

# Ten Ways Financial Planners Can Add Value And Fulfill Their Fiduciary Duties To Their Clients

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**Introduction.** The adoption by the Certified Financial Planner Board of Standards, Inc. of new *Rules of Professional Conduct* (effective July 1, 2008) represents a significant advance in the quest for financial planning to be regarded as a true profession. As stated in Rule 1.4 of the proposed *Rules of Professional Conduct*, “A certificant shall at all times place the interest of the client ahead of his or her own. When the certificant provides financial planning or material elements of the financial planning process, the certificant owes to the client the duty of care of a fiduciary as defined by CFP Board.”

As fiduciary duties are increasingly clearly applicable both for CFP® certificants and other financial planners,<sup>1</sup> all financial planners are bound to wrestle with such questions as “What are my fiduciary duties?” and “How can I ensure that I am satisfying the fiduciary duties of utmost due care, loyalty, and good faith?” This article explores several aspects of these fiduciary duties and demonstrates how processes designed to ensure adherence to fiduciary duties can also add significant value in the eyes of a financial planner’s clients.

**1. Seek out long-term relationships with clients.** Every experienced financial planner knows that few individual consumers are equipped to navigate life’s diverse and complex financial challenges. Yet consumers of financial planning services, when evaluating a financial planner’s services, tend not to focus on the financial planner’s high technical level of expertise. Rather, what is truly important to clients is the client’s depth of relationship with his or her financial planner.

Knowledge of the details of a client’s life is also important to fulfilling the fiduciary duty of utmost due care. A financial planner’s adherence to his or her fiduciary duty of due care involves both procedural due care (whether the decision made by the fiduciary was informed following a prudent process) as well as substantive due care (whether the substance of the advice was made utilizing good

judgment). Procedural due care requires at the inception of most financial planner-client relationships learning the details of the client's financial life.

There are many good ways to initiate such an inquiry. A financial planner should consider first learning about the client's personal life history, such as where the client grew up, went to school, and what jobs has he or she held? A financial planner might inquire as to what persons (and pets) are important to the client. Using empathy and understanding, a financial planner might ask each client, "What is important about money to you?" As each answer is uncovered the financial planner may seek the client to elaborate upon the answers provided. The financial planner could also ask, "What were your experiences with your other professional advisors?" and "How would you like to be served by me?" Most importantly, the financial planner may ask this question: "If you had but a short time to live, and if you would be as healthy during that time as you are now, what would you like to do or accomplish during that time so that, at the end of your lifetime, you would have no regrets."

Seasoned financial planners seek to spend extra time to meet with the client, gather required information, and really get to know the prospective client well. Such a process also enables the financial planner, who desires a longer-term investment advisory relationship with a client, to discern if the prospective client's investment philosophies and personality are a good match for the financial planner and his or her firm.

Several good practice coaches exist who can teach financial planners to better discern the intimate details of each client's financial life, how to best record this information discerned (and update), and to utilize the knowledge acquire to better serve and build long-lasting relationships with the client. All financial planners (this author included) can benefit from further lessons in how to be a better listener, on how to jointly explore with clients potential solutions to their problems, and how to best engender a deep and trusted relationship with their clients.

**2. Undertake appropriate due diligence in investment product selection.** Once thorough knowledge of the client is obtained, analysis is undertaken, and a financial plan is developed and presented, the financial planner may be involved in implementation of the financial plan. At this point, how does the financial planner fulfill his or her fiduciary duty of utmost due care in undertaking due diligence in product selection. While this issue is multi-faceted, one specific aspect of this issue that is certain to arise under new disclosure regimens under consideration (by the CFP Board and by the SEC) is that of the fees and costs relating to the investment products recommended by the financial planner.

Like it or not, financial planners are faced with a dilemma. Substantial academic research demonstrates that on average the fees and costs incurred by the client in connection with the receipt of financial planning and investment advice, and in connection with the client's investments, reduce the client's net investment returns. Take for example mutual funds, which offer important diversification benefits for many investors. The higher the costs of a mutual fund, the lower its likely returns when compared to other similar mutual funds.<sup>2</sup> Given the impact of fees and costs on investment portfolio net returns, it seems clear that a financial planner, as part of his or her fiduciary duty of utmost due care, should reasonably ensure that the total fees and costs borne by the client in

connection with the any investment recommendations are fair and reasonable. This does not mean that the least expensive alternative must always be used, but it does mean that a cost-benefit analysis must be considered for each expense to be incurred by the client.

One essential skill for those who choose to utilize stock mutual funds, unit investment trusts, exchange-traded funds, hedge funds, and variable annuity sub-accounts is estimating the “total fees and costs” of such investments by “digging deep” during the financial planner’s investment due diligence process. Any pooled investment vehicle’s annual expense ratio is an important factor, as well as commissions or deferred sales charges relating to the sale of an investment product, mortality and expense charges (including costs relating to riders) associated with variable annuity products, and performance fees associated with certain hedge funds. Just as important can be harder-to-discern (“hidden”) fees and costs of pooled investment vehicles. These other fees and costs, which are not included in but which may well exceed a pooled investment vehicle’s annual expense ratio, include transaction costs such as bid-ask spreads, market impact costs, and opportunity costs due to delayed or canceled trades. They also include commissions paid out of the investment fund in connection with trading within the pooled account. Significant opportunity costs due to cash holdings within the pooled investment vehicle may also exist. Other costs which may arise from investing in overseas markets include taxes imposed on trading activities or securities ownership and certain exchange fees. One method of using publicly available data to estimate the “total fees and costs” of stock mutual funds is set forth in a recent white paper, “Estimating The Total Costs of Stock Mutual Funds.”<sup>3</sup> The analysis suggested therein can be supplemented, as part of a financial planner’s due diligence process, by additional research into the pooled investment vehicle’s management, including whether patient trading strategies are employed, whether discount block sales or purchases of securities are undertaken, and the extent of securities lending revenue (and whether such revenue is retained by the fund completely, or paid in part to the fund’s investment manager or others). With knowledge of the “total fees and costs” of pooled investment vehicles, financial planners can better adhere to their fiduciary duty of utmost due care and ensure that clients are paying reasonable total fees and costs relating to all of their investments and the receipt of investment advisory services. Moreover, detailed knowledge of the many different ways compensation may be shared between pooled investment vehicles and their management firms can assist the financial planner in fulfilling his or her duty of loyalty to the client and in crafting more comprehensive disclosures in order to comply with Rule 1.2(b) of the proposed CFP Board *Rules of Conduct*. This proposed rule requires certificants to discuss the “[c]ompensation that any party to the agreement or any legal affiliate to a party to the agreement will or could receive under the terms of the agreement [for financial planning services]; and factors or terms that determine the cost to the client, how client decisions benefit the certificant and the relative benefit to the certificant.” It is submitted that the best method to evidence the discussion of compensation to financial planners, their firm, and affiliates of their firm is through written disclosure.

The author does not suggest that fees for financial planning services must be low in order to be reasonable. A financial planner’s reasonable fees for comprehensive, ongoing financial planning services can easily be justified by adding value to his or her client, not only in the selection of

appropriate investment products, but also through many other aspects of comprehensive and integrated financial planning and portfolio management services, including those discussed below.

**3. Design investment portfolios and undertake financial planning decisions with due attention to taxes.** Financial planners should reasonably consider and recommend to the client financial strategies and investment products which may reduce the tax burdens imposed upon the client over time.

Is consideration of taxes part of the financial planner's duty of due care? To answer this it must first be asked if tax considerations are material for the client. In the context of individual consumers of financial planning services it is clear that minimizing tax liabilities is vitally important to a client's long-range net "after-tax" returns.<sup>4</sup> Next in the analysis is whether financial planning professionals possess the knowledge to advise upon tax issues relating to financial planning. In order to determine the core knowledge reasonably expected of a financial planning professional, one need look no further than the exam administered by the Certified Financial Planner Board of Standards, Inc.'s exam for its CFP® program certification. The content of this exam arguably sets the standard for the *minimum* amount of knowledge required of a financial planner. Fourteen percent of the exam directly relates to the area of "income tax planning," and tax concepts must be understood in a number of other areas (including education planning, taxation of insurance products and their premiums and benefit payments, income tax implications of various employee benefits, stock option planning, tax efficiency with regard to investment choices, retirement plans – each with their own tax rules, and estate and gift tax planning). Hence, in adhering to the substantive duty of due care, a financial planner must at all times exercise good judgment, applying his or her education, skills, and expertise to the financial planning issue before the financial planner and considering the tax implications of the proposed decision or its alternatives.

Many financial planners may be tempted to disclaim away the provision of tax advice, as these lines from the disclosure document of a large wirehouse firm's investment adviser division states: "[Name of firm] and its Financial Executives do not give tax advice." The validity of such a blanket disclaimer is doubtful, given the importance of tax considerations in the financial planning process and the non-waivable nature of many fiduciary duties. Moreover, such an attempted disclosure misses an important point – the provision of financial planning advice to individual consumers nearly always involves the provision of tax advice. Erase a general knowledge of tax law from a financial planner's brain (while retaining all non-tax knowledge) and financial planners would likely be unable to guide their clients in many basic financial planning decisions.

Accordingly, it may be concluded that every financial planner is required to possess a reasonable knowledge of tax reduction strategies. However, the complexity and breadth of tax laws may require financial planners to seek out tax advice from appropriate tax professionals where appropriate to meet the needs of the client or as a means of supplementing the financial planner's own tax expertise. While a financial planner should not be permitted to disavow the duty to generally consider taxes in the furnishing of financial planning services to the client, the financial planner may seek to delegate or assign the necessary provision of tax advice in connection with specific financial planning and investment issues to a qualified tax professional.

The fiduciary duty of utmost due care, which appears to mandate financial planners to seek to reduce the long-term tax burden for a client, also presents a real opportunity to add value and market the financial planner's services. For example, few individual investors are aware of the many rules relating to qualified retirement plan and IRA contributions and distributions. Many opportunities for valued advice exist both in the accumulation phase and in the distribution phase of a client's financial lifecycle. Additionally, financial planners can seek to harvest losses where appropriate in client portfolios. Carefully selecting tax lots to sell in a client's investment portfolio can greatly minimize or even eliminate short-term capital gains for the client and substantially reduce realization of long-term capital gains.<sup>5</sup>

Financial planners could seek to engage each client's CPA or tax accountant to undertake tax planning for the client between October 16<sup>th</sup> and the end of each calendar year. This is typically a slow period for tax accountants, and many CPAs and tax accountants will welcome the additional income these tax planning activities provide. They are especially appreciative when the financial planner is able to accumulate and provide to the tax planner all of the data from the client needed to undertake the tax planning activities. The CPA or tax accountant's fees may be paid either directly by the client or by the financial planner (with full disclosure to the client, and with a mutual agreement under which the tax advisor and financial planner agree that each possesses a duty to keep the best interests of the client paramount). During these year-end tax planning sessions a myriad of tax planning opportunities can be discerned, such as potential Roth IRA conversion planning, planning to bunch itemized deductions, planning to avoid or minimize the alternative minimum tax, harvesting of capital losses, and taking advantage of present or future lower marginal income tax brackets.

**4. Design and manage investment portfolios for risk reduction.** There are many risks relating to investing, especially in connection with addressing the lifetime financial needs of our clients. In order to adhere to the financial planner's duty of utmost due care these risks should be discerned and discussed with the client. Certain risks may be substantially reduced or eliminated without any adverse affect on the client's lifetime financial goals (or the net expected returns of the client's portfolio). Other risks must be prudently weighed and undertaken by both the financial planner and the client, taking into account many factors. Fulfilling the fiduciary duty of utmost due care involves ascertaining, explaining, monitoring and where appropriate seeking to reduce risks (or incur greater risks of one nature, to offset other risks or to achieve the client's desired goals). Investment portfolio risk reduction is a fundamental aspect of the duty of utmost due care required of financial planners.<sup>6</sup>

While the design of investment portfolios to reduce various types of risks is beyond the scope of this article, an important aspect of risk reduction for any financial planner is preparing clients for the inevitable downturns in values which occur in many of our capital markets. Individual investors often react inappropriately to either drops or surges in valuation levels of certain asset classes. The consequences of such inappropriate decision making are reflected in Morningstar's decision in 2006 to issue "asset-weighted returns" for mutual funds, which depict the returns earned by the typical

investor in a particular fund. Morningstar reports that, on average, investors in mutual funds lag the returns of the funds themselves.<sup>7</sup>

Preparing clients for investment portfolio volatility can be undertaken by many different means. Wise financial planners and investment advisers will screen their clients to understand their understanding of, and potential reaction to, capital markets valuation downturns. For example, after several conferences with a potential client it may be asked, “What will you do if, the day after we undertake investments in your portfolio, the stock market falls 30%?” If the client’s answer is not “buy,” knowing full well the “flight or flee emotion” which may exist at that time, further education of the potential client is necessary, or alternatively the client’s expectations may be unreasonable and the financial planner should reconsider establishing or maintaining a financial planning relationship.

**5. Coordinate biannual estate plan reviews with the client’s attorney.** When a financial planner undertakes comprehensive and ongoing financial planning for a client, tremendous value can be added through periodic estate plan reviews. While the financial planner need not be an expert in the many intricacies of estate planning, the financial planner may nevertheless form an important part of his or her client’s estate planning team, may seek to maintain consolidated and useful information, and may aid in spotting estate planning needs.

Practicing tax and estate planning attorneys will tell you that the major problem they discern during reviews of existing clients’ estate plans are incorrect beneficiary designations and asset ownership. The best estate plan in the world won’t work if assets which should be separately owned by a husband and wife are jointly owned, if a client’s revocable living trust is not funded purposefully, or if accounts possess incorrect beneficiary designations. A financial planner can undertake a significant service for a client by accumulating information concerning a client’s assets, their current values, their ownership, and detailed information on beneficiary designations.

A financial planner might seek to outsource estate planning review engagements to the client’s own estate planning attorney. For example, the financial planner may seek to accumulate scans of all of the client’s life insurance policies, annuity contracts, and account statements into an online, secure database for each client. Current beneficiary designations could also be collected, scanned, and posted online. An updated summary of the client’s assets and their values in graphical format can also be undertaken for ease of review by the client’s estate planning attorney. Copies of the client’s current estate planning documents could also be placed into the secure online database for ease of reference. With the client’s permission the financial planner could then provide the password to the secure online database to the client’s attorney. The financial planner could then seek to arrange biannual estate planning review conferences at the estate planning attorney’s office (always checking in advance to make certain the client’s waiver of attorney-client privilege, due to the financial planner’s presence at such a meeting, is appropriate and acceptable to both the attorney and the client). Since attorneys are very sensitive to the need for clients to pay their fees directly, to encourage clients to undertake biannual estate plan reviews the financial planner could provide his or her clients with a fixed fee credit against the annual investment advisory fees (and the attorney would be made aware of this credit).

Attorneys are very receptive to this arrangement, since it provides them with a steady flow of estate planning reviews and its consequential income. Possessing updated and detailed information about the client's assets and liabilities, and ownership and beneficiary designations eases the workload of the attorney significantly.

There are other ways that financial planners can add value to the estate planning process. Estate planning attorneys tend to be creatures of habit, and many are slow to change their forms or procedures. Providing suggestions on new ways estate planning attorneys can add value to their clients, such as by suggesting a separate form be added to their practice entitled "HIPPA Authorization To Release Medical Information Or Records." Guidance can also be provided to attorneys on customized beneficiary designations for IRA, annuity and qualified retirement plan accounts, in order to better coordinate with the terms of a will or trust agreement; when the need for a client to have a customized beneficiary designation is ascertained the financial planner and client can jointly inform the estate planning attorney of the need, and the financial planner can provide specific information to the estate planning attorney on the actions which may be required. Articles relating to relatively new techniques can be distributed to attorneys occasionally, such as recent developments relating to IRA Conduit or Accumulation Trusts. Attorneys can also be provided marketing guidance on how to utilize new estate planning techniques to better serve their existing clients and generate new client interest. All of these activities can lead to increased referrals from select estate planning attorneys as the attorneys become aware of the methods in which the financial planner adds value to both the client and to the attorneys' own practices.

**6. Undertake biannual risk management reviews.** A client's multi-million dollar portfolio might be tax-efficient, low-cost, and well-designed to counter investment risks. But if the investment portfolio is not protected against potential claims of general creditors, then all the years of careful portfolio management may evaporate through a creditor's levy upon a client's non-exempt account.

Financial planners can and should undertake a wide variety of risk management reviews for their clients, either alone if permitted under state law or with the aid of a qualified insurance consultant or attorney. Key questions a financial planner might review with each client, biannually (in years opposite the estate plan reviews), might include: (A) Do you possess adequate liability insurance coverage, including auto, homeowners, RV, boat, jet ski, airplane, and umbrella insurance? (B) Is your home's value and its contents insured against loss to the degree desired? (C) Do you possess adequate disability and/or long term care insurance? (D) Do you need any life insurance to replace lost income, fund a buy-sell arrangement, or provide estate tax liquidity? If so, is the need temporary or permanent? Are your current life insurance policies adequate or excessive as to coverage, and the correct type of coverage considering your needs? Are the life insurance policies correctly owned and do you possess updated beneficiary designations (and evidence of receipt of such by the insurance company)?

While financial planners should avoid giving specific insurance advice if they are not licensed to provide such advice (and if such licensure is required by the state in which the client resides),

financial planners can serve a client's interest well by identifying insurance-related issues which should be addressed by the appropriate professional. Knowledgeable financial planners also suggest conversations with the client's insurance agent on certain techniques which may serve to reduce the cost of the insurance premiums through proper structuring of the either the policy itself or premium payments.

A host of other risk-related issues may arise which implicate strategies involving insurance protection. For example, some clients will have need for more sophisticated asset protection planning, which will usually involve the client's estate planning attorney (and/or a specialist attorney in this field). Other clients may own a business, be the trustee of an ERISA plan, or serve on a Board of Directors of a business entity or non-profit corporation, and in each instance the financial planner can assist in identifying, weighing, and appropriately addressing the various risks which may be involved. Such comprehensive advice better fulfills the financial planner's duty of due care and adds valued services appreciated by the client, leading to a longer-lasting, deep and trusting relationship with the client.

**7. Assist clients to guard against identity theft.** Surveys of consumers consistently rank identity theft as one of the top concerns of consumers today. All financial planners possess a general duty of confidentiality relating to their client's information and should possess policies and procedures designed to safeguard client information. What more can be done?

One way of adding value is to enroll the client in a credit bureau monitoring service, such as the Equifax Credit Watch™ 3-In-1 Gold program which provides e-mail or U.S. mail alerts to clients of possible identity theft activity. By paying for this service directly (and obtaining discounts on the program cost by purchasing multiple certificates for enrollment in the program), a financial planner may deepen his or her relationship with each client and provide an important component of comprehensive planning to assist the client to achieve financial "peace of mind."

**8. To keep the client's best interests paramount, seek to avoid conflicts of interest.** While it has often been stated that in the United States federal securities law's exclusive focus is on full disclosure of material facts and conflicts of interest, disclosure alone is not sufficient to satisfy the financial planner's fiduciary obligation. *The reason is simple and straightforward - disclosure of conflicts of interest does not defeat the continuing duty of the financial planner to act in the best interests of the client.*

The term "fiduciary" is utilized to mark certain relationships where a party with superior knowledge and information acts on behalf of one who usually does not possess such knowledge and information. Financial planning is such a relationship. Furthermore, learning the personal details of a client's financial affairs, their hopes, dreams, and aspirations cultivates a confidential and intimate relationship. In these relationships the person with the dominant position (the "fiduciary") acts as if the interests of the other party (the "client") were the fiduciary's own. The duty to act in the interests of the client is an expression of the general fiduciary duty of loyalty. This duty of loyalty requires that financial planners should not act in their own interest, engage in self-dealing,

misappropriate a client's assets or opportunities for their own purposes, or otherwise profit in a transaction that is not substantively fair to the client. Disclosure of material facts, including conflicts of interest, is essential (but not conclusive) to fulfilling the financial planner's duty of loyalty.

It should be recognized that the existence of significant conflicts of interest in either quantity and/or quality, even when they are fully disclosed, can serve to undermine the fiduciary relationship and the relationship of trust and confidence with the client. The existence of substantial or numerous conflicts of interest can lead to not only an erosion of the financial planner's relationship with the client, but also an erosion of the reputation of the profession of financial planning. Hence, financial planners shall reasonably act to seek to avoid conflicts of interest.

How does this add value to the client? The lesser the number of conflicts which exist between the financial planner and the client, the greater the perceived trust the client can place in his or her financial planner. This facilitates more frequent and higher-quality exchanges of information and ideas between the financial planner and client and strengthens the depth of the relationship. Additional financial planning issues which may have been overlooked will rise to the surface and can then be appropriately, timely, and proactively addressed by the financial planner. Increased trust and confidence by the client in the financial planner also leads to greater prospects for retention of the client, as well as greater referrals of new clients to the financial planner. Both the client and the financial planner benefit, especially since the financial planner's time which would otherwise be devoted to securing new clients can be refocused on serving the needs of the financial planner's clients.

**9. Enhance disclosure and proper management of non-avoided conflicts of interest.** Like it or not, every financial planner will still have some conflict of interest with a client, and often those conflicts relate to compensation. Disclosure of such conflicts is mandated, as evidenced by the CFP Board's *Rules of Conduct* (effective July 1, 2008) states in pertinent part: "If the services include financial planning or material elements of the financial planning process, prior to entering into an agreement, the certificant and the prospective client shall discuss ... [c]ompensation that any party to the agreement or any legal affiliate to a party to the agreement will or could receive under the terms of the agreement; and factors or terms that determine the cost to the client, how client decisions benefit the certificant and the relative benefit to the certificant [and] [t]erms under which the agreement permits the certificant to offer the client proprietary investment products."

Rather than shy away from disclosure of the specific amount (or percentage) of compensation paid to the financial planner or his or her firm, the process of disclosure provides the opportunity to the financial planner to demonstrate the due diligence he or she undertook with respect to investment product selection. Reasonable total fees and costs incurred by a client should not be discussed by the financial planner apologetically. Instead, forthright and specific disclosures and the ensuing discussion can serve to enhance the client's understanding of the significant effort the financial planner (or other members of his or her firm) undertook in choosing investment products which might best suit the clients' needs.

All financial planners will possess conflicts of interest relating to compensation. In such regard, all financial planners should consider whether to undertake the following disclosures. (Please note that the form of the following sample disclosure is highly generalized. Each financial planner should have his or her compliance department review this disclosure prior to application to a financial planner's specific disclosure documents.)

*“Conflicts of Interest Relating To Other Uses of Cash Funds.* [1] We will counsel clients to pay down debt unless: (a) The client has a clear need for liquidity (that cannot otherwise be obtained by other means, such as a home equity line of credit); or (b) From the standpoint of income tax savings (i.e., the after-tax cost of interest payments is less than the after-tax returns on fixed income investments, taking into account federal, state and local taxes), the client would benefit from having deductible interest debt; or (c) The client, after consultation, still does not want to pay down the debt (in which event we will document this decision in the client's financial plan). [2] At times our clients will desire to invest in closely-held businesses or private real estate holdings. We recognize that private equity investments, especially those in commercial real estate (particularly income-producing) or residential real estate (particularly low-cost housing) may constitute an important diversifier to a sophisticated client's portfolio. We will counsel the client accordingly, given the knowledge and skill of the client as to the ability to select, negotiate the purchase of, and manage and maintain such ventures. [3] Our clients may desire to gift cash or investment assets to family members or charities, or may desire to undertake expenditures relating to the pursuit of lifetime financial goals or enjoyment of life. In each instance we will seek to objectively evaluate the propriety of the gift or expenditure and counsel the client accordingly.”

*“Our Attendance At Third Party-Sponsored Educational Seminars.* We are offered the opportunity to attend educational seminars put on by product providers (i.e., mutual fund companies, etc.) and custodians (brokerage firms which serve our firm and our clients) from time to time. There is generally no cost to our firm relating to the educational presentations nor the materials provided, and on occasion group meals and beverages are also provided. It is industry practice to accept this “free” benefit. While these educational presentations can be useful to advance our own educational efforts, we do not believe these seminars to be material compensation to us, as we could easily obtain similar knowledge through other means. However, we will always pay our own travel costs (airfare, hotels, etc.) to attend these seminars, and we will never permit the benefits we receive from these seminars to become so significant as to unduly influence our independent professional judgment on our client's behalf.”

Disclosures of material conflicts of interest, and even immaterial conflicts of interest, can greatly enhance the relationship with the client if properly handled. In addition, if the client knows that the financial planner and his or her firm has adopted strict policies to properly manage conflicts of interest which are not reasonably avoided, the client is likely to feel more trusting of the financial planner, leading to a more open disclosure of the client's situation and needs, better financial planning advice, and a more secure relationship between the financial planner and the client.

**10. Dedicate yourself to the profession and accept the important role of stewardship of your client's goals.** As concluded by the FPA® Fiduciary Task Force's "Preliminary Report" issued in March 2007, "financial planners [shall] attain a special place in our society through the adoption of professional standards of conduct. With such adoption will follow the status and prestige accorded to true professionals and the resulting increased demand for their all-important professional services." In order for financial planning to continue to advance to status as a true profession, financial planners must embrace the belief that their practice and sense of responsibility goes beyond just making a living. Professional financial planners, in adhering to a fiduciary standard of conduct, answer the call to dedicate their lives to assist others.

The world, alas, is ever-changing. New products and techniques and changed laws abound. Hence, each and every financial planner must dedicate himself or herself to ongoing education and skills enhancement.

Into the hands of doctors patients trust their health and our lives. Into the hands of financial planners clients trust their wealth and financial futures. Regardless of whether custody of client's assets is undertaken, financial planners are stewards of their clients' dreams, goals and aspirations. The high degree of trust and confidence which clients place in their financial planners should never be betrayed by inappropriate action, nor through inaction, recklessness, or lack of attention. When all financial planners embrace the fiduciary oath which the financial planning profession undertakes, financial planners will enjoy a status as distinguished professionals and fiduciaries, with all the benefits flowing from the enhanced prestige this position in our society enjoys.

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<sup>1</sup> The FPA Fiduciary Task Force's Preliminary Report, released in March 2007 by the Financial Planning Association's Board of Directors, explains the increasing likelihood that all financial planners are likely to be held to a fiduciary standard by state courts. In a January 22, 2007 legal memorandum prepared by the law firm of Pickard and Djinis LLP, attached as Exhibit C to the Preliminary Report, it was stated: "[A]t least one jurisdiction has stated categorically that "[f]inancial planners . . . owe a fiduciary duty to their customers." [citing *Johnston et al. v. CIGNA Corporation et al.*, 916 P.2d 643, 647 (Colo. Ct. App. 1996).] This approach is consistent with the well-established treatment of investment advisers as fiduciaries, which we discussed in our December 5, 2006 memorandum, and is logical in light of the frequency with which financial planners delve into the investment advisory arena. It is also consistent with the heightened fiduciary standard that applies to persons who hold themselves out as financial planners, by virtue of Advisers Act Rule 202(a)(11)-1, as discussed in our December 21, 2006 memorandum. Even jurisdictions that have not adopted a bright-line rule regarding the application of common-law fiduciary duties to financial planners have nonetheless given strong indications that holding oneself out as a financial planner may expose one to fiduciary obligations. For example, in *Murphy v. Northwest Mutual Insurance Company et al.* [2005 U.S. Dist. LEXIS 43627 (W.D. Mo. 2005)], the court noted that an insurance agent who allegedly held himself out as an expert in securities and financial planning could owe his customers a duty akin to that owed to customers of an investment adviser. While the *Murphy* court did not establish the actual nature of the duty owed by the financial planning "expert" in question, the court's suggestion that such a duty could rise to the level of that owed by an investment adviser illustrates a general acceptance of the idea that financial planners should be regarded as fiduciaries under common law. The court in *Koehler v. Pulvers* [614 F. Supp. 829 (S.D. Cal. 1985)] took a similar approach in finding that a group of real estate developers stood in a fiduciary relationship with purchasers of limited partnership interests by virtue of, among other things, the developers' 'purported disinterested financial planner status.'" Several other recent cases indicate that fiduciary status may be found for financial advisors through the actual provision of advice on asset allocation and investment manager selection, by actually providing financial advisory services, or by committing to or actually monitoring a customer's investment portfolio. Other cases find fiduciary status when one "holds out" as a "financial planner" or "financial advisor" or "estate planner" or "investment counselor," or as one possessing experience in the field of investment consulting and management. In addition, a dual registrant who undertook the monitoring of variable annuity sub-accounts

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and to give financial advice, and who held out as a “financial advisor” was held to be a fiduciary. For a discussion of these cases, please refer to the pamphlet, “Common Sense,” available at [www.JosephCapital.com](http://www.JosephCapital.com).

<sup>2</sup> Mark Carhart found that net returns are negatively correlated with expense levels, which are generally much higher for actively managed funds. Worse, Carhart found that the more actively a mutual fund manager trades, the lower the fund's benchmark-adjusted net return to investors. Carhart, “On persistence in mutual fund performance,” *Journal of Finance* 52, 57–82 (1997). A more recent paper commissioned by the Zero Alpha Group also highlights the importance of keeping costs low, explaining: “The more rigorous academic studies find that annual expense ratios generally detract from fund performance (*see, for example*, Elton, Gruber, Das and Hlavka (1993), Gruber (1996), and Carhart (1997)). On average, fund managers are unable to recoup the expenses that funds pay via better performance. Wermers (2000) finds that the underlying equity holdings of equity mutual funds do outperform the market, but that cash drag, annual expenses and transaction costs more than offset this outperformance. These findings suggest that basing fund investment decisions at least partially on fees is wise. Lower cost funds have a smaller drag on performance that active managers must overcome. Taken to their logical conclusion, these results may suggest that index funds, accompanied by the lowest expense ratios in the mutual fund industry, are a more logical long-run investment choice than more expensive actively-managed funds.” Karceski, Livingston, and O’Neal, “Portfolio Transaction Costs at U.S. Equity Mutual Funds” (2004).

<sup>3</sup> “Estimating The Total Costs of Stock Mutual Funds” (2005), available at [www.JosephCapital.com](http://www.JosephCapital.com) under Resources / White Papers.

<sup>4</sup> SEC Release IC-24832 (2001) noted that “Taxes are one of the most significant costs of investing in mutual funds through taxable accounts ... Recent estimates suggest that more than two and one-half percentage points of the average stock fund's total return is lost each year to taxes ... Despite the tax dollars at stake, many investors lack a clear understanding of the impact of taxes on their mutual fund investments.” The International Organization for Standardization, in its recently promulgated ISO 22222 (2005), set forth as part of the core competencies of financial planners, “Personal financial planners shall be able to identify and analyze relevant tax issues and related implications for their clients ... [s]hall possess a broad general knowledge of individual and business taxes as they relate to personal financial planning ... [s]hall possess a general knowledge of how the timing of an event can affect taxes ... [and] [s]hall be able to analyze tax situations and understand the implications....”

<sup>5</sup> It should be asked whether a financial planner or investment advisor who always uses FIFO when selling within a client's taxable client is maximizing the value which can be added to the client and fulfilling his or her fiduciary duty of utmost due care.

<sup>6</sup> ISO 22222 (2005), provided significant detail relating to a financial planner's duty of competence, including the requirement that: “Personal financial planners shall be able to compare the client's tolerance for financial risks and the financial risks that may be involved in achieving his or her goals and assist the client in resolving any differences.” ISO 22222 also notes that financial planners shall “understand personal financial risk tolerance” and “shall understand the risks in financial strategies.”

<sup>7</sup> Christine Benz, “How Did Investors Really Do? - Investor returns help capture shareholder experience,” (Nov. 13, 2006), available at [www.morningstar.com](http://www.morningstar.com).