In addition, NAIC provided a written response, which is reprinted in appendix II. NAIC said it generally agreed with the contents of the draft report and would give consideration to our recommendation regarding consumers' understanding of the standards of care with regard to the sale of insurance products.

NASAA also provided a written response, which is reprinted in appendix III. In its response, NASAA said it agreed that a specific layer of regulation for financial planners was unnecessary and provided additional information on some aspects of state oversight of investment advisers. NASAA also said that it welcomed the opportunity to continue to collaborate with SEC to identify methods to better understand and address problems specifically involving financial planners, as we recommended. In addition, NASAA expanded upon the reasons for its opposition to proposals that would augment oversight of investment advisers with an SRO.

We are sending copies of this report to interested congressional committees, the Chief Executive Officer of FINRA, Chief Executive Officer of NAIC, Executive Director of NASAA, and the Chairman of SEC. In addition, the report will be available at no charge on GAO's Web site at http://www.gao.gov.

If you or your staffs have any questions about this report, please contact me at (202) 512-8678 or cackleya@gao.gov. Contact points for our Offices of Congressional Relations and Public Affairs are on the last page of this report. GAO staff who made major contributions to this report are listed in appendix IV.

Alicia Puente Cackley
Director, Financial Markets
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List of Congressional Addressees

The Honorable Bob Corker
The Honorable Tim Johnson
The Honorable Herbert Kohl
The Honorable Richard C. Shelby
United States Senate

The Honorable Spencer Bachus
Chairman
The Honorable Barney Frank
Ranking Member
Committee on Financial Services
House of Representatives

Appendix I: Scope and Methodology

Our reporting objectives were to address (1) how financial planners are regulated and overseen at the federal and state levels, (2) what is known about the effectiveness of regulation of financial planners and what regulatory gaps or overlap may exist, and (3) alternative approaches for the regulation of financial planners and the advantages and disadvantages of these approaches.

For background information, we obtained estimates for 2000 and 2008, and projections for 2018, from the Bureau of Labor Statistics on the number of individuals who reported themselves as "personal financial advisers," a term that the agency said was interchangeable with "financial planner." The bureau derived these estimates from the Occupational Employment Statistics survey and the Current Population Survey.[1] According to the bureau, the Occupational Employment Statistics' estimates for financial planners have a relative standard error of 1.9 percent, and the median wage estimate for May 2009 has a relative standard error of 1.5 percent. Because the overall employment estimates used are developed from multiple surveys, it was not feasible for the bureau to provide the relative standard errors for these financial planner employment statistics. To estimate the number of households that used financial planners, we analyzed 2007 data from the Board of Governors of the Federal Reserve's Survey of Consumer Finances. This survey is conducted every three years to provide detailed information on the finances of U.S. households.[2] Because the survey is a probability sample based on random selections, the sample is only one of a large number of samples that might have been drawn. Since each sample could have provided different estimates, we express our confidence in the precision of our particular sample's results as a 95 percent confidence interval (e.g., plus or minus 2.5 percentage points). This is the interval that would contain the actual population value for 95 percent of the samples that could have been drawn. In this report, for this survey, all percentage

[1]As explained by the Bureau of Labor Statistics, the Occupational Employment Statistics program produces employment and wage estimates for over 800 occupations. These are estimates of the number of people employed in certain occupations, and estimates of the wages paid to them. Since self-employed persons are not included in the estimates, the bureau also considers information from the Current Population Survey, a monthly survey of households conducted by the Bureau of Census for the Bureau of Labor Statistics, to derive its occupation estimates.

[2]Additional information on the sample design and data collected by the Survey of Consumer Finances is available at http://www.federalreserve.gov/pubs/oss/oss2/about.html.

estimates have 95 percent confidence intervals that are within plus or minus 2.5 percentage points from the estimate itself.

To identify how financial planners are regulated and overseen at the federal and state levels, we identified and reviewed, on the federal level, federal laws, regulations, and guidance applicable to financial planners, the activities in which they engage, and their marketing materials, titles, and designations. We also reviewed relevant SEC interpretive releases, such as IA Rel. No. 1092, *Applicability of the Investment Advisers Act to Financial Planners, Pension Consultants, and Other Persons Who Provide Investment Advisory Services as a Component of Other Financial Services*. We also discussed the laws and regulations relevant to financial planners in meetings with staff of the Securities and Exchange Commission (SEC), Financial Industry Regulatory Authority (FINRA), Department of Labor, and Internal Revenue Service. We also interviewed two legal experts and reviewed a legal compendium on the regulation of financial planners. At the state level, we interviewed representatives from the North American Securities Administrators Association (NASAA) and the National Association of Insurance Commissioners (NAIC) and reviewed model regulations developed by these agencies. In addition, we selected five states—California, Illinois, North Carolina, Pennsylvania, and Texas—for a more detailed review. We chose these states because they had a large number of registered investment advisers and varying approaches to the regulation of financial planners, and represented geographic diversity. For each of these states, we reviewed selected laws and regulations related to financial planners, which included those related to senior-specific designations and insurance transactions, and we interviewed staff at each state's securities and insurance agencies.

To identify what is known about the effectiveness of the regulation of financial planners and what regulatory gaps or overlap may exist, we reviewed relevant federal and state laws, regulations and guidance. In addition, we spoke with representatives of the federal and state agencies cited above, as well as FINRA and organizations that represent or train financial planners, including the Financial Planning Coalition, The American College, and the CFA Institute; organizations that represent the financial services industry, including the Financial Services Institute, Financial Services Roundtable, Securities Industry and Financial Markets Association, Investment Advisers Association, American Society of Pension & Professional Actuaries, National Association of Insurance and Financial Advisors, American Council of Life Insurers, Association for Advanced Life Underwriting, American Institute of Certified Public Accountants, American Bankers Association; and organizations

representing consumer interests, including the Consumer Federation of America and AARP. We also spoke with selected academic experts knowledgeable about these issues. In addition, we reviewed relevant studies and other documentary evidence, including a 2008 study of the RAND Corporation that was commissioned by SEC, "Investor and Industry Perspectives on Investment Advisers and Broker-Dealers"; "Results of Investor Focus Group Interviews About Proposed Brokerage Account Disclosures," sponsored by SEC; results of the FPA Fiduciary Task Force, "Final Report on Financial Planner Standards of Conduct"; "U.S. Investors & The Fiduciary Standard: A National Opinion Survey," sponsored by AARP, the Consumer Federation of America, the NASAA, the Investment Adviser Association, the Certified Financial Planner Board of Standards, the Financial Planning Association, and the National Association of Personal Financial Advisors; and the 2009 National Financial Capability Study, commissioned by FINRA. We determined that the reliability of these studies was sufficient for our purposes. In addition, we reviewed relevant information on the titles and designations used by financial planners, including FINRA's Web site that provides the required qualifications and other information about the designations used by securities professionals.

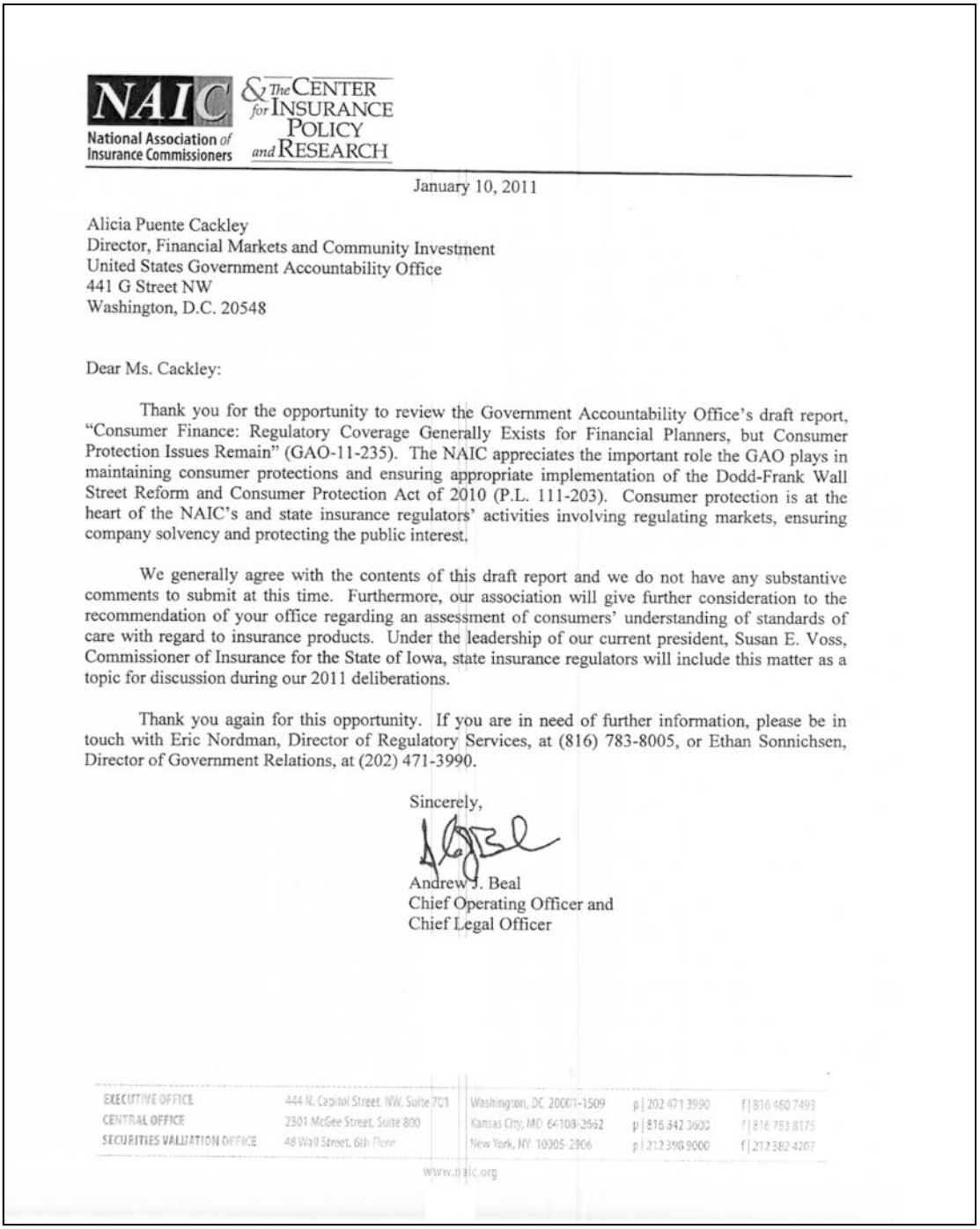
We also obtained and reviewed available data on complaints and selected enforcement actions related to financial planners from the Federal Trade Commission, Better Business Bureau, and SEC. We collected from the Federal Trade Commission complaint data from its Consumer Sentinel Network database, using a keyword search of the term "financial planner" for complaints filed from 2005 to 2010. From the Better Business Bureau, we collected the number of complaints about the financial planning industry received in 2009. From SEC, we collected complaints from the agency's Investor Response Information System that had been coded as relating to "financial planners" from November 2009 to October 2010. We also reviewed data from SEC's Tips, Complaints, and Referrals database that resulted from a keyword search for the terms "financial planner," "financial adviser," "financial advisor," "financial consultant," and "financial counselor" from March 2010 to October 2010. In addition, at our request, SEC and NASAA provided us anecdotally with examples of enforcement actions related to individuals who held themselves out as financial planners. SEC identified 10 formal enforcement actions between August 2009 and August 2010 and NASAA provided us selected examples of state enforcement actions involving financial planners from 1986 to 2010 from 30 states. We gathered information on SEC- and state-registered investment advisers from SEC's Investment Adviser Registration Database. FINRA did not provide us with data on complaints, examination results, or

enforcement actions specific to financial planners; FINRA officials told us they do not track these data specific to financial planners.

To identify alternative approaches for the regulation of financial planners and their advantages and disadvantages, we conducted a search for legislative and regulatory proposals related to financial planners, which have been made by Members of Congress, consumer groups, and representatives of the financial planning, securities, and insurance industries. We identified and reviewed position papers, studies, public comment letters, congressional testimonies, and other documentary sources that address the advantages and disadvantages of these approaches. In addition, we solicited views on these approaches from representatives of the wide range of organizations listed above, including organizations that represent financial planners, financial services companies, and consumers, as well as state and federal government agencies and associations and selected academic experts.

We conducted this performance audit from June 2010 through January 2011 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Appendix II: Comments from the National Association of Insurance Commissioners



NAIC National Association of Insurance Commissioners & The Center for Insurance Policy and Research

January 10, 2011

Alicia Puente Cackley
Director, Financial Markets and Community Investment
United States Government Accountability Office
441 G Street NW
Washington, D.C. 20548

Dear Ms. Cackley:

Thank you for the opportunity to review the Government Accountability Office's draft report, "Consumer Finance: Regulatory Coverage Generally Exists for Financial Planners, but Consumer Protection Issues Remain" (GAO-11-235). The NAIC appreciates the important role the GAO plays in maintaining consumer protections and ensuring appropriate implementation of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (P.L. 111-203). Consumer protection is at the heart of the NAIC's and state insurance regulators' activities involving regulating markets, ensuring company solvency and protecting the public interest.

We generally agree with the contents of this draft report and we do not have any substantive comments to submit at this time. Furthermore, our association will give further consideration to the recommendation of your office regarding an assessment of consumers' understanding of standards of care with regard to insurance products. Under the leadership of our current president, Susan E. Voss, Commissioner of Insurance for the State of Iowa, state insurance regulators will include this matter as a topic for discussion during our 2011 deliberations.

Thank you again for this opportunity. If you are in need of further information, please be in touch with Eric Nordman, Director of Regulatory Services, at (816) 783-8005, or Ethan Sonnichsen, Director of Government Relations, at (202) 471-3990.

Sincerely,

Andrew J. Beal
Chief Operating Officer and
Chief Legal Officer

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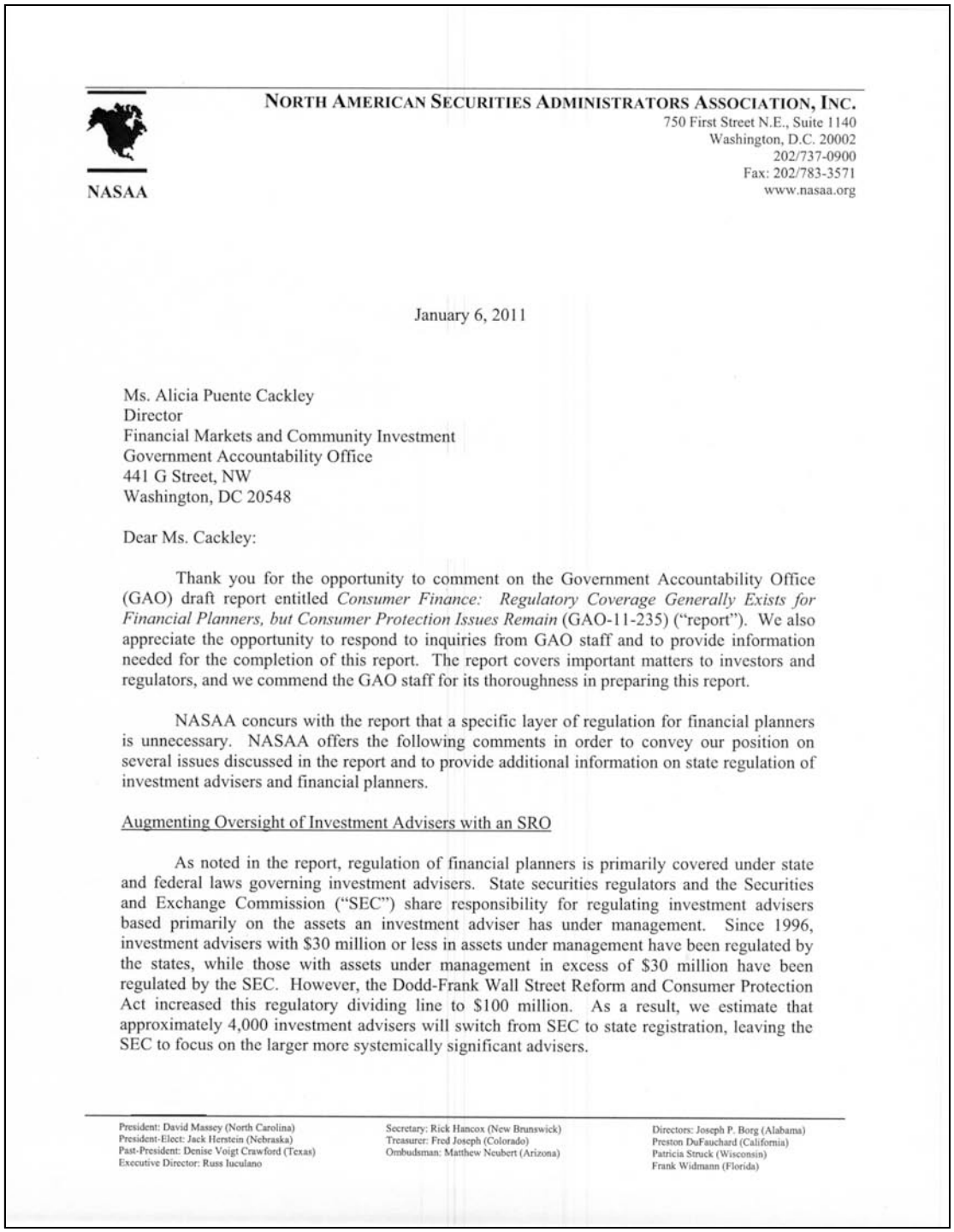
Appendix III: Comments from the North American Securities Administrators Association



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NASAA

January 6, 2011

Ms. Alicia Puente Cackley
Director
Financial Markets and Community Investment
Government Accountability Office
441 G Street, NW
Washington, DC 20548

Dear Ms. Cackley:

Thank you for the opportunity to comment on the Government Accountability Office (GAO) draft report entitled *Consumer Finance: Regulatory Coverage Generally Exists for Financial Planners, but Consumer Protection Issues Remain* (GAO-11-235) ("report"). We also appreciate the opportunity to respond to inquiries from GAO staff and to provide information needed for the completion of this report. The report covers important matters to investors and regulators, and we commend the GAO staff for its thoroughness in preparing this report.

NASAA concurs with the report that a specific layer of regulation for financial planners is unnecessary. NASAA offers the following comments in order to convey our position on several issues discussed in the report and to provide additional information on state regulation of investment advisers and financial planners.

Augmenting Oversight of Investment Advisers with an SRO

As noted in the report, regulation of financial planners is primarily covered under state and federal laws governing investment advisers. State securities regulators and the Securities and Exchange Commission ("SEC") share responsibility for regulating investment advisers based primarily on the assets an investment adviser has under management. Since 1996, investment advisers with $30 million or less in assets under management have been regulated by the states, while those with assets under management in excess of $30 million have been regulated by the SEC. However, the Dodd-Frank Wall Street Reform and Consumer Protection Act increased this regulatory dividing line to $100 million. As a result, we estimate that approximately 4,000 investment advisers will switch from SEC to state registration, leaving the SEC to focus on the larger more systemically significant advisers.

Regulation of investment advisers is a topic of considerable debate, and the report covers various proposals on how the oversight of financial planners and investment advisers should be handled. One of the proposals discussed in the report is the formation of a self-regulatory organization ("SRO") for investment advisers. The report considers potential advantages and disadvantages of this approach, and NASAA believes there are significant concerns with this concept beyond those noted in the report that must be considered.

NASAA's position is that investment adviser regulation is a governmental function that should not be outsourced to a private, third-party organization that does not have expertise or experience with investment adviser regulation. One can readily conclude that the designation of an SRO for the oversight of investment advisers, with its attendant direct and indirect costs, its opaque structure and attendant lack of accountability and transparency, would outweigh any perceived benefits to the investing public.

The chief concerns the states have with the designation of an SRO for the oversight of investment advisers are the collaboration, transparency, accountability, and conflict issues that have always been inherent to the SRO model. While industry SROs had historically worked as a partner with the SEC and the states (creating what was referred to as the "three-legged stool" of regulation), this model recently changed based on an over-broad construction of the "government actor doctrine." It has been our experience that, to avoid a classification as a "government actor", the relevant SRO has restricted the release of information to the government and has affirmatively taken the position that it is prohibited from active collaboration with governmental regulators, including the governmental entity responsible for its oversight. As such, previous synergies with the SRO have been lost, and it has become increasingly difficult for the governmental regulators to meaningfully control oversight or investigations over registrants subject to the current SRO model.

Collaboration issues aside, the regulatory work performed by SROs lacks transparency. Although SROs have been performing governmental functions for decades, they are not subject to similar Freedom Of Information Act (FOIA) and public records requirements as are the SEC and state securities regulators. Even where there is public disclosure by SROs regarding members, as in the case of BrokerCheck, the SRO has placed limitations and filters on regulatory records that far exceed FOIA provisions. The end result is that vital information is withheld from the investing public. Without greater transparency, investors cannot obtain the information they need to make informed decisions.

Finally, the current SRO model raises accountability and conflict concerns. Even where there is an independent Board of Directors, SROs remain organizations built on the premise of self-rule and are, as a matter of first principle, accountable to their members rather than the investing public. Ultimately, no matter how many safeguards are instituted, an SRO has substantial conflicts of interest that governmental regulators do not. This is particularly true in situations where industry and investor interests conflict, as in the case of mandatory pre-dispute arbitration clauses and the disclosure or expungement of historical settlements, judgments, and investor claims. Ultimately, SROs simply cannot match the accountability of government

regulators, nor the proximity and familiarity of state regulators, in particular, when considering investor protection and regulatory thoroughness.

State Regulation of Investment Advisers and Investment Adviser Representatives

The report discusses both state and SEC regulation of investment advisers, including the registration forms required by the SEC and the disclosure of that information to investors. We believe it is important to note that these forms, the ADV Parts 1 and 2, are also required by the state securities regulators.

In addition to these forms, state-registered advisers are also required to submit additional forms and supplemental information such as client contracts or financial statements. State regulators also require investment advisers to complete additional disclosure questions. Specifically, in Part 2 of the ADV, commonly referred to as the firm brochure, an investment adviser registering with a state securities regulator must disclose additional information about outside business activities, certain fee arrangements, and arbitration claims against the adviser or a management person. The information contained in these registration forms is available to the investing public from the adviser, state securities regulators, or online at www.adviserinfo.sec.gov. As explained in the report, most states register investment adviser representatives and important information about the backgrounds of these individuals is also available on the same website.

Conclusions and Recommendations

The report's conclusions include a reference to the lack of complaint information available to state and federal regulators. While states track complaint and enforcement information on investment advisers as noted in the report, that information generally does not distinguish between complaints or enforcement actions lodged against an investment adviser versus a financial planner. NASAA understands the GAO's concern with potential complaints against financial planners given the increase of individuals and firms providing financial planning services. NASAA is taking steps to gauge whether there are in fact significant numbers of complaints against investment adviser firms providing financial planning services and, if so, how better to track this information and address potential problems.

Finally, the report includes a recommendation that the SEC "collaborate with state securities regulators in identifying methods to better understand the extent of problems specifically involving financial planners and financial planning services, and take actions to address any problems that are identified." Over the years, NASAA has worked closely with the SEC on matters specific to the regulation of investment advisers, including revisions to registration forms, the development of the electronic system for registration used by investment advisers, and the upcoming implementation of the increased assets under management threshold. NASAA welcomes the opportunity to continue to work with the SEC and to address potential issues involving financial planners as recommended in the report.

Thank you again for the opportunity to review and comment on the draft report. We look forward to working with the GAO on future studies.

Sincerely,

David Massey,
NASAA President and
North Carolina Deputy Securities Administrator

Appendix IV: GAO Contact and Staff Acknowledgments

GAO Contact

Alicia Puente Cackley (202) 512-8678 or cackleya@gao.gov

Staff Acknowledgments

In addition to the contact named above, Jason Bromberg (Assistant Director), Sonja J. Bensen, Jessica Bull, Emily Chalmers, Patrick Dynes, Ronald Ito, Sarah Kaczmarek, Marc Molino, Linda Rego, and Andrew Stavisky made key contributions to this report.

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