



Legal Risk Management Tip September 2009

Regulation of Financial Planners

Introduction

On July 17, 2009, the Certified Financial Planner Board of Standards, the Financial Planning Association, and the National Association of Personal Financial Advisors (collectively the Financial Planning Coalition) made a statement to the House of Representatives Committee on Financial Services calling for “the creation of a professional oversight board for financial planners.”¹ This board would be called to regulate individuals who provide financial planning services but not the firms they work for. Since that time, Financial Planners have inquired about what this could mean to them. Consequently, this month’s Risk Management Tip focuses on how the current requirements apply to a practicing financial planner and the potential impact of those proposed by the Financial Planning Coalition which call for greater regulation of its members.

What professional designations are required to conduct business as a financial planner?

An individual does not need any professional designation to conduct business as a financial planner. However, many financial planners choose to obtain *Certified Financial Planner* or *Personal Financial Specialist* designations.

In order to obtain these designations, a financial planner must meet strict educational and ethical standards and complete a rigorous certification program. Holding a specialist designation often assists Financial Planners in making their services more marketable and allows them to charge higher fees for their greater level of expertise. However, many clients may not be aware of the importance of these credentials and the Coalition is concerned that clients may be selecting less qualified financial planners on the misconception that all financial planners have the same level of expertise.

Call from the Coalition

By making the professional oversight board “responsible for establishing baseline competency standards” the Coalition’s proposals would ensure that only professionals who meet these standards could conduct business as a financial planner.

¹ www.cfp.net, July 17, 2009, Statement of the Financial Planning Coalition Before the United States House of Representatives Committee on Financial Services on the Obama Administration’s Regulatory Reform Proposals, September 18, 2009 (http://www.cfp.net/downloads/Coalition_HFSC_Testimony.pdf)

What securities registrations are required to conduct business as a financial planner?

Many financial planners are registered as representatives of investment advisers, broker-dealers or both. However, such registration is only required to the extent that the financial planner provides implementation of the financial plan through transactions in securities or in providing securities advice. This is because investment advisory activity relates to “investing in, purchasing, or selling securities”² and brokerage activity relates to “effecting transactions in securities for the account of others.”³

While most if not all financial planners provide guidance on certain investments for their clientele to consider, not all effectuate that advice. Some financial planners may opt to refer clients to third-party advisers or other professionals. Still many financial planners maintain at least one securities registration because they want to be able to offer securities advice to continue to maintain the client relationship. This action, however, could create a conflict of interest since the financial planner will earn additional revenue by helping the client to implement the financial plan, either through managing client assets as an investment adviser representative or by selling investment products to clients as a broker-dealer representative.

Call from the Coalition

The Coalition does not wish to alter the existing securities registration structure. In fact, they explicitly state that their proposals are designed to “operate consistently with existing federal regulation for broker-dealers and investment advisers”. However, they are concerned by the conflicts of interests that can exist due to a financial planner’s ability to provide additional services through holding a securities registration. With this in mind, they propose making the professional oversight board responsible for “developing a code of professional conduct”. Unfortunately, the Coalition has not offered any details as to what this code would cover, but it is probable that it would deal with managing such conflicts of interest.

How does a financial planner’s securities registration affect the manner in which they provide financial planning services?

If a financial planner is registered as an investment adviser representative, they owe their client a fiduciary duty when providing financial planning advice. This means that any advice they give must be in the best interests of the client. If the planner is registered as a broker-dealer representative, the planner must ensure that the product is suitable for the client.

This difference in standards is subtle but important. Many similar investments may be suitable for a client, but may not be in the client’s best interests. Let’s assume that a client needs to purchase shares in a mutual fund in order to implement part of their

² Investment Advisers Act of 1940 §202(a)(11)

³ Securities Exchange Act of 1934 §3(a)(4)

financial plan. An investment advisory planner would be required to find the mutual fund that it is in the client's best interests. A brokerage planner would be permitted to sell shares in any suitable mutual fund, which may include funds sponsored by the broker-dealer with which the financial planner is associated. This may create another conflict, which should be mitigated, if possible.

Call from the Coalition

The Coalition is concerned that brokerage planners are not subject to a fiduciary duty and cite examples of planners "looking to profit from commissions [who] may not have even considered the client's best interests." The position is compounded, in their eyes, because many financial planners are representatives of both investment advisers and brokerage firms. This can sometimes allow a dually registered representative to circumvent the fiduciary duty associated with acting in an advisory capacity by acting in a brokerage capacity.

Currently, credentialed financial planners, such as Certified Financial Planners or Personal Financial Specialists are subject to a fiduciary duty regardless of the securities registration under which they conduct business. The Coalition proposes that all professionals who provide financial services or who hold themselves out as financial planners be subject to this same standard.

Conclusion

At present, there is no consistency amongst the standards which govern financial planning activities. Regulations vary depending on whether one holds a professional designation, advises on securities, or conducts business as an investment adviser representative or broker-dealer representative. Not only does this cause confusion and potential difficulties for consumers, it can also make it hard for financial planners and the firms that employ them to know which regulatory regime to follow when conducting business. Despite the Coalition's general proposals, there is no substantive legislation before Congress which might produce a uniform system of regulation. Elsewhere, President Obama has suggested imposing a fiduciary duty on broker-dealers.⁴ Although this would overcome some of the inconsistencies described above, it would not alter the fundamental problem that the financial planning industry is governed by three differing sets of rules and regulations.⁵ With this in mind, financial planning professionals and firms should take special care to ensure that they comply with perhaps the highest standard applicable to their unique business model.

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⁴ The Department of the Treasury, June 17, 2009, Financial Regulatory Reform: A New Foundation, p15, September 18, 2009 (http://www.financialstability.gov/docs/regs/FinalReport_web.pdf)

⁵ This is five if we consider: (1) that many financial planners are licensed as insurance agents; and (2) it is possible to provide financial planning without any securities registration if you do not discuss securities.

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