Statement
submitted on behalf of
Attorney General Robert Abrams
by
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Assistant Attorney General
before N.Y.S. Senate Committee
on Banking
Senator Ralph Marino, Chairman
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I am submitting this statement on behalf of Attorney General Robert Abrams, commenting on the subject of financial planners and financial planning and the need for regulation under the laws of this State, and more particularly, regulation as proposed by S. 8790.

My name is Orestes J. Mihaly. I am the Assistant Attorney General in charge of the Bureau of Investor Protection and Securities and have held that position for 11 years. I am also the Vice-Chairman of the Financial Planning Committee and a member of the Board of Directors of the North American Securities Administrators Association (NASAA), which is an organization of the securities administrators of the fifty states, the District of Columbia, the Canadian Provinces, Puerto Rico and Mexico.

We applaud your efforts and the efforts of others in the New York legislature in seeking to determine the extent of abuses that may exist in the financial planning area and in developing an appropriate legislative response.

Financial planning and financial planners have been the topic of a great deal of recent discussion in the media and of much concern to state and federal regulators and legislators throughout the country. Not a week goes by without one reading about financial planners in a newspaper, or in a magazine, or hearing about them on radio or television.

Financial planning has been described as the organization of an individual's financial and personal data for the purpose of developing a plan to manage income, assets and liabilities to meet near or long-term goals with periodic review and monitoring of the plan. Financial planners are reimbursed in three different ways. Some charge a straight fee for their services. These are the so-called "fee only" planners. Others receive their remuneration from commissions on the products they recommend. Still others charge a basic fee, and also receive commissions on products that they recommend to their clients.

Since 1921 the New York State Attorney General has been given the authority under the Martin Act (Article 23-A of the General Business Law) to regulate the offer and sale

of securities and commodities within and from this state. The Martin Act was amended in 1960 to provide for the registration of investment advisors. There are presently some 500 investment advisors who file registration statements with our office on an annual basis. The definition of investment advisor in the Martin Act is quite similar to the federal definition of investment advisor in the Investment Advisors Act of 1940. The New York State definition of investment advisor is contained in §359-eee of the General Business Law as follows:

> "Investment advisor" shall mean any person who, for compensation, engages in the business of advising members of the public, either directly or through publications or writings within or from the State of New York, as to the advisability of investing in, purchasing, or selling or holding securities, or who, for compensation issues or promulgates analyses or reports concerning securities to members of the public within or from the State of New York.

The overwhelming majority of financial planners fall within the above definition of investment advisor, since most financial planners advise their clients as to the value of

securities, or as to the advisability of investing in, purchasing or selling securities.

Within the last few years our office has become more and more aware of the role of "financial planners" in the offer and sale of securities. For example, we have had recent prosecutions and investigations that have involved financial planners and the losses of millions of dollars by investors. In one recent tax shelter prosecution, the investments were recommended and sold nationwide through financial planners. We are in the process of extradicting one of the defendants from Israel. A trial is expected in the fall. We also have a major investigation in progress inquiring into the activities of another financial planner that has been successful in recommending and selling investments to customers in New York State amounting to hundreds of thousands of dollars while concealing a criminal felony conviction of its principal.

Section 359-eee of the General Business Law is a statute that is already in effect in New York, under which many financial planners are currently being regulated as investment advisors. The regulatory provisions of §359-eee should be expanded and strengthened and made specifically applicable to

financial planners. We believe this is a better approach than giving the Department of Education regulatory authority over financial planners. The Attorney General has been regulating the offer and sale of securities since 1921 and has developed considerable expertise and judicial precedent in the regulation of individuals and entities engaged in the offer and sale of securities and commodities. The Attorney General is presently responsible for the regulation of tens of thousands of salespersons and broker-dealers in securities and commodities who are registered with his office as such. It would not be appropriate, or in the public interest to alter the mode of regulation with respect to financial planners, who are already subject to regulation under the Martin Act by providing a licensing procedure in the Education Department. Moreover, and perhaps most importantly, this approach would not be consistent with the approach of other states and would lead to less uniformity and preclude any form of national central registration under an expanded central registration depository system which is already in effect with respect to the registration of securities salespersons and broker-dealers. New York would not be able to have a central registration depository with respect to investment

advisors if the registration function were not under the aegis of the Attorney General's office, as the Securities Administrator of this State.

Our comments are based in part on the conclusions reached in a hearing conducted by the Financial Planning Committee of the North American Securities Administrators Ass'n (NASAA) in March of 1985. It was the consensus of the witnesses who appeared at this hearing that further regulation of financial planners on a state level be made by amendment to the Investment Advisor's Acts of the various state jurisdictions. These statutes, of course, grant authority of regulation of investment advisors to the Securities Administrators of the various states.

Another important development of the NASAA hearings in 1985, was the conclusion that uniformity was an essential goal in the approach of any additional state regulation of financial planners. To that end, a proposed amendment to the Uniform Securities Act of 1956, (which most states have adopted in one form or another) has been drafted by the NASAA Financial Planning Committee. The comment period for the draft proposal expired on August 15, 1986. The final draft will be presented to the NASAA

membership for adoption at its fall conference in November. New York's Martin Act clearly is not based on the Uniform Securities Act, but that does not prevent New York from being as uniform as possible with its sister states, so that under our dual regulatory system of federal and state regulation, the legitimate investment advisory industry is not confronted with 50 different state regulations.

We support legislation that would provide the maximum amount of uniformity among the states and which would be keyed into a national registration system such as is presently in place in connection with registration of broker dealers and salespersons in securities.

Broker-dealers and salespersons in securities must register with the Attorney General and provide certain information including their education, their prior employment history and affiliations and whether or not they have been convicted of certain crimes. For the past five or six years this registration function has been done through the Central Registration Depository (CRD) system. This system is a result of an agreement between NASAA and the National Association of

Securities Dealers (NASD). It provides for the simultaneous registration of salespersons or broker-dealers by a securities firm that does business in more than one state by a single filing in a central registration depository in Washington, DC. The information contained on a uniform form is fed into a computer and a bulk fee, representing the appropriate fees for the many states involved, is paid to the system. The individual states, in turn, receive the fees to which they are entitled by bank wire or draft from the NASD. Hard copy of the forms is kept in Washington and the states have the ability to access the information contained in the registration forms through cathode ray terminals (CRT) in the various state offices. The amount of clerical work, storage space, etc. saved by this system is tremendous. The states have saved millions of dollars, and industry also has benefited by not having to prepare 50 different forms to be filed manually in 50 different states.

Likewise the examination required by most states as a minimum test of a salesperson's knowledge of state law relating to securities is administered on a uniform basis as a result of another agreement between NASAA and the NASD. The Uniform State

Securities Agent Law Examination (USALE) is an examination prepared by another NASAA committee. Salespersons are able to take these uniform examinations in 54 locations throughout the country by sitting down before a CRT provided by the Plato system of Control Data Corp. Again one uniform examination is provided to cover the testing requirements of many states, saving the states and industry substantial time, effort, and money.

However, there is no current provision for a uniform system for the registration of investment advisors or investment advisor representatives, although as a result of a resolution adopted by NASAA at its Spring Conference in 1986, the CRD Committee of NASAA has been designated to inquire into the feasibility of establishing a clearing house facility, such as the CRD, with respect to the uniform registration of investment advisors or financial planners and their agents.

Similarly, the Uniform Examinations Committee of NASAA is working on a uniform state law and ethics examination with the assistance of the Securities and Exchange Commission. It would test for knowledge of fiduciary responsibilities, due diligence, penalties, registration and disclosure requirements. This test

could also be administered through the existing Plato system much the same way that the USALE exam is administered or through a system that is similar.

All the advantages of uniformity given by the CRD system and the Plato system would not be possible if the regulatory authority was some agency other than the Attorney General. The Attorney General is a member of NASAA and is the beneficiary of the agreements which provide such uniform procedures with the NASD.

Let us examine what we believe to be the two major areas of concern that we have with regard to the ever burgeoning financial planning field. The first area of concern is the qualifications or lack of qualifications of those who hold themselves out as financial planners. Presently, under New York and federal law, there is no minimum qualification for investment advisors or financial planners by examination or otherwise. On June 11, 1986 at a congressional hearing before the House Subcommittee on Telecommunications, Consumer Protection and Finance, it was concluded that an investment advisor or a financial planner can merely pay the required fee, hang out his shingle, and legally give advice to the public without any

requirement of qualification. Indeed, it is reported that some jokester, to prove this point, successfully registered his "dog" as an investment advisor with the S.E.C. We are concerned with the possibility that charlatans, as well as well meaning, but unqualified persons, may become registered as investment advisors or financial planners and cause financial injury to the investing public.

At the present time salespersons and principals of brokerage houses are required to pass qualifying examinations with the NASD before they are allowed to function as such. There is no reason why the legislature can not establish minimum qualifications for investment advisors and to require a qualifying examination such as is being prepared by NASAA for uniform applicability.

The second major problem in the financial planning field is the question of the innate conflict of interest that a financial planner may have. When a client deals with someone who is obviously a salesperson, he or she can assume that the salesperson is obtaining a fee or commission for his activity. Thus, a sales representative for a brokerage house is really the agent for the broker-dealer and the customer is aware that the

representative is getting commissions every time the sales representative effectuates a purchase or sale. This is not true when a financial planner approaches a client with an aura of objectivity. The client must be informed of the fact that a commission may be paid to the planner for any specific investment product recommended to the client for acquisition. Thus many insurance companies now employ people who are trained in the financial planning technique and who represent themselves to be financial planners. When they recommend a variable annuity that provides them with a commission the customer should be made aware of the self interest that the financial planner has in recommending this particular investment vehicle.

The financial planner must make his client aware of the fact that he may be less than objective in the recommendation of specific products since he is receiving a commission from its sale. The financial planner must be required to disclose that he is receiving compensation, either as a principal or agent, as a result of the rendering of investment advice, before the investment advisory contract or financial planner agreement is signed.

Under current provisions of the Martin Act only investment advisory firms are required to register. New York, unlike other states, does not require registration of investment advisor representatives. The registration of investor advisor agents is necessary in order to achieve regulatory control over them much in the same way that securities salespersons are registered and are subject to having their registration revoked if their activity as securities salespersons are contrary to the regulations governing their activity. I believe that a subtantial segment of the industry will agree that such registration is desirable. We support the idea of the registration of investment advisor representatives only if their registration is able to be accomplished through a central registration system similar to the system presently in place for securities salespersons that we have described previously.

In order to make perfectly clear that the investment advisor laws are applicable to those persons who hold themselves out as financial planners, we recommend that the definition of investment advisor in § 359-eee should include a definition of financial planner and financial planning along the following lines:

> The term "financial planner" shall include all persons or entities who, for compensation, hold themselves out to the public as a financial planner, financial advisor, or under a similar term that reflects this type of activity, who advise the public directly with respect to the management of financial resources or affairs.
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> "Financial planning" means providing, or offering to provide, financial planning services or financial counseling or advice, on a group or individual basis. A person who, on advertisements, cards, signs, circulars, letterheads, or in any other manner, indicates that he or she is a "financial planner" "financial counselor," "financial advisor," "financial consultant," or any other similar designation or title or combination thereof, is considered to be representing himself or herself to be engaged in the business of financial planning.

We also recommend that exemptions from registration should be narrowly interpreted to provide an exemption only when determining if financial planning or investment advice is incidental to the performance of another profession, trade, or business, provided those persons - natural or legal - do not hold themselves out to be a financial planner or investment advisor. The burden of proof should rest with the individual who claims the exemption.

We also urge that the Attorney General be given the administrative authority to suspend, deny, or revoke a registration statement of investment advisors and agents along the lines set forth in the Uniform Securities Act. Such action could be taken by the Attorney General based on a finding that (1) such bar is in the public interest; (2) or the registrant or applicant (A) has filed an application which is incomplete in some material respect or contained false or misleading statements; (B) has wilfully violated or failed to comply with the law or regulations issued thereunder; (C) has been convicted in the past 10 years of a felony, or a misdemeanor involving securities; (D) is permanently or temporarily enjoined by any court of competent jurisdiction from engaging in the securities business or from engaging in any fraudulent practices; (E) is the subject of an administrative order denying or suspending or revoking a registration as an investment advisor; (F) is the subject of an adjudication or determination by a securities or commodities agency or administrator of another state or a court of competent jurisdiction finding that the person has violated the Securities Act of 1933, the Securities Exchange Act of 1934, the Investment Advisors Act of 1940, the Investment Company Act

of 1940, or the Commodity Exchange Act or the securities or commodities law of any state; (G) has engaged in dishonest or unethical practices in the securities business; (H) is insolvent, either in the sense that his liabilities exceed his assets or in the sense that he cannot meet his obligations as they mature; (I) is not qualified on the basis of such factors as training, experience, and knowledge of the securities and commodities business; (J) has failed to reasonably supervise his investment advisor representatives to assure their compliance with § 359-eee; or (K) has failed to pay the proper filing fee.

We would also urge that the law set forth in § 7427 of S.8790 not exempt from registration "any individual registered as an investment advisor under the Federal Investment Advisors Act of 1940 or anyone employed by a registered investment advisor." In our opinion, this language would exempt the majority of persons who engage in financial planning since it is our understanding that the majority of financial planners are or should be registered under the federal act. § 7427 also provides that attorneys, accountants, insurance agents etc. are exempted from registration if the financial planning advice is incidental to his or her other activities. We would urge that the bill make

clear that if an individual or firm in one of these exempt professions holds himself or herself out as a financial planner, whether incidental or not to the practice, then there must be compliance with the statute.

We especially applaud the felony penalty provision § 7434(3) of the statute and the provision for a strong private right of action contained in § 7437, including the ability to obtain treble damages and attorneys fees. Other sections of S. 8790 could be modified to include some of our proposals. For instance, we believe that our proposals setting forth the bases for revocation of a registration is more encompassing. For example, S. 8790 does not provide for revocation or denial or suspension of the registration where an applicant or registrant is a convicted felon or is not qualified, or when the registrant has engaged in dishonest or unethical practices.

In conclusion, we agree completely that a legislative response to the financial planning phenomenon is warranted. We believe that such legislation should be added to the existing statutory scheme under the Martin Act and that the expansion of requirements of qualification, testing and registration be keyed to the implementation of a national uniform system.

We are pleased to work with you in an effort to enact appropriate legislation in this area which we believe will be in the public interest.