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Subject: **ERISA 411 & ADVISOR BACKGROUND CHECKS**

Given the negative headlines, challenging markets and repeated investment scandals, the need to establish trust through full disclosure and transparency has never been more important.

The SEC has already increased their focus on wealth managers who hold assets through banks, brokers, advisors and accounting firms. Additionally, they have stepped up efforts to verify that account statements sourced from advisors match custodial records. Large custodians of RIA assets are also focusing on the verification of wire transfer authorizations.

ERISA Section 411 specifically precludes those convicted of a variety of crimes, including substance abuse and other financial shortcomings, from serving ERISA plans. Ironically, **most investors and plan sponsors do not perform background checks before hiring an advisor.**

Unfortunately, the fraud detection components of the nation's financial regulatory system are not fully coordinated. As a result, **the public lacks an all inclusive central depository for background checks.**

Many firms perform background checks during the hiring process and then default to self-reporting for updates. Reportable items are supposed to include formal investigations, regulatory actions, customer disputes, criminal charges and/or convictions. Financial disclosure, including bankruptcies, unpaid judgments and liens should also be disclosed.

In addition to system shortcomings, many advisors fail to self-report for a variety of reasons. While they are a good place to start, **the various regulatory databases may not be current or accurate.** Moreover, unless they are securities licensed, insurance agents may not be subject to any disclosure beyond the hiring process.

Given the importance of a background check, **sponsors should use all credible means at their disposal to check an advisor's background,** including credentialing organizations, FINRA, the SEC, NASAA, NAIC, state securities and insurance departments, the Better Business Bureau, vendors who offer background checks and the internet.

**The level of risk should play a role in determining the depth of the advisor's background check.** Risk assessment is important because the level of risk varies with the advisor's role, i.e., advising the fiduciary, custodial, independent recommendations & monitoring, discretionary investment manager, named fiduciary, etc.

In addition to insurance policy reviews and discounts, **the EAE Program will offer plan sponsors an “optional” advisor background check service.** While the sponsor must pay the fee for the outsourced service, the advisor finalists must give their permission before the background check is initiated. Advisors would also see the report in advance and be given the opportunity to correct any inaccuracies.

For more information on ERISA Section 411, visit the BenefitsLink.com website at: [http://benefitslink.com/erisa/crossreference\\_short.html](http://benefitslink.com/erisa/crossreference_short.html).

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### Credentialing Organizations

Credentialing organizations like the CFP Board, the IMCA and others maintain high standards when advisor candidates apply, including background checks and cross checking with State authorities. FINRA’s Central Registration Depository (CRD) and the SEC’s Investment Advisor Registration Depository (IARD) are also checked.

Developed by FINRA and NASAA, the **CRD** consolidated a multiple paper-based state licensing and regulatory process into a single nationwide computer system. The database contains the licensing and disciplinary histories of more than 650,000 securities professionals and 5,200 firms.

While developed jointly by NASAA and the SEC, the **IARD** is operated by FINRA. FINRA does not have regulatory authority over investment advisors, but the IARD is to investment advisors what the CRD is to broker-dealers. The IARD contains the employment and disciplinary histories of more than 11,000 investment firms and 173,000 individual investment advisors.

Once advisors receive their designations, they are subject to self-reporting, including civil matters, litigation and criminal reporting. The credentialing organizations also expect to hear from third parties, including disgruntled clients, their attorneys and other designation holders.

Cognizant of the potential risk for slander and defamation lawsuits, the organizations tend to err on the side of caution. When a series of complaints have been filed against an advisor, the organization must conduct their own internal investigation before taking any action.

Credentialing organizations often note that the disciplinary process must be fair to all parties, but **the membership of the major organizations may have become too large for these groups to routinely check the nation’s regulatory databases.** Monitoring membership conduct is further complicated by the fact that **settlements could be reached and/or sanctions imposed before the acts are reported on the organization’s website.**

Credentialing organizations do not view themselves as policemen, but many feel that **more time and resources should be devoted to monitoring members** after they receive their designations.

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### **FINRA (Registered Reps)**

Registered reps (brokerage firm employees) are regulated by the Financial Industry Regulatory Authority (FINRA), the industry's self-policing body. As noted, FINRA tracks the employment, qualifications and disciplinary history of more than 650,000 advisors.

To help the public evaluate advisors, FINRA offers a free and widely used service called BrokerCheck. According to FINRA, twelve million reviews were conducted in 2008 through BrokerCheck.

After entering an advisor's name, the online tool allows users to access complaints, outcomes, states licensed to transact business in, industry exams passed, previous employment history and outside affiliations (including compensation received from other sources.)

In the past, **the public's access to disciplinary history has been limited to two years after the advisor left the industry.** However, a new rule has been approved and it will expand the reporting history for those who were subject to FINAL REGULATORY ACTION and reported to the CRD system as defined in the Form U4.

The expanded period will access records back to 1999 and will include any final regulatory action from:

- FINRA
- SEC
- CFTC
- Federal Banking Agency
- National Credit Union Administration
- Other Federal Regulatory Agencies
- State Regulatory Agencies
- Foreign Regulatory Authorities

The new rule is expected to become effective in late 2010, but it will NOT include the availability of other information such as:

- Customer Complaints
- Bankruptcies
- Liens
- Criminal Events
- Arbitration
- Revocation/Suspension To Act As An Attorney, CPA Or Federal Contractor

Some critics disagree, but according to FINRA, **reportable financial matters do not warrant permanent disclosure** because they do not have the same degree of materiality as final regulatory action.

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### **FINRA Limitations**

Most registered reps have unblemished records. Less than 3% of all registered reps have multiple complaints on their records and a smaller group has more.

Nevertheless, **the histories of the 15,000 advisors who have left the industry due to regulatory action are not currently available through BrokerCheck.** An additional 300-400 advisors per year are also suspended and/or barred from the industry.

Currently, **only brokers with three or more actions against them are flagged** by BrokerCheck. **Settled complaints may also be expunged and if the complaint was filed against the firm rather than the advisor, it may not show up** on BrokerCheck.

**The U4 and U5 Forms may also be subject to a lack of full disclosure at the firm level.** The U4 (Uniform Application for Securities Industry Registration or Transfer) lists the advisor's qualifications and disciplinary history. The U5 (Uniform Termination Notice for Securities Industry Registration) discloses why the broker left the firm.

**The quality of reporting on the U5 varies greatly** because firms are leery of lawsuits and defamation. Indeed, some feel it is better to terminate the advisor and let others deal with the problematic behavior. On the other hand, advisors could be dismissed for political reasons and not be in a position to correct their U5.

FINRA has indicated that heightened supervision is warranted for brokers whose records reflect disciplinary actions involving sales practice abuse, a history of customer complaints and/or arbitrations that were not resolved in their favor. Unfortunately, **heightened supervision may be a double-edged sword at the firm level.** In other words, the firm could be criticized for forgoing heightened supervision of a broker who meets the aforementioned criteria as well as problems emanating from brokers who were under heightened supervision.

For more information on the professional background of current and former FINRA-registered brokerage firms & advisors, FINRA's Broker Check may be visited at:

<http://www.finra.org/Investors/ToolsCalculators/BrokerCheck/index.htm>.

For other FINRA enforcement actions, including Sanction Guidelines, Adjudication and Disciplinary Actions, visit: <http://www.finra.org/Industry/Enforcement/index.htm>.

## **SEC & STATE SECURITIES REGULATORS**

Depending on the amount of assets under advisement, investment advisors (RIAs) are regulated by the SEC or state regulators. The SEC registers RIA firms, but does not register individual representatives (IARs) of RIA firms. The state registers both RIAs and IARs.

The SEC and state securities regulators require registered investment advisor (RIA) firms to disclose settled and ongoing disciplinary history on their Form ADV. Item eleven (11) on Part I of the ADV specifically requires disclosure of certain criminal, regulatory and civil proceedings. The form also contains information about investment advisors and their business operations.

SEC regulated firms may limit the disclosure of any event to ten (10) years following the date of resolution. On the other hand, state registered firms may have to disclose beyond the ten year period. In reality, state registered firms may be held to a higher standard because they are generally required to disclose financial (judgments & liens), arbitration and civil proceedings as well.

Many RIA firms overlook the fact that in addition to the firm's history, **the history of affiliates must also be disclosed, including partners, directors, non-clerical employees and other controlled persons.**

Disclosure events are considered material and as a result, the ADV is to be updated promptly, usually within 30 days.

While RIAs are required to "offer" a copy of their Form ADV Part II to all their clients on an annual basis, Part I of their publicly disclosed ADV can be viewed on the SEC's Investment Advisor Public Search website.

**The SEC search is currently limited to RIA firms**, but it will provide the ability to search for individual advisors in the future. The database **does NOT include those exempt from registration, unapproved applications or those who have not filed through the electronic IARD system.**

The SEC's Investment Advisor Public Search website is located at:  
[http://www.adviserinfo.sec.gov/IAPD/Content/IapdMain/iapd\\_SiteMap.aspx](http://www.adviserinfo.sec.gov/IAPD/Content/IapdMain/iapd_SiteMap.aspx) .

For other SEC enforcement action, visit: <http://www.sec.gov/divisions/enforce.shtml>.

## **NASAA**

State securities regulators were protecting investors long before the creation of the SEC and FINRA. Organized in 1919, the North American Securities Administrators Association (NASAA) is the oldest international organization devoted to investor protection.

NASSA is a voluntary organization whose members consist of 50 states, the District of Columbia, Puerto Rico, the U.S. Virgin Islands, Canada and Mexico.

The public may not realize it and while it is still a work in progress, investors are protected by federal agencies, self-regulatory organizations, credentialing organizations and the states working in a collaborative manner.

Given that the SEC's website searches are limited to RIA firms, it is important to note that **NASAA's Investment Adviser Public Disclosure Individual System is expected to be operational during the first half of 2010.**

The NASAA system will provide the public with a national database devoted to the disclosure of information applicable to IARs. Unfortunately, investors must currently check with individual state regulators to get that information.

With less than 80% of their jurisdictions reporting, NASAA's website indicates that more than 8,000 enforcement actions (administrative, civil & criminal) were initiated during the three years ending in 2007.

To contact the appropriate State Securities Regulator, NASAA's website may be visited at:  
<http://www.nasaa.org/QuickLinks/ContactYourRegulator.cfm>.

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## **NAIC**

Founded in 1871, the National Association of Insurance Commissioners (NAIC) is a voluntary organization of insurance regulators whose members consist of 50 states, the District of Columbia and the five U.S. territories.

A state regulator's primary responsibility is to protect the interests of insurance consumers. The NAIC helps regulators fulfill that obligation through shared objectives and the coordination of regulations applicable to multistate insurers.

Insurance agents are regulated separately by each state. Unfortunately, **there is no central database that collects complaints against insurance agents.** As a result, the state insurance sites are limited to an agent's name and licenses held, i.e., **background checks are not available.**

To contact the appropriate State Insurance Commission, the NAIC website may be visited at:  
<http://www.nasaa.org/QuickLinks/ContactYourRegulator.cfm>.

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### **CFDD 2010 ADVISOR CONFERENCE: The Fonz Lives**

The CFDD's October 6-8 (Wednesday-Friday), 2010 Advisor Conference, *NEW AGE MARKETING: What Worked In The Past Is No Longer Effective*, will return to the downtown Chicago Fairmont - Millennium Park Hotel, Chicago, Illinois.

Given the evolving decision making process, the retirement industry must adapt to the new environment to maintain and increase market share. The CFDD's sole purpose centers on **helping specialists grow their retirement plans business and professionalizing the advisor selection process.** Given our mission, the new ERISA Advisor Evaluator program for plan sponsors will play a key role in the consolidation of retirement plan advisory services.

While CFDD '09 was another homerun, CFDD '10 is designed more intimately to facilitate deeper networking and enhanced learning. Specific education tracks will be threaded throughout the event and more advisor roundtables will be included in the program, including spirited after hour meetings.

The CFDD's conferences sell out early and **more than 1,000 retirement plan experts will attend the 2010 Advisor Conference, including more than 500 accomplished retirement plan advisors.**

To bridge the conference's educational demands and create a relaxed atmosphere, **CFDD '10 will feature a lively 50's theme**, including an Elvis impersonator, professional entertainers, a Grand Prize Trip To Graceland for two and major photo-ops for sponsors. In addition to authentic 50's His & Her Attire Awards, the Kick-Off Party will feature hula hoop, twist and Fonz look-a-like contests. The '57 Chevy may be no more than a ghost, but cats & chicks can still roll up t-shirt sleeves, don retro sunglasses, poodle skirts, pony tails, ducktails and network in a friendly environment.

The Chicago Fairmont's exhibitor space is limited to sixty exhibition booths and while only twenty are left, all booth locations are equally traffic friendly. To facilitate increased networking, **all food and beverage will be served in the exhibition area.**

As a bonus, **the 2010 exhibition package includes complimentary advertising on the CFDD's website and in our email newsletter with a value up to \$25,000.** The website is currently experiencing more than 300,000 page visits per month and our newsletter reaches a highly targeted audience of over 35,000 retirement plan professionals.

The CFDD already offers more value, unbiased content, CE credits and attracts more accomplished retirement plan advisors than any other industry event. To add even more value, **join exhibitors who register early and benefit from banner ad exposure on the CFDD's entire website and our email newsletter for up to one year without additional cost.**

Our limited 2010 booth space will sell out early. To secure your space now, **benefit from extended complimentary advertising and exposure to the industry's most powerful database of retirement plan specialists,** exhibitors should click [HERE](#) to register.

Rather than continue to offer selective group discounts to large organizations, we are donning our Robin Hood hats and making the discounts available to all individual advisor registrants. **To benefit from the maximum discount, you must register early.** To register early and save, individual advisors should click [HERE](#)

For more information on the conference, visit: <http://www.thecfdd.com/CFDDconference2010>.

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