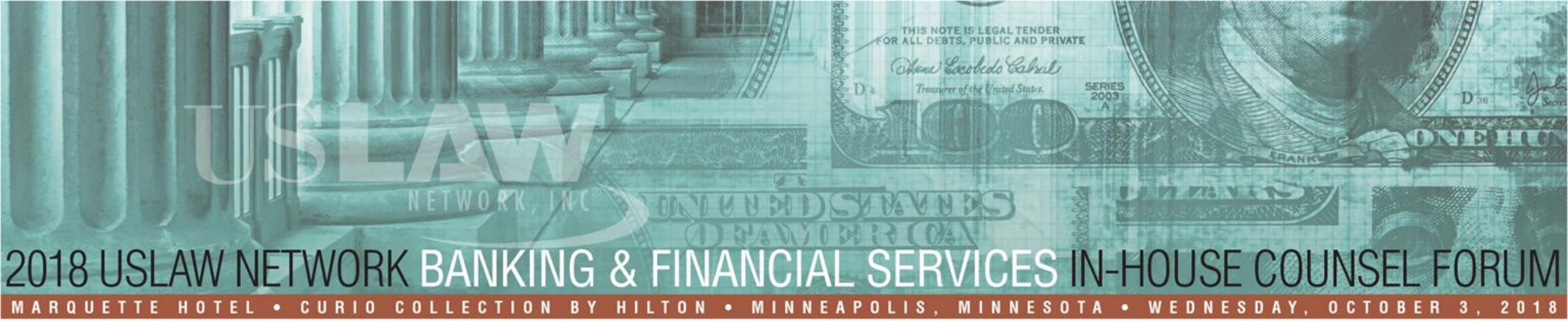

The New CFP Fiduciary Standard and the Implications for Wealth Management Operations

October 3, 2018

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Financial Services Providers

Providers many times fit into multiple categories and can have multiple professional designations.

- Investment Advisor/Investment Company
- Broker Dealer
- Register Investment Advisor (RIA)
- Trustees
- Bank/Other Banking Affiliates
- Insurance Companies/Other Affiliates

The FINRA site lists 203 professional designations, which includes the CFP designation.

Standards Based on Advisory Designation and/or Types of Services Provided

- Suitability Standard
- Best Interest Standard
- Fiduciary Standard

Recent History of Financial Services Regulations– DOL Rules

- The United States Department of Labor's ("DOL") final Fiduciary Duty Rule (the "Fiduciary Rule") would have impose fiduciary standards for financial advisors of retirement accounts and was set to take effect in 2017.
- President Trump orders DOL to review the Fiduciary Rule.
- The DOL delayed the Fiduciary Rule's implementation based on President Trump's directive.
- Fifth Circuit Court of Appeals struck down the Fiduciary Rule. The DOL did not seek review of the Fifth Circuit decision, so the Fiduciary Rule has been killed (at least for the time being).

Recent History of Financial Services Regulations— SEC Rules

Securities and Exchange Commission Regulation Best Interest Rule

- Current Securities and Exchange Commission (the "SEC") policy requires that broker-dealers follow a suitability rule, which requires that the broker-dealer recommendation is suitable considering such consumer's particular circumstances.
- In April 2018, the SEC proposed the Regulation Best Interest, which would require broker-dealers to act in a client's best interests under certain circumstances and to make certain heightened disclosures. The Regulation Best Interest also addresses and clarifies fiduciary duties owed by investment advisors.
- The Regulation Best Interest has not yet been enacted, and the SEC chairman has declined to set a deadline for the final rule.
- There is criticism that this rule does not go far enough to protect consumers. Multiple states have written to the SEC, advocating for a fiduciary rule at least as strong as the DOL's proposed Fiduciary Rule.

Recent History of Financial Services Regulations— State Legislation

Various states have recently introduced or enacted legislation regulating financial planning. The CFP Board does not support and will affirmatively oppose any such state legislation attempting to regulate financial planning. The following states provide a sample of proposed and enacted legislation:

- **Nevada**
  - Nevada has enacted a statute regulating financial planning in Nevada Revised Statutes Ch. 628A (effective July 2017).
  - This legislation expanded the definition of financial planner to include broker-dealers and investment advisors. This means that these individuals must comply with Nevada's regulations pertaining to financial planners, including making certain disclosures and following a fiduciary standard.
- **Connecticut**
  - Connecticut has enacted a statute regulating financial planning in Connecticut General Statutes § 36a-860 (effective July 2017).
  - This legislation requires a financial planner, upon a consumer's request, to disclose whether or not such planner has a fiduciary duty to the consumer.
  - Financial planner is defined as "a person offering individualized financial planning or investment advice to a consumer for compensation where such activity is not otherwise regulated by state or federal law."

Recent History of Financial Services Regulations— State Legislation (Cont.)

- **New York**
  - A proposed New York statute (NY AB 2464) is in progress of becoming law. The New York legislature laid the proposed statute aside in May 2018, but the bill has not been abandoned.
    - This proposal applies to "investment advisors currently not subject to a fiduciary standard under existing state and federal laws or regulations or by any applicable standards of professional conduct."
    - Non-fiduciary investment advisors (including brokers, dealers, financial planners, etc.) must disclose that they are not fiduciaries and must make consumers aware of potential conflicts of interest.
  - Further, the New York State Department of Financial Services has issued a final regulation requiring those licensed to sell life insurance and annuities to follow a "best interest" standard.

History of Revised CFP Code

- The initial revisions to the CFP Board Code of Ethics and Standards of Conduct were issued on June 20, 2017. This was followed by a sixty day open comment period.
- The CFP Board then released a second round of revisions on December 20, 2017. This was followed by a secondary comment period that ended on February 2, 2018.
- The new CFP Code was approved on March 29, 2018 and is effective on October 1, 2019.

What is a CFP Professional?

- The Certified Financial Planner Board of Standards, Inc. Board of Directors (the "CFP Board") is a non-governmental body that regulates financial planners by setting and upholding standards for personal financial planning.
- A financial planner may become certified by the CFP Board as a CFP professional. CFP professionals are subject to standards and regulations promulgated by the CFP Board.
- Over 82,000 professionals hold a CFP license.

Overview of Code of Ethics and Standards of Conduct

- The CFP Board Code of Ethics and Standards of Conduct (the "CFP Code") is effective on October 1, 2019.
- The CFP Code has been subject to widespread criticism. Among others, the following entities have publicly commented expressing concern with the CFP Code: Financial Services Institute, the Securities Industry and Financial Markets Association, Ameriprise Financial Services, Inc., Morgan Stanley Wealth Management, LPL Financial, RBC Wealth Management US, Wells Fargo Advisors, Edward Jones, UBS Financial Services, Inc., and AXA Advisors.

Financial Planning Coalition

- The Financial Planning Coalition is an organization made up of the CFP Board, the Financial Planning Association, and the National Association of Personal Financial Advisors.
- The Financial Planning Coalition advocates, among other things, that there should be a uniform standard regulating the provision of financial planning.
- The Financial Planning Coalition argues that this uniform standard should be modeled after the CFP certification.

Overview of Revised CFP Code Changes

- Among other things, the revised CFP Code enacts the following changes:
  - Any CFP professional providing Financial Advice must adhere to stringent fiduciary duties, including acting in the Client's best interest.
  - There are changes to definitions of terms, particularly "Financial Planning."
  - CFP professionals must comply with heightened disclosure and conflict of interest requirements.

Biggest Criticisms of Proposed Revisions to CFP Code

- The revised CFP Code will result in inconsistent and duplicative standards of conduct for financial professionals, particularly as current marketplace standards also regulate these individuals and the SEC has recently proposed rules governing the same conduct.
  - The CFP Board has referred to regulatory rules governing financial professionals as a “minimum standard” of care.

CFP Code – Best Interest Standard (Duty of Loyalty)

The revised CFP Code duty of loyalty standard requires the following:

- "At all times when providing Financial Advice to a Client, a CFP professional must act as a fiduciary, and therefore, act in the best interests of the Client."
    - This definition currently applies only to the provision of Financial Planning but now applies to Financial Advice, which "includes discretionary authority as well as communications that would be viewed as a recommendation that the Client take or refrain from taking a particular course of action" with respect to a wide range of financial matters."
    - As previously stated, this definition does *not* include: responses to directed orders, "the provision of services or the furnishing or making available of marketing materials, general financial education materials, or general financial communications that a reasonable CFP professional would not view as Financial Advice."
    - According to the CFP Board, this rule is intended to eliminate confusion concerning whether a fiduciary duty is owed in a particular instance and to ensure that the public benefits from CFP professionals' adherence to a fiduciary standard.

SEC Best Interest Standard

- The SEC Best Interest Standard does not broaden the fiduciary duty requirements beyond Section 206 of the U.S. Investment Advisers Act of 1940, as amended.

Biggest Criticisms of Proposed Revisions to CFP Code

The revised CFP Code is not business model neutral, particularly regarding brokerage activity.

Compensation Disclosure

- A CFP professional must disclose, when providing Financial Advice or Financial Planning, how the CFP Professional (and the CFP Professional's Firm/any Related Party) is compensated.
- A CFP professional who does not operate on a solely "fee-only" compensation scheme must not use the term "fee-based" (or any other term) in a manner suggesting the compensation arrangement is "fee-only."
- Such CFP professional must also clearly state that either the CFP professional (or the CFP Professional's Firm) "earns fees and commissions" or that the CFP professional (or the CFP Professional's Firm) is "not fee-only."
- Many CFP professionals advertise that they receive fee and commission-based compensation, as opposed to solely fee or commission-based compensation.

Biggest Criticisms of Proposed Revisions to CFP Code (Cont.)

- The definitions contained within the revised CFP Code, particularly concerning “Financial Planning,” are too broad and ambiguous.
- Rebuttable presumption that CFP professionals are providing Financial Planning when providing Financial Advice.
- When providing Financial Planning or Financial Advice that requires Financial Planning in order to meet the CFP professional’s fiduciary obligations (or when a client reasonably believes the CFP professional will provide or has provided Financial Planning), a CFP professional must follow the Practice Standards.

Integration Factors

- Among the factors that the CFP Board will weigh in determining whether a CFP professional has agreed to provide or provided Financial Advice that Requires Financial Planning are:
  - The number of relevant elements of the Client's personal and financial circumstances that the Financial Advice may affect;
  - The portion and amount of the Client's Financial Assets that the Financial Advice may affect;
  - The length of time the Client's personal and financial circumstances may be affected by the Financial Advice;
  - The effect on the Client's overall exposure to risk if the Client implements the Financial Advice; and
  - The barriers to modifying the actions taken to implement the Financial Advice.

CFP Code Definitions

The CFP Code contains a definitions section. For purposes of this presentation, pertinent definitions are as follows:

- **CFP Professional's Firm(s)** means "[a]ny entity on behalf of which a CFP professional provides Professional Services to a Client, and that has the authority to exercise control over the CFP professional's activities, including the CFP professional's employer, broker-dealer, registered investment adviser, insurance company, and insurance agency."
  - This definition centers around the concept of control.
- **Client** means "[a]ny person, including a natural person, business organization, or legal entity, to whom the CFP professional provides or agrees to provide Professional Services pursuant to an Engagement."
- **Engagement** means "[a]n oral or written agreement, arrangement, or understanding."
  - The Commentary states that general principles of contract law apply to this definition, and there can be an engagement without any compensation.
- **Financial Assets** means "[s]ecurities, insurance products, real estate, bank instruments, commodities contracts, derivative contracts, collectibles, or other financial products."
  - The Commentary states that this list is not all-inclusive.
- **Financial Planning** means "[a] collaborative process that helps maximize a Client's potential for meeting life goals through Financial Advice that integrates relevant elements of the Client's personal and financial circumstances."

Definition of Financial Advice

- **Financial Advice** means
    - "A communication that, based on its content, context, and presentation, would reasonably be viewed as a recommendation that the Client take or refrain from taking a particular course of action with respect to:
        - The development or implementation of a financial plan;
        - The value of or the advisability of investing in, purchasing, holding, or selling Financial Assets;
        - Investment policies or strategies, portfolio composition, the management of Financial Assets, or other financial matters;
        - The selection and retention of other persons to provide financial or Professional Services to the Client; or
    - The exercise of discretionary authority over the Financial Assets of a Client.
    - The determination of whether Financial Advice has been provided is an objective rather than subjective inquiry. The more individually tailored the communication is to the Client, the more likely the communication will be viewed as Financial Advice. The provision of services or the furnishing or making available of marketing materials, general financial education materials, or general financial communications that a reasonable CFP professional would not view as Financial Advice, does not constitute Financial Advice."
- **Financial Advice** does *not* mean responses to directed orders, "the provision of services or the furnishing or making available of marketing materials, general financial education materials, or general financial communications that a reasonable CFP professional would not view as Financial Advice."

Biggest Criticisms of Proposed Revisions to CFP Code (Cont.)

Financial professionals will be disinclined to provide services unless a client has investment assets of significant value.

- A 2016 study addressing the potential effects of the Department of Labor's proposed fiduciary standards "found that 71 percent of financial professionals will disengage from at least some retirement savers because of the Fiduciary Rule." Generally, this study showed that these financial professionals would cease working with investors with "less than $300,000 in net investable assets." Lt to Office of Regulations and Interpretations, Employee Benefits Security Administration, U.S. Dep't of Labor from Insured Retirement Institute (April 17, 2017).
- There is an argument that this study is also applicable to the revised CFP Code fiduciary standards.

Biggest Criticisms of Proposed Revisions to CFP Code (Cont.)

The revised CFP Code inefficiently requires financial professionals to provide a level of service that might not be necessary in all circumstances for all clients. This could needlessly increase the cost of investment services to lower net worth clients.

Biggest Criticisms of Proposed Revisions to CFP Code (Cont.)

- The revised CFP Code would require firms to either hold all of their financial professionals to a heightened fiduciary standard or would necessitate a bifurcated compliance approach, where CFP professionals would be held to a different standard than the rest of the firm's financial professionals. This would be inefficient, particularly if the firm was also required to comply with new SEC regulations and also could result in increased liability.
- However, the CFP Code specifically exempts CFP professionals from discipline for violating firm policies and procedures that conflict with CFP standards.

Comply with Lawful Objectives of CFP Professional's Firm

A CFP professional:

- Will be subject to discipline by CFP Board for violating policies and procedures of the CFP Professional's Firm that do not conflict with these Standards.
- Will not be subject to discipline by CFP Board for violating policies and procedures of the CFP Professional's Firm that conflict with theses Standards.

Third-Party Liability Based on CFP Code

- The CFP Board has stated that the CFP Code is not meant to "be a basis for civil liability, and that Clients of a CFP® professional and other third parties are not intended to be considered third-party beneficiaries of a CFP professional's agreement to adhere to the Code and Standards."
- This statement is not found within the CFP Code itself and is instead found within the Commentary to the CFP Code.
- There are questions concerning whether this statement is sufficient to prevent the imposition of liability upon CFP professionals and a CFP Professional's Firm based on the new standards.

Comparison Between the CFP Code and Restatement Fiduciary Standards

- **CFP Code Fiduciary Standards**
  - At all times when providing Financial Advice to a Client, a CFP professional must act as a fiduciary. This means that the CFP professional must:
    - Act in the best interests of the Client.
    - Abide by a duty of loyalty by (i) placing the Client's interests above the CFP professional (and CFP Professional's Firm), (ii) avoiding or disclosing (and managing) Conflicts of Interest, and (iii) acting solely with regard to the Client's financial or other interests.
    - Abide by a duty of care by acting with the care, skill, prudence, and diligence of a prudent professional in light of the Client's circumstances.
    - Follow the Client's instructions (including the Client's objectives and restrictions).

Comparison Between the CFP Code and Restatement Fiduciary Standards (Cont.)

- **Restatement (Third) Of Agency §§ 8.01-8.09 (2006) (the "Restatement")**
    - "An agent has a fiduciary duty to act loyally for the principal's benefit in all matters connected with the agency relationship."
        - The agent must not receive a material benefit from a third party arising out of the agent's position as an agent.
        - The agent must not act as or on behalf of an adverse party when dealing with the principal in a transaction connected to the agency relationship.
        - The agent must refrain from competing with the principal (including assisting the principal's competitors).
        - The agent must not use the principal's property or confidential information for the agent's purposes (or for a third party's purposes).
    - The agent must act in accordance with any contract with the principal.
    - The agent must act with the "care, competence, and diligence normally exercised by agents in similar circumstances." The duty of care considers whether the agent has any special skills or knowledge.
    - The agent must follow the principal's lawful instructions and must "[t]ake actions only within the scope of the agent's actual authority."

Comparison Between the CFP Code and Restatement Fiduciary Standards (Cont.)

- **Key Differences Between the CFP Code and Restatement Fiduciary Standards**
  - The Restatement is not solely applicable to the provision of Financial Advice.
  - The Restatement does not impose a best interest standard.
  - Both standards impose duties of loyalty and care, as well as require the CFP (or agent) to follow the Client's (or principal's) instructions. Further, though phrased differently, both standards seem to require avoidance or disclosure of conflicts of interest.

Potential Overarching Consequence of CFP Code

- One potential overarching consequence of the Revised CFP Code is that individuals and firms would relinquish (or cease advertising) their CFP designations.
- There is a question whether a CFP professional is bound to act in accordance with the CFP Code if the CFP professional does not advertise his or her CFP designation.
    - The CFP Board website states that the current CFP Board Standards of Conduct are "binding on all certificants, regardless of their title, position, type of employment or method of compensation, and they govern all those who have the right to use the CFP marks, whether or not those marks are actually used."
    - There is an argument that this statement disallows a CFP professional's ability to avoid compliance by failing to advertise his or her certification.

Overview of Code of Ethics and Standards of Conduct (Cont.)

- The CFP Code is divided into two sections:
  - First Section: Contains a concise six-pronged code of ethics
    - A CFP professional must:
      1. Act with honesty, integrity, competence, and diligence.
      2. Act in the client's best interests.
      3. Exercise due care.
      4. Avoid or disclose and manage conflicts of interest.
      5. Maintain the confidentiality and protect the privacy of client information.
      6. Act in a manner that reflects positively on the financial planning profession and CFP certification.
  - Second Section: Describes appropriate standards of conduct satisfying the code of ethics described in the first section.

CFP Code – Standards of Conduct

- The Standards of Conduct makes up the bulk of the CFP Code and provides a practical application of the Code of Ethics.
- Perhaps the most significant change between the current CFP Code and the revised CFP Code is the new fiduciary duty standard.
- The revised CFP Code fiduciary duties are implicated when a CFP professional provides Financial Advice to a Client and requires a CFP professional to act in the Client's best interests (as further discussed on the following slide). The following fiduciary duties are imposed when a CFP professional provides Financial Advice:
    - A duty of loyalty, requiring the CFP professional to place the Client's interests above the CFP professional's/CFP Professional's Firm's interests, to act without regard to any other interests, and to avoid or materially disclose and manage conflicts of interest.
    - A duty of care, requiring a CFP professional to "act with the care, skill, prudence, and diligence that a prudent professional would exercise" considering the Client's circumstances; and
    - A duty to follow lawful client instructions.

CFP Code – Standards of Conduct (Cont.)

- CFP professionals must perform Professional Services with integrity, with an emphasis on honesty and a prohibition against fraud.
- CFP professionals must competently provide Professional Services.
- CFP professionals must act diligently by promptly and thoroughly provide Professional Services.
- CFP professionals must disclose and manage Material Conflicts of Interest.
    - This includes, when appropriate, obtaining a client’s informed consent of a Material Conflicts of Interest.
    - Further, managing a Material Conflict of Interest requires the CFP professional to “adopt and follow business practices reasonably designed to prevent Material Conflicts of Interest from compromising the CFP professional’s ability to act in the Client’s best interests.”

CFP Code – Standards of Conduct (Cont.)

- CFP professionals must exercise sound and professional judgment on the Client's behalf, which requires that the CFP professional not subordinate the Client's interest to any other person's interest (including the professional's interest) and further requires that the professional not solicit or accept any gifts that could reasonably be expected to compromise the professional's objectivity.
- CFP professionals must act with professionalism.
- CFP professionals "must comply with the laws, rules, and regulations governing Professional Services."
- CFP professionals must follow all applicable confidentiality and privacy rules, including complying with the circumstances in which Client information may be disclosed and acting to protect a Client's information.
    - The Code contains a safe harbor stating that a CFP professional is deemed to comply with this requirement "if the CFP Professional's Firm is subject to, and the CFP professional complies with, Regulation S-P under the federal securities laws or substantially equivalent federal or state laws or rules."

CFP Code – Standards of Conduct (Cont.)

- CFP professionals must provide certain information to Clients, and such disclosure differs depending on whether the professional provides Financial Planning in addition to Financial Advice.
- When communicating with a client, the CFP professional must provide accurate information and respond to reasonable client requests in a manner and format that Clients can reasonably understand.
- CFP professionals must not make false or misleading representations concerning methods of compensation.
    - The Code of Ethics provides circumstances in which a CFP professional may represent his/her/the CFP Professional's Firm's methods of compensation as fee only or fee-based.
- CFP professionals also have certain duties when (i) recommending, engaging, and working with additional individuals to provide financial or Professional Services to a Client, or (ii) selecting, using, and recommending technology.
- CFP professionals must refrain from borrowing or lending money from or to a Client and must avoid commingling financial assets with a Client.

CFP Code – Financial Planning and Application of the Practice Standards for the Financial Planning Process

- The CFP Code states that Financial Planning is a "collaborative process that helps to maximize a Client's potential for meeting life goals through Financial Advice that integrates relevant elements of the Client's personal and financial circumstances."
  - "Relevant elements" vary according to each Client.
- In a disciplinary proceeding, the CFP professional has the burden of proof to show that such professional was not required to comply with the Practice Standards.
- If a CFP professional would otherwise be required to comply with the Practice Standards but the Client does not engage the CFP professional to provide Financial Planning, the CFP professional has a few options, including terminating the Engagement.

CFP Code – Financial Planning and Application of the Practice Standards for the Financial Planning Process (Cont.)

- When complying with the Practice Standards, the CFP professional <u>must properly document</u> aspects of the client relationship. Further, the CFP professional must: (i) understand the client's personal and financial circumstances, (ii) identify and select client goals, (iii) analyze the client's current and potential alternative courses of action, (iv) develop, present, and implement the Financial Planning recommendations, and (v) monitor client's progress and, if necessary, update responsibilities.
- The CFP professional must exercise reasonable care while supervising subordinates, must comply with the lawful objectives of the CFP Professional's Firm, and must provide notice to the CFP Professional's Firm of any public discipline imposed by the CFP Board.

CFP Code – Financial Planning and Application of the Practice Standards for the Financial Planning Process (Cont.)

- "A CFP professional may not engage in conduct that reflects adversely on his or her integrity or fitness as a CFP professional, upon the CFP marks, or upon the profession."
  - This includes a personal or business bankruptcy.
- The CFP professional must provide written notice to the CFP Board after the CFP professional or an entity controlled by such CFP professional has engaged in delineated adverse conduct.
  - Such notice must contain a narrative statement describing the conduct.
- The CFP professional must cooperate with CFP Board's requests and decisions and must comply with the "Terms and Conditions of Certification and License."
- The CFP professional must not circumvent the CFP Code by acting indirectly.

Required Disclosure Format

- The CFP Code requires full disclosure of all Material Conflicts of Interest. However, this disclosure is not required to be in a written format.
- Specifically, the CFP Code states "[e]vidence of oral disclosure of a conflict will be given such weight as the CFP Board in its judgment deems appropriate. Written consent to a conflict is not required."