

CENTER FOR DUE DILIGENCE

P.O. Box 8 • Western Springs, Illinois 60558
(630) 662-0284 • Fax (630) 662-0286

E-mail: CFDD@TheCFDD.com

Web: <http://www.TheCFDD.com>

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Subject: EVALUATING ERISA PLAN ADVISORS PART II: Registration Categories & Fiduciary Status

Facing ever complicated products, investment conditions, scrutiny and liability, investors and plan sponsors have increasingly turned to financial intermediaries for help. While they may provide similar products and services in the eyes of the buyer, **the regulatory landscape governing financial intermediaries varies widely.**

There are always exceptions, but the public and plan sponsors are generally not cognizant of the differences between the various registration categories applicable to financial intermediaries. While **clients generally enter into relationships with financial intermediaries based on trust, the intermediary may not have a legal requirement to place a client's interest first.**

SECURITIES REGULATION & INSURANCE LICENSING

The Securities and Exchange Commission (SEC) was established by Congress in 1934 to regulate the equity markets and administer laws that govern the securities industry. These laws include the Securities Exchange Act of 1934, which regulates Broker-Dealers (B-Ds) and the Investment Advisers Act of 1940, which regulates Registered Investment Advisers (RIAs).

In addition to the SEC, the national Association of Securities Dealers (NASD) was founded as a self-regulatory organization in 1939 and was succeeded by the Financial Industry Regulatory Authority (FINRA) in 2007. FINRA is responsible for the regulation of B-Ds, registered representatives (registered reps), enforcement and arbitration. Although larger RIAs are still regulated by the SEC, smaller RIAs are state regulated.

Insurance agents and brokers are state regulated and must obtain licenses in the states where they plan to conduct business. Separate licenses are required for Life & Health as well as Property & Casualty Insurance. The insurance industry is moving toward uniform state licensing standards and as the demand for financial planning increases, a growing number of insurance intermediaries are pursuing their securities licenses.

REGISTERED REPRESENTATIVES: Suitability

Approximately 5,000 B-D firms are registered with FINRA, including wirehouses, independents, regionals and others. Over 600,000 **registered representatives** operate under B-D umbrellas, including 300,000 - 400,000 active producers and 150,000 advisors with **dual registration**.

Mergers/acquisitions have unsettled the wirehouse landscape and some are suffering from cultural shock as well as losing talent. Stripping the hype away, DC plan flexibility, including the ability to assume an ERISA fiduciary role & operate with dual registration, varies widely among B-Ds. The additional flexibility is also generally limited to a very small group that meets internal standards. These restrictions, along with financial instability, a loss of trust, emphasis on proprietary products and new technology, have fueled the growth behind independent B-Ds and RIAs.

Registered reps, also known as financial advisors, financial consultants and brokers, are often viewed as salespeople. They are typically Series 6 or 7 licensed, affiliated with a B-D and earn commissions on transaction-based business. Registered reps may also provide investment advice if it is “incidental” to their business under a suitability standard.

B-Ds are regulated under the Securities Exchange Act of 1934 and as such, are not deemed to be fiduciaries under Securities law. **The B-Ds’ registered reps are subject to the “suitability” standard and are not required to place client interests ahead of their own.** While they are not required to function in a fiduciary capacity, and in many cases are not permitted, it is important to note that many registered reps operate with a fiduciary standard of care. However, this fact may not be acknowledged to the client.

The 1934 Act is often referred to as a **rules-based** statute. By following the suitability rule and providing disclosure, B-Ds have generally been protected from liability even when engaging in practices that might not be in the best interest of clients.

B-Ds were initially transaction-based organizations, but the landscape has changed in recent years. Today, many registered representatives provide investment advice, deemed as incidental, similar to the services offered by RIAs.

RIAs: Fiduciary Standard

Meaningful industry data on the different categories of registration is difficult to decipher, particularly at the RIA level. The RIA title includes large money managers as well as one-man advisory firms.

Excluding hedge funds, approximately 10,000 **RIAs** are registered with the SEC. The RIAs registered with the SEC are tracked at the firm level and do not reflect the number of individual Investment Advisor Representatives (**IARs**) employed at or operating under the RIA. Most RIAs are, however, small firms and employ five or fewer employees.

Given that many SEC registered firms are also state registered, it is difficult to obtain meaningful information on the number of small **state registered RIAs** and the IARs operating under their umbrella.

RIAs may or may not have a B-D affiliation, but unlike registered reps, RIA compensation is not transaction-based. RIAs are compensated on a fee basis, including hourly fees, flat dollar fees, asset-based fees, graded asset fees and other arrangements. The fees charged by the RIA could be project based or recurring.

RIAs with more than \$30 million in assets under advisement must register with the SEC by completing Form ADV Parts I & II. The ADV is a two-part disclosure and anti-fraud document. The first part answers basic questions, including ownership disclosure and disciplinary events. The second part consists of narrative disclosure, including potential conflicts.

While the word fiduciary is not prominent in the Investment Advisers Act of 1940, the courts have recognized the fiduciary nature of the investment advisory relationship as well as the Congressional intent to eliminate and/or manage conflicts of interest. As a result, **pure RIAs must follow the fiduciary standard of the principles-based statute and place client interests ahead of their own under Securities law.**

The nature of a fiduciary relationship is complex and generally receives little attention in compliance material. While practical guidance may be lacking, the broad fiduciary principles imposed by law include a duty of due care, loyalty and utmost good faith, i.e., the avoidance of conflicts and self-dealing.

Due care is relational and consists of both a substantive (judgment) and a procedural (prudent process) duty. While the duty of utmost good faith is often viewed as separate from other duties, it is the duty of loyalty that is the most demanding. It requires full disclosure of all material facts as well as conflicts of interest, which include all forms of compensation.

While RIAs must adhere to a fiduciary standard by Securities law, that does not mean they are more knowledgeable or more specialized than other financial intermediaries. RIAs may or may not be credentialed, most do not have the CFP, ChFC or CFA designations, and the scope of the registered rep required Series 6 or 7 is far broader than the Series 65.

DUAL REGISTRATION

The cloudy world of dual registration, which allows registered reps to maintain a fee and commission-based practice, will be discussed in our next newsletter. The hybrid model is no longer viewed as transitory, but rather as a viable long-term business model. As a result, wirehouses and independent B-Ds are both embracing the model.

Given compliance challenges and the increased costs of operating a small RIA firm, a growing number of independent RIAs are now viewing IAR status (dual registration) under an independent B-D umbrella as the best of both worlds.

While there are pros and cons of dual registration versus independent RIA status, the ability to accept fiduciary status under ERISA standards is paramount to the pursuit of retirement plan engagements.

INSURANCE AGENTS & BROKERS: Limited Suitability & Fiduciary Standard

While over 1.3 million individuals hold insurance licenses of all types, the number of actively licensed **insurance agents and brokers** is around 1.0 million.

Insurance intermediaries working for one insurance company are referred to as captive agents while independents or brokers may represent numerous companies. To preclude “selling away,” captives may have access to pre-approved outside products, but their compensation and benefit credits may be skewed towards proprietary products.

Approximately 300,000 of the 1.0 million active insurance producers are also FINRA registered, but Life & Health licensed producers may not have to be registered to sell group annuity products to retirement plans.

Insurance brokers and agents are typically licensed under state insurance laws, but as noted, they could also be registered reps under the Securities Exchange Act of 1934. Very few are registered as RIAs. Unlike registered reps and RIAs, **state insurance laws make little reference to suitability or fiduciary standards.** Like registered reps and RIAs, insurance brokers and agents could, however, become functional fiduciaries.

ERISA: The High Ground

The Employee Retirement Income Security Act of 1974 (ERISA) is a federal statute that establishes minimum standards for pension plans in private industry and provides extensive rules on the federal income tax effects of transactions associated with employee benefit plans. ERISA was enacted to protect the interest of plan participants and their beneficiaries by requiring disclosure, establishing standards of conduct, providing appropriate remedies and access to federal courts.

ERISA enforcement is divided among the Department of Labor, the Department of the Treasury, particularly the Internal Revenue Service, and the Pension Benefit Guaranty Corporation.

In contrast to the Investment Advisers Act of 1940, which requires RIAs to act in the best interest of clients, **ERISA requires fiduciaries to act “solely” in the interest of plan participants and their beneficiaries.** ERISA fiduciaries must also act in accordance with the terms of the plan’s document and ensure the reasonableness of fees. Additionally, ERISA requires fiduciaries to act with the care, skill, prudence and due diligence of a knowledgeable person acting in a like capacity and familiar with such matters.

The “sole interest” and “exclusive purpose” rules under ERISA are drawn from trust law. The duties of loyalty and prudence also underlie fiduciary trust law.

NEW REGULATORY PROPOSALS: Turf War & Dilution

Like fee compression and increased competition, regulatory consolidation is a natural by-product of maturing markets. FINRA is lobbying to equalize the difference between registered representatives who provide advice and RIAs. In addition to expanding their turf, the apparent goal is to replace the suitability standard applicable to B-Ds with a “new” fiduciary standard similar to the one that governs RIAs.

If FINRA is successful, the regulatory landscape would change, but it may not improve. If the fiduciary standard currently applicable to RIAs is diluted to meet the needs of the financial services industry, rather than requiring the industry to adopt higher standards, the public would not benefit from the new standard.

In spite of FINRA’s cry for a new fiduciary standard, fiduciary law is already well defined. It has also evolved over many decades, although it really hasn’t changed much since the enactment of the Investment Advisers Act of 1940.

The ongoing debate over fiduciary responsibilities and attempts to define a fiduciary standard can be quite confusing. Nevertheless, an extensive body of law and legal opinions already impose fiduciary status on anyone acting in a position of trust for the benefit of others. In other words, **fiduciary status is determined by function rather than registration status.**

As the industry matures and buyers become more knowledgeable, registration status, fiduciary standards, conflict recognition, credentials, association memberships, reasonable fees and value are destined to play a large role in the advisor selection process.

Nevertheless, registration status, compensation methodology and fiduciary standards do not equate to knowledge, experience, expertise and or specialization. In short, **buyers of the future will demand and get the whole enchilada.**

ONE STOP SHOPPING FOR CE CREDITS

As the industry matures, becomes more competitive and advisors seek to distinguish themselves, **designations, credentials and association memberships have become key components of the sales, marketing and selection process** for professionals.

Buyers are also becoming more cognizant of the differences between the various registration and licensing categories as well as the legal fiduciary standards that may or may not apply.

As the CFDD's new online ERISA Advisor Evaluator service for plan sponsors professionalizes advisor selection, the EAE will become a center of gravity and a library of intellectual capital on how to select advisors. **The EAE will also help sponsors evaluate designations, licensing, registration status, fiduciary standards, disclosure, conflicts, insurance coverage, experience, recognition, collateral resources, organizational depth and much more.**

Based on increased business demands and the growing importance of professional development for competitive positioning, CE credits have become invaluable to overburdened advisors. To meet these needs, **the CFDD's conveniently located Chicago-based Advisor Conference is THE one stop shop for core CE credits.**

Widely known as the unbiased King of Content, CE credits applicable to the various designations from the **IMCA, ASPPA, fi360, NIPA** and **FSS** are all available to attendees of the CFDD's 2009 Advisor Conference.

The conference was also awarded an unprecedented 41 hours of CE credits by the **CFP** Board and 30 hours of credits by the **IBF**. Additionally, CE credits apply to the various designations offered by **The American College** and the **College for Financial Planning**, including the CLU, ChFC and the CRPS.

While acceptance varies, select B-Ds will apply CFDD Advisor Conference CE credits to **FINRA's** annual Firm Element requirement.

Information on **NASBA, SPARK, CLE** and **CFA Institute** credits will follow. To stay current on the expanding CE credits applicable to other designations, please visit the CFDD's continuing education page at: http://www.thecfdd.com/continuingeducation_2009.

2010 CONFERENCE AGENDA: Developing Early

Consistent with our initiative to expand the CE credits offered by the conference and the growing importance of credentials, the CFDD's October 6-8, 2010 Advisor Conference agenda will include four sessions on ***CREDENTIALS: Which Ones & Why***. The sessions will center on the major designations applicable to Investments, Fiduciary Governance, Plan Design and Financial Planning. As you might guess, the major credentialing organizations will be represented on the panels.

Consistent with the professional theme, Jim Scheinberg (Managing Partner, North Pier Fiduciary Management) will moderate a session on ***Ethics***. Given the importance of industry associations, codes of ethics and their subsequent impact on the standard of care, the major associations will be invited to participate.

Given that retirement plan purists lacking participant advice solutions have lost ground below the large plan market, Edward Lynch (Managing Director, 401(k) Advisors Group) will moderate a session on the need for: ***A MENU OF PARTICIPANT ADVICE SOLUTIONS: Individual, Team, Firm Or Outsourced.***

Joining Lynch as new faces on the agenda, The Bostonian Group's Bob Clark (Managing Director, Retirement Services Practice) and Stephanie Gallegos (Consultant) will leverage a core strength and moderate the session on ***Leveraging Centers of Influence.***

Joined by Brian Hubbell (Principal, Hubbell Consulting), Don Stone (President, Plan Sponsor Advisors) will return to the CFDD's agenda by moderating sessions on ***What Does It Take To Play In The Large Plan Market & Why Would You Want To*** and ***The Economics & Service Dynamics of Small Firms Merging.***

Returning to the trenches, the 2010 agenda will include advisor populated sessions on ***Developing Your Own Lists, Referrals, Informational Marketing and Behavioral Bias.***

One year of intense effort is required to develop and populate a large, content rich agenda. With over sixty different sessions, more than half of the CFDD's 2010 Advisor Conference agenda is already developed. If you would like to participate or have topic suggestions, please email them to: CFDD@TheCFDD.com

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 enhanced learning and deeper networking.** Specific education tracks will be threaded throughout the event and more advisor roundtables will be included in the program, including spirited after hour meetings.

To bridge the conference's educational demands and create a relaxed atmosphere, **CFDD '10 will feature a lively 50's theme**, including a Fonz look-a-like contest, hula hoop/twist contests, an Elvis impersonator, professional entertainers and major photo-ops for sponsors. Consistent with our theme, the conference will feature authentic 50's Attire Awards and a Grand Prize Trip to Graceland for two. 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 fun & outreach friendly environment.

The Chicago Fairmont can only accommodate sixty exhibition booths and while one-third are already committed; **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 a **15% early registration discount**, extended complimentary advertising and **exposure to the industry's most powerful database of retirement plan specialists**, exhibitors should click [HERE](#) to register early.

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 registrants. **To benefit from the maximum discount, you must register before year-end.** To register early and save up to \$1,000, click [HERE](#)

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

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