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Via e-mail to: mail@CFPBoard.org

April 23, 2007

CFP Board
Attn: Ethics Task Force
1670 Broadway, Suite 600
Denver, CO 80202

Re: Comments, *Second Exposure Draft*

Dear Members of the CFP Board's Ethics Task Force:

Thank you for the opportunity to comment on the *Second Exposure Draft.* While I have been supportive of several organizational efforts with regard to fiduciary duty issues, I would like to stress that the comments set forth in this correspondence are mine alone.

First, I would to express my appreciation to the Ethics Task Force, and to the entire Certified Financial Planning Board of Standards, Inc. ("CFP Board"), for carefully considering all of the prior comments relative to the *First Exposure Draft*. The changes undertaken, especially as they relate to adoption of the "best interests of the client" standard at all times and the fiduciary duty of care, reflect careful consideration of the ongoing developments in the common law, important public policy issues, and the need to benefit consumers through the continued evolution of financial planning into a genuine profession.

In these comments I set forth an explanation of *when* fiduciary status attaches to financial planners under the common law. I believe that many financial planners, whether or not they are Certificants, are unaware of the high legal standard to which they are held – not necessarily by statute or regulation – but rather through the application of the common law of the many states. It is my hope that these comments will assist the CFP Board and its committees and Certificants. These comments are organized as follows:

A. Application of The Common Law of Agency To Financial Planners

B. Recent Case Law Imposing Fiduciary Status On Financial Planners Under the Common Law

C. Public Policy Considerations Which May Guide the CFP Board

D. Specific Recommendations

A. Application of The Common Law of Agency To Financial Planners.

A.1. The Common Law, Generally. The common law forms a major part of the law of those countries of the world with a history as British colonies. In the United States, the common law includes extensive non-statutory law reflecting precedent derived from centuries of court decisions, both in the United States and England. Applying the common law, it has become apparent in recent years that federal and state courts are highly likely to find that financial planners are fiduciaries.

A.2. Common Law Imposition of Fiduciary Status Is Not Dependent Upon Any Statute, Regulation, nor Regulatory Authority. It must be emphasized that courts in the United States may find that a financial planner is a fiduciary to his or her client independent of any statute or regulation. For example, a financial planner who is subject to the Investment Advisers Act of 1940 (and the similar laws of the various states) is certainly a fiduciary to his or her client (pursuant to the landmark *Capital Gains* decision). Whether or not a financial planner is subject to the Investment Advisers Act of 1940, the common law may also impose fiduciary status upon the financial planner. As will be shown in these comments, a Certificant is *highly likely* to be found to be a fiduciary to his or her customer or client when any financial advisory services are provided to the client. Stated differently, merely because the SEC or a state securities regulatory authority does not assert the application of fiduciary status through statutory law or regulation does not negate the highly probable finding that a financial planner is a fiduciary under the common law.

A.3. Application of the Common Law of Agency: The Creation of A Fiduciary Relationship. At its heart, the financial planner – client relationship is one of an "agent" to a "principal." General principles of agency law and trust law, from which fiduciary law is derived, therefore apply. And this body of "fiduciary law" reflects the "common law" of the many states.

The draft Restatement (Third) of Agency, which is a summary of the common law of the many states (and an ongoing attempt to unify such common law), describes the principal-agent relationship as a fiduciary one, and sets forth how it is created under the following principles:

> § 1.01 *Agency Defined.* Agency is the fiduciary relationship that arises when one person (a "principal") manifests assent to another person (an "agent") that the agent shall act on the principal's behalf and subject to the principal's control, and the agent manifests assent or otherwise consents so to act.
>
> § 1.02 *Parties' Labeling And Popular Usage Not Controlling.* An agency relationship arises only when the elements stated in § 1.01 are present. Whether a relationship is characterized as agency in an agreement between parties or in the context of industry or popular usage is not controlling.
>
> § 1.03 *Manifestation.* A person manifests assent or intention through written or spoken words or other conduct.

A principal-agent relationship may be an "express fiduciary relationship." For example, the financial planner may set forth in his or her client services agreement with the client, "I agree that I will act in a fiduciary capacity to you at all times."

A principal-agent relationship may also be an "implied fiduciary relationship." This is where the common law will likely impose fiduciary status upon most Certificants. Under §1.01 of the Restatement (Third) of Agency, set forth above and as interpreted by the courts, the key elements required to support the establishment of implied fiduciary status upon a financial planner are:

(1) The placement of trust and confidence by the client;

(2) A substantial disparity in the knowledge of the parties; and

(3) Some recognition, acceptance, or undertaking by the financial planner to advise, counsel, or protect the client.

Each of these requirements is discussed in the sections which follow.

A.3.a. Placement of Trust and Confidence By the Client, and Reasonable Reliance. There must be a placement of trust by the client in the financial planner. Generally speaking, it would be hard for a financial planner to rebut an allegation that the client "trusted" the financial planner, since such evidence exists from the state of mind of the client, which is provided by the client's testimony.

However, the reliance upon the financial planner for advice must be reasonable. For example, if one says, "I'm a financial planner, but I only have a 2nd grade education, and my training in financial planning only consisted of going to a course at Clown College," then reasonable reliance would not follow. However, if the financial planner touts designations, such as CFP® (or other designations), or represents how many financial plans he or she has prepared, or indicates some form of education in financial planning, then reliance would be reasonable in most circumstances.

Note that the mere placement of trust, or subjective feelings of the client, is not sufficient to establish the existence of a confidential relationship. *Lee v. Hasson*, No. 14-05-00004-CV (Tex. App. 1/30/2007) (Tex. App., 2007). In order to establish the existence of an informal fiduciary relationship, the record must show that one of the parties relied on the other 'for moral, financial, or personal support or guidance.'" *Trostle v. Trostle*, 77 S.W.3d 908, 915 (Tex. App.-Amarillo 2002, no pet.).

"As in a status relation, one party to a fiduciary relation (the entrustor) is dependent on the other (the fiduciary). This dependence, however, is seldom as broad and pervasive as that in status relations. By definition, the entrustor becomes dependent because he must rely on the fiduciary for a particular service." Tamar Frankel, *Fiduciary Law*, 71 Calif. L. Rev. 795, 797 (1983).

Note that a "nonfiduciary" business relationship may become a relationship of trust and confidence when one person gains the confidence of the other and purports to act or advise that person with the other's interest in mind. Bogert, *Trusts and Trustees* p 482 (1978); Page and Keeton, *The Law of Torts* sec. 106, p. 738 (1984); James and Gray, *Misrepresentation--Part II*, 37 Md.L.Rev. 488, 524-525 (1978); *Restatement (Second) of Trusts*, sec. 2, p. 7 (1957); 1 Scott, *Trusts*, sec. 2.5, pp. 39-42 (1967).

While the placement of trust and confidence by the client in another is an essential element, it is only one element; the mere fact that one person trusts another, and relies upon his promise to perform a contract, does not rise to a confidential relationship. There must also exist a substantial disparity in the knowledge or expertise of the parties, as well as some act or conduct which manifests an acceptance of the trust or confidence.

A.3.b. Substantial Disparity In The Knowledge of the Parties. Another required element is a substantial disparity in the knowledge of the financial planning activities at hand. "The *sine qua non* of professionalism is specialized knowledge, and not just any sort of specialized knowledge. It is an accumulated and ordered knowledge, built up over time by the experience, analysis and insight of predecessors in the field. It is knowledge that penetrates to the root of the matter and gives its possessor an understanding not only of how things are, but why they are. It is also hard-won knowledge that requires time and effort to possess, knowledge that many people cannot achieve. Lastly, it is powerful knowledge, and historically those in a position to pass it on have ordinarily demanded some evidence from students that they are worthy to receive it." [Emphasis in original.] Robert G Kennedy, Ph.D., *The Professionalization of Work*.

It is submitted that there exists a vast disparity in knowledge between a trained financial planner and his or her client in the vast majority of instances. As evidence of the tremendous difficulty consumers of financial services possess in understanding financial planning concepts, and the difficulty in making good decisions even when handed knowledge of investment products, *see* James J. Choi, David Laibson, Brigitte C. Madrian, *Why Does the Law of One Price Fail? An Experiment on Index Mutual Funds*. The abstract for this article states: "We report experimental results that shed light on the demand for high-fee mutual funds. Wharton MBA and Harvard College students allocate $10,000 across four S&P 500 index funds. Subjects are randomized among three information conditions: prospectuses only (control), summary statement of fees and prospectuses, or summary statement of returns since inception and prospectuses. Subjects are randomly selected to be paid for their subsequent portfolio performance. Because payments are made by the experimenters, services like financial advice are unbundled from portfolio returns. Despite this unbundling, subjects overwhelmingly fail to minimize index fund fees. In the control group, over 95% of subjects do not minimize fees. When fees are made salient, fees fall, but 85% of subjects still do not minimize fees. When returns since inception (an irrelevant statistic) are made salient, subjects chase these returns. Interestingly, subjects who choose high-cost funds recognize that they may be making a mistake." This study confirms what every seasoned financial planner knows – that the vast majority of consumers of financial planning services lack the knowledge to undertake sound financial and investment decisions by themselves. Given the increased complexity of our financial world – the breadth of financial products available today, complex tax laws affecting financial planning and investment planning decisions (and providing both opportunities for tax-savvy financial planners, as well as traps for the unwary), and the interrelationship of all financial planning, estate planning, risk management planning, tax planning, and investment advice – it is no wonder that the financial planning profession has progressed so rapidly in recent years. Nor is it surprising that the CFP® examination requires extensive knowledge for its passage; nor is it surprising that many who may take the examination without adequate and extensive preparation fail to pass this strenuous test.

It is submitted that in most situations the first and second elements involved in this analysis will be satisfied when a person holds himself or herself out as a "financial planner" (or similar terms) or performs services for an individual client (at least one who is not sophisticated in financial planning matters). Hence, the focus of many court decisions, and of this inquiry, involves the third element – **whether and when a "financial planner" manifests some act which accepted the relationship of trust and confidence or undertaking of the duties**.

A.3.c. Recognition or Acceptance of Relationship Or Undertaking To Advise The Client. Evidence that one party placed trust or confidence in the other party does not create a fiduciary relationship in the absence of "some recognition, acceptance or undertaking of the duties of a fiduciary on the part of the other party." *Lanz v. Resolution Trust Corp*., 764 F. Supp. 176, 179 (S.D.Fla.1991) (citing *Harris v. Zeuch*, 103 Fla. 183, 137 So. 135 (1931*)); Barnett Bank v. Hooper*, 498 So.2d 923 (Fla.1986). Neither the mere placement of trust and confidence by a person in another, nor the substantially unequal knowledge of the parties, creates a relationship which is automatically fiduciary in nature. In order to be liable the superior party must *assume* a duty to act in the dependent party's best interest. *Hill v. Bache Halsey Stuart Shields Inc.,* 790 F.2d 817 (10th Cir.1986) (recognizing that fiduciary liability requires not only a repose of trust, but an assumption of a duty and breach of that duty); *First Nat'l Bank of Meeker v. Theos*, 794 P.2d 1055 (Colo.App.1990) (same). As set forth by the draft Restatement (Third) of Agency, the agent (financial planner) must "manifest assent" or "otherwise consent to act" as an advisor (or financial planner) to the client. However, as also demonstrated by the Restatement (Third) of Agency, a "person manifests assent or intention through written or spoken words or other conduct."

"It is axiomatic that before a plaintiff may state a claim for breach of a fiduciary duty, that plaintiff must show a fiduciary relationship with the defendant against whom the claim is brought. And before a defendant may be charged with a fiduciary obligation, 'he must either knowingly undertake to act on behalf and for the benefit of another, or must enter into a relationship which imposes that undertaking as a matter of law.'" *Lubin v. Sybedon Corp*., 688 F.Supp. 1425 (S.D. Cal., 1988), *citing Committee on Children's Television, Inc. v. General Foods Corp*., 35 Cal.3d 197, 221, 197 Cal.Rptr. 783, 673 P.2d 660 (1983) (which opinion states: "the efforts of commercial sellers--even those with superior bargaining power--to profit from the trust of consumers is not enough to create a fiduciary duty. If it were, the law of fiduciary relations would largely displace both the tort of fraud and much of the Commercial Code. Something more is needed. *It is difficult to define that additional element precisely, and courts have traditionally refrained from definitions that would place strict limits on this equitable concept. It would appear, however, that before a person can be charged with a fiduciary obligation, he must either knowingly undertake to act on behalf and for the benefit of another, or must enter into a relationship which imposes that undertaking as a matter of law*. (*See* Scott, *The Fiduciary Principle* (1949) 37 Cal.L.Rev. 539, 540; Rest.2d Trusts (1959) § 2.) The relationship of seller to buyer is not one ordinarily vested with fiduciary obligation, even though sellers routinely make representations concerning their product, often on the basis of a claimed expert knowledge about its utility and value. In such transactions, the seller is held to the mores of the marketplace. A fiduciary, by contrast, assumes duties beyond those of mere fairness and honesty in marketing its product--he must undertake to act on behalf of the beneficiary, giving priority to the best interest of the beneficiary. (*See* Rest.2d Trusts (1959) §§ 2 and 170.)." [*Emphasis added*.]

Furthermore, under comment b to §1, Restatement (Second) of Agency, it is said: "The relation which the law calls agency does not depend upon the intent of the parties to create it, nor their belief that they have done so. To constitute the relation, there must be an agreement, but not necessarily a contract, between the parties*; if the agreement results in the factual relation between them to which are attached the legal consequences of agency, an agency exists although the parties did not call it agency and did not intend the legal consequences of the relation to follow.*"

The fiduciary relationship may come into being by the *manifestation of consent* by the fiduciary to act on behalf of another. *State v. Knight*, 232 Wis.2d 305, 606 N.W.2d 291 (citing *Restatement (Second) of Agency* § 1(1) (1958). **This begs the question - what is a "manifestation of consent" to acceptance of the trust of a client by a financial planner?**

Circumstantial Evidence Permitted. "An agency may be proven not only by direct evidence of an agreement between the parties but also by circumstantial evidence, such as their words and conduct, from which the intention to create an agency may be fairly implied." *Asa-Brandt, Inc. v. Adm Investor Services, Inc.*, No. C01-3021-MWB (N.D. Iowa 4/18/2001) (N.D. Iowa, 2001), *citing Walnut Hills Farms, Inc. v. Farmers Coop. Co.*, 244 N.W.2d 778, 781 (Iowa 1976) (*quoting Martin v. Jaekel*, 188 N.W.2d 331, 333-34 (Iowa 1971)). An agency relationship may be established by consent manifested in words and conduct. *Groh v. Shelton*, 428 S.W.2d 911, 916 (Mo.App. 1968). Neither a contract nor an express appointment and acceptance is essential to the formation of an agency relationship. *Id.* Like other questions of fact there must be substantial evidence bearing on the existence of a principal-agent relationship to generate a jury question; a mere scintilla is not enough. In *Groh v. Shelton*, the Court stated: "The relation of principal and agent is created by *manifestation of consent* by one person to another that the other shall act on his behalf and subject to his control, and consent by the other so to act. Neither a contract between the principal and the agent nor an express appointment and acceptance is necessary, but *consent may be manifested and the relation may be created by words and conduct.* Payment of, or an agreement to pay, compensation to the agent is not an essential to creation or existence of the relation, and agency may be a wholly gratuitous undertaking. And, although '(t)he parties may not have intended to create the legal relationship or to have subjected themselves to the liabilities which the law imposes as a result of it, nevertheless, the relationship exists 'if there has been a manifestation by the principal to the agent that the agent may act on his account, and consent by the agent so to act." *Groh* at 916. [*Emphasis added.*]

No Express Assumption of Fiduciary Status Is Required. It is important to note that no express assumption of the fiduciary relationship is required by the agent (i.e., financial planner). "It is well-settled that liability for breach of a fiduciary duty is not dependent solely upon an agreement or contractual relation between the fiduciary and the beneficiary but results from the relation … It is not essential for a fiduciary relationship to be formalized in writing for fiduciary obligations to exist; rather, 'the ongoing conduct between parties may give rise to a fiduciary relationship that will be recognized by the courts.' … In addition, *fiduciary duties may arise out of a contractual relationship which is independent of the contract itself ... For instance, "[i]f a contract establishes a relationship of trust and confidence between the parties ... then a fiduciary duty arises from the contract which is independent of the contractual obligation.*" *Lumbermens Mut. Cas. v. Franey Muha Alliant Ins.*, 388 F.Supp.2d 292 (S.D.N.Y., 2005). [*Emphasis added.*]

Undertaking Action (i.e., Financial Planning) Can Be A Manifestation of Consent. Conduct of the agent may, by and of itself, be a manifestation of consent. By way of illustration, in a case involving a tax preparer obtaining a loan against a prospective tax refund, a Maryland court emphasized that undertaking action of the type expected of the other party in a relationship would be sufficient to establish an agency. The court stated: "Particularly in the context of its promotional efforts, it would be reasonable to conclude that H&R Block, as an agent, is seeking - and gaining - the consent of its customers to act on their behalf

with respect to the transactions with the lending bank as well as the IRS. While H&R Block disputes that it has consented to act as its customers' agent in securing the loan, an 'agent need not necessarily communicate his consent to the principal if, under the circumstances, *embarking on the purpose of the agency is, itself, a sufficient indication of consent*.' W. EDWARD SELL, SELL ON AGENCY 7, at 8 (1975)." *Green v. H&R Block, Inc. et al.*, 735 A.2d 1039 (Md., 1998). [*Emphasis added.*]

The Provision of Advice Can Be A Manifestation of Consent. In some situations in which fiduciary relationships are formed the giving of "advice" appears to be the key to a "manifestation of consent." For example, as one court stated: "It is not without precedent for a jury to find a fiduciary relationship between a farmer and a cooperative … the jury in this case heard evidence that Wesley's manager, Art Beenken, was more experienced, more sophisticated, and more privy to information than were the Farmers about HTAs and the risks inherent in their use. The Farmers also testified that they were encouraged by Beenken to enter into HTAs, and that they relied upon his advice in executing them. Obviously, this fiduciary relationship did not arise through a simple buyer/seller relationship. Rather, as the district court found, it arose through the Farmers' reliance upon their cooperative, its manager, and his *advice* to them with respect to growing and marketing their grain, advice which included measures to improve their yield, when to sell their grain, and, most importantly, how to use HTAs to enhance the profitability of their operations. Given the evidence presented, we will not disturb the jury's finding that a fiduciary relationship existed between the Farmers and Wesley." *Asa-Brandt, Inc. v. Adm Investor Services, Inc.*, 344 F.3d 738 (8th Cir., 2003). [*Emphasis added.*]

B. Recent Case Law Imposing Fiduciary Status On Financial Planners Under the Common Law.

B.1. Holding Out As A CFP® Certificant As Manifestation of Consent To An Agency (Fiduciary) Relationship. How are the foregoing general principles of agency applied in cases involving financial planners or the undertaking of financial planning? Many Certificants may be surprised to here that there is substantial support under the common law for finding that CFP® Certificants are fiduciaries. Several cases in support of this conclusion are explored in this section.

B.2. *U.S. v. Williams* (2006): U.S. Court of Appeals Holds Financial Planner - Estate Planner To Be A Fiduciary (Applying The Common Law). In the recent case of *U.S. v. Williams*, decided in 2006 in the U.S. Court of Appeals for the 9th Circuit, a self-employed insurance seller and licensed financial planner took advantage of his position as a financial advisor to gain the trust of an 87-year-old man, Stubbs, convincing the elderly man to grant him a power of attorney, with which the financial planner stole about $400,000. The court held that the licensed financial planner was employed as a fiduciary, specifically noting that the elderly man relied upon the fiduciary as a financial advisor and estate planner. *U.S. v. Williams*, 441 F.3d 716, 724 (9th Cir. 2006). The U.S. Court of Appeals also noted that the 87-year-old-man had provided to the financial planner authority under a power of attorney, which power of attorney was utilized to effect the theft of fund. While an attorney-in-fact is clear a fiduciary under the law to his principal, the finding of fiduciary status for the financial planner did not rest solely upon this determination. The court apparently made a separate finding of fiduciary status through the existence of the financial planner/estate planner relationship, with the court stating: "Stubbs employed Defendant as a

fiduciary, and Defendant therefore undertook the high duties of honesty and loyalty to him. Specifically, Stubbs hired and relied on Defendant as a financial advisor and estate planner. He entrusted Defendant with large sums of money and signed a durable power of attorney naming Defendant as his agent."

B.3. *Hatleberg v. Norwest Bank* (2005): Bank Holding Out As "Investment Planner," "Financial Planner," or A "Financial Advisor" May Be A Fiduciary. In *Hatleberg v. Norwest Bank*, the Supreme Court of Wisconsin in 2005 noted that fiduciary duties may arise from the relationship between a financial advisor and a client, stating: "Whether Wells Fargo styles itself an 'investment planner,' 'financial planner,' or 'financial advisor,' it bears responsibility for its actions. A fiduciary duty may arise in these circumstances." The court further addressed the issue of a fiduciary duty for financial advisors in a separate section of the opinion, stating: "B. Duties Arising in Wells Fargo's Capacity as Financial Advisor. Hatleberg argues that Wells Fargo held itself out as an expert in financial planning, and that it committed professional negligence by failing to inform her of the problems with the trust. As a threshold matter, Wells Fargo disputes the contention that it was Erickson's 'financial planner,' alleging instead that it was only her 'investment planner.' On the facts here, we fail to see how the label pinned on the bank would include or exclude the bank from concern about the tax consequences flowing from its management of Erickson's money. The facts show that, by his own admission, Wells Fargo's employee, Sevig, deliberately solicited Erickson's business and extensively managed her financial affairs. Indeed, Wells Fargo's own expert admitted at trial that if he had been on the receiving end of Sevig's solicitations, he would have concluded that Wells Fargo wanted to be his 'investment planner.' Whether Wells Fargo styles itself an 'investment planner,' 'financial planner,' or 'financial advisor,' it bears responsibility for its actions. A fiduciary duty may arise in these circumstances. *See Merrill Lynch v. Boeck*, 127 Wis.2d 127, 136, 377 N.W.2d 605 (1985) ('A fiduciary relationship arises from a formal commitment to act for the benefit of another ... or from special circumstances from which the law will assume an obligation to act for another's benefit.'). In determining whether a fiduciary relationship has arisen, courts consider a variety of factors, including whether there is dependence and inequality based on weakness of age or mental strength, lack of business intelligence, inferior knowledge of facts involved, or other conditions giving one side an advantage over the other. *Prod. Credit Ass'n of Lancaster v. Croft,* 143 Wis.2d 746, 755-56, 423 N.W.2d 544 (Ct.App.1988)." *Hatleberg v. Norwest Bank*, 283 Wis.2d 234, 700 N.W.2d 15, 25 (WI, 2005). Note that despite the extensive language of the opinion addressing the probable fiduciary status of financial advisors, the court was not called upon to find that Wells Fargo, as a financial advisor, was a fiduciary to the client (Erickson), as the court noted that Wells Fargo admitted at oral argument that it owed a fiduciary duty to Erickson.

B.4. *Koehler v. Pulvers*: Real Estate Developers Holding Out As Disinterested Financial Planners To Solicit Investment Funds Held To Be Fiduciaries. A U.S. District Court in 1985 held that a fiduciary relationship existed in part because of a defendant's status as financial planner to a client. *Koehler v. Pulvers*, 614 F. Supp. 829 (USDC, Cal, 1985). In the case the defendant, CSCC, was primarily in the business of real estate syndication, but also in business under the name Creative Financial Planning. As stated in the decision, "The developer defendants obtained investment capital from the public by posing as financial planners. CSCC employed a small group of so-called 'financial planners' whom it supplied with CSCC office space, and to whom it paid commissions for the sale of investments to 'clients.' The financial planners typically had a background in either insurance or real estate sales. Both defendants

Brophy and Pulvers acted as financial planners in addition to their other duties. As an alleged financial planning company, CSCC, dba Creative Financial Planners, contacted potential investors by conducting Creative Financial Planning seminars open to the public. Utilizing a slick presentation normally presented by Mr. Brophy, CSCC attempted to lure investment capital out of savings accounts, home equity, insurance policies, and other conservative investment vehicles and into the speculative real estate ventures it controlled. CSCC conducted these seminars on a regular basis at the Rancho Bernardo Inn and the Mission Viejo Country Club. Several of the plaintiffs also attended CSCC sponsored seminars at their mobile home parks. At the seminars, CSCC offered to draft a 'Coordinated Financial Plan' for attendees at little or no charge. Individuals who accepted this offer received recommendations to purchase limited partnership or trust deed interests in CSCC controlled partnerships and project ...." *Id*. The court also noted, "Most of the plaintiffs are and were unsophisticated investors. Few had a preexisting relationship with the developer defendants at the time they purchased their securities ... [the investors] relied upon the misrepresentations discussed in detail below. This reliance was reasonable in part because of the developer defendants' purported disinterested financial planner status." *Id*. The court held that "The developer defendants ... stood in a fiduciary relationship with plaintiffs. Fiduciary obligations arose by virtue of their purported disinterested financial planner status, their broker/agent status, and/or from the control they exercised over 21-31 Ltd. *Credit Managers Assn. v. Superior Court,* 51 Cal. App.3d 352, 360, 124 Cal.Rptr. 242 (1975); *Cooper v. Jevne*, 56 Cal.App.3d 860, 866, 128 Cal. Rptr. 724 (1976); *cf. Jones v. H.F. Ahmanson & Co*., 1 Cal.3d 93, 81 Cal. Rptr. 592, 460 P.2d 464 (1969). By their numerous omissions and nondisclosures they breached their fiduciary obligation of full disclosure, rendering them liable for constructive fraud." *Id.*. In this decision, note that there was not a long-standing relationship between the investors and the financial planners.

<u>B.5. *Cunningham v. PLI Life Insurance Company*: Insurance Agents Providing Financial Advice and/or Investment Plans May Be Fiduciaries.</u> In a 1990 U.S. District Court decision applying Iowa common law, arising out of insurance sales abuses, "the Plaintiffs allege that AEGON and its subsidiaries, through their agents, provided advice and offered counsel on tax deferred investing for retirement. The Plaintiffs maintain that AEGON and its subsidiaries owed a fiduciary duty to fully disclose inter alia the nature of the product being sold (life insurance) and the financial effect of the transaction, including fees and expenses relating to the life insurance ... Iowa courts will find a fiduciary relationship exists when 'there is a reposing of faith, confidence, and trust, and the placing of reliance by one upon the judgment and advice of another.' *McCracken v. Edward D. Jones & Co*., 445 N.W.2d 375, 381 (Iowa App.1989). Because the circumstances giving rise to a fiduciary duty are so diverse, any such relationship must be evaluated on the facts and circumstances of each case. *Kurth v. Van Horn*, 380 N.W.2d 693, 697 (Iowa 1986). When one party acts as an investment advisor for another party, Iowa courts are more likely to find a fiduciary relationship. *Kurth*, 380 N.W.2d at 698; McCracken, 445 N.W.2d at 381. In this case, the insurance agents allegedly introduced themselves as investment counselors or enrollers. The agents tailored the plans for each person depending on the individual's financial position and on the amount each wished to 'deposit' in their 'investment plan' or 'savings plan.' The Plaintiffs were asked to provide personal financial information to the agents. No mention was made of the fact that the agents were selling life insurance at the initial consultation. In fact, according to the sales scripts, the agents were instructed to conceal that they were selling life insurance. Consequently, the Plaintiffs were led to believe that the insurance agents were drafting an investment plan suited to each of the Plaintiffs' needs. Such conduct, at

least in the context of a motion to dismiss, could be seen as giving rise to a fiduciary duty." *Cunningham vs. PLI Life Insurance Company*, 42 F.Supp.2d 872, 888-889 (1990).

B.6. A Conclusion From the Case Law: "Holding Out" As A Financial Planner Or Certified Financial Planner™ Is Likely To Lead To A Finding Of Fiduciary Status. It appears from the case law above, and general principles of agency law, that "manifestation of consent" may exist by "holding out" as a financial planner. For example, in the *Hatleberg v. Norwest Bank* decision, discussed above, the court stated: "Whether Wells Fargo styles itself an 'investment planner,' 'financial planner,' or 'financial advisor,' it bears responsibility for its actions." Additionally, in the *Koehler vs. Pulvers* decision, discussed above, the court stated: "The developer defendants and WIN additionally stood in a fiduciary relationship with plaintiffs. Fiduciary obligations arose by virtue of their purported disinterested financial planner status, their broker/agent status, and/or from the control they exercised over 21-31 Ltd." In the *Cunningham vs. PLI Life Insurance Company* decision the court stated: "In this case, the insurance agents allegedly introduced themselves as investment counselors or enrollers. The agents tailored the plans for each person depending on the individual's financial position and on the amount each wished to 'deposit' in their 'investment plan; or 'savings plan.' The Plaintiffs were asked to provide personal financial information to the agents. No mention was made of the fact that the agents were selling life insurance at the initial consultation. In fact, according to the sales scripts, the agents were instructed to conceal that they were selling life insurance. Consequently, the Plaintiffs were led to believe that the insurance agents were drafting an investment plan suited to each of the Plaintiffs' needs. Such conduct, at least in the context of a motion to dismiss, could be seen as giving rise to a fiduciary duty." Again the court references how the defendants portrayed themselves. It also referenced what the defendants actually did – prepare an investment plan.

In other words, holding out as a financial planner (or similar terms) manifests an acceptance of trust and confidence. Additionally, actually undertaking a financial plan (whether comprehensive or segmented) and providing financial advice (outside of the discussion of a specific product's features) also may be conduct which manifests an acceptance of trust and confidence. In either situation – "holding out" as a "financial planner" or the provision of non-product specific "financial planning" or "financial advice," a fiduciary relationship is likely to result

B.7. Academic Views Bolster The Foregoing Conclusion. Academic views lend further credence to supporting the application of fiduciary status to financial planning and financial advisory activities. "The fiduciary concept, so prevalent in American law today, has its origins in the law of trusts and agency. Trustees - through a legal fiction - own property but manage it for beneficiaries. Agents are subject to control by other parties who authorize them to act on their behalf. Both trustees and agents are prohibited from furthering their own interests when performing their work. Over time, courts made analogies between trustees, agents, and others who performed similar roles and extended legal principles governing trustees and agents to these other relationships. Courts and scholars abstracted from these different examples and spoke of fiduciaries as a class of relationships which resembled each other. Now fiduciary relationships include guardians to wards, lawyers to clients, corporate officers and directors to shareholders, government officials to the public, and **financial advisors, brokers, and money managers to clients**. In all these relationships, the party who provides service is the fiduciary." [**Emphasis added.**] Marc A. Rodwint, *Strains in the Fiduciary Metaphor: Divided Physician Loyalties and Obligations in a*

Changing Health Care System, 21 AMERICAN JOURNAL OF LAW & MEDICINE 241, 243 (1995), *citing:* Austin W. Scott, *The Fiduciary Principle*, 37 CAL. L. REV. 539, 541 (1949); James E. Holmes, Note*, The Federal Conflicts of Interests Statutes and the Fiduciary Principle*, 14 VAND. L. REV. 1485, 1499 (1961). *See* ROBERT C. CLARK, CORPORATE LAW 141-57 (1986); CHARLES W. WOLFRAM, MODERN LEGAL ETHICS 145 (1986). See generally I TAMAR FRANKEL, *THE REGULATION OF MONEY MANAGERS: THE INVESTMENT COMPANY ACT AND THE INVESTMENT ADVISERS ACT 4-6* (1978); BAYLESS MANNING, *FEDERAL CONFLICT OF INTEREST LAW* (1964); Kathleen Clark, *Do We Have Enough Ethics in Government Yet? An Answer from Fiduciary Theory*, 1996 U. ILL. L. REV. (forthcoming 1996).

As seen, the fiduciary concept has been extended to cover situations not just involving the handing over of property by one person to another, but also certain relationships in which advisory services are provided. "Over time, courts have developed the fiduciary concept in several distinct areas of law and extended the metaphor by applying the doctrine to new circumstances that appeared analogous, borrowing rules used in one situation for others. In addition, state and federal legislatures have enacted legislation that imposes fiduciary obligations on certain professionals. The result is a diverse set of rules held together by some broad common principles. No simple criteria fully explain how courts decide which relationships they will recognize as fiduciary. Courts make the decisions as they resolve individual disputes. The decision is a social and policy choice as well as a legal one. It requires choosing which metaphor to use to view a relationship." Rodwindt at p.245.

C. Public Policy Considerations Which May Guide the CFP Board.

C.1. The Greater Public Policy Debate Continues. The *First Exposure Draft* and this *Second Exposure Draft* of the CFP Board necessarily involves the CFP Board in a broader public policy issues.

Americans today face a very tough financial future. The United States has tens of billions of dollars of unfunded promises in its various entitlement programs. It is highly likely that retirement and other benefits Americans may expect to rely upon will be required to be reduced and/or means-tested, and/or that additional tax burdens will be felt by all Americans. Additionally, over the last 30 years there has been a dramatic shift from corporate defined benefits plans to defined contribution plans. Americans face greater responsibility for their own financial futures precisely when their life expectancies have been extended significantly, tax laws have grown increasingly complex, and investment products have proliferated in type, number and complexity. Additionally, in today's complex world proper integration of financial, risk management, tax, and estate planning and investment advice is required in order to achieve each American's lifetime and testamentary goals.

As stated by Professor Macey in his 2002 white paper prepared for the Financial Planning Association, "[E]ffective financial planning is important to the success of a free-market economy. If people do not make careful, rational decisions about how to self-regulate the patterns of consumption and savings and investment over their life cycles, government will have to step in to save people from the consequences of their poor planning. Indeed the entire concept of government-sponsored, forced withholding for retirement (Social Security) is based on the assumption that people lack the foresight or the discipline, or the expertise to plan for themselves. The weaknesses in government-sponsored social security and

retirement systems places increased importance on the ability of people to secure for themselves adequate financial planning." *Regulation of Financial Planners*, April 2002, at p.2.

It has become increasingly clear that our inconsistent regulation of financial intermediaries, with the same functional activities regulated under different standards of conduct, has led many investors to substantial harm. The receipt of *truly objective* financial advice by consumers, under a standard in which the individual client's best interests remain paramount at all times, is more important today than it ever was. Despite this huge need, powerful forces oppose reforms to an antiquated system of product sales and voluminous conflicts of interests which serve to deny investors both the proper share of the returns the capital markets have to offer and the highly qualified advice investors deserve to avoid tax entanglements. Abuses are ripe and rampant, including 25% commissions on sales of equity-indexed annuities, sales of expensive and tax-inefficient variable annuities to senior citizens and others (with little discussion of the many detrimental affects of these products), continued pushing of life insurance products as "retirement savings vehicles," and the sale of expensive mutual fund products in which only a portion of the true costs of the products are disclosed in the funds' prospectuses. [*See* Bauer, Frehen, Lum and Otten, *The Performance of U.S. Pension Funds: New Insights into the Agency Costs Debate*, April 3, 2007; *also see* Rhoades, *Estimating The Total Costs of Stock Mutual Funds*, March 9, 2006]. I have personally seen the harm of the very low standard of "suitability" (which relates only to risk tolerance of a client, and not to fees and costs nor to suitability from a tax perspective, nor to suitability as to overall integration with planning decisions) as to hundreds of people who have come to me over the years after their receipt of "advice" from a product seller disguised as a "financial consultant" or "estate planner". Literally billions of dollars are at stake, as well as the financial futures of tens of millions of Americans, as the continued debate over the application of fiduciary duties to the activities of all financial advisory activities continues in the halls of Congress, our state legislatures, the SEC and state securities regulatory agencies, various securities industry professional and trade organizations, and among various financial intermediaries.

Given the prestige afforded the CFP Board, I urge the CFP Board (within the limits of its charter) to continue to participate in this public policy debate in order that high-quality, competent and ethical financial advice under the "best interests" standard can be afforded to all Americans, not just those who will be lucky enough, after the implementation of the *Second Exposure Draft*, to engage a Certified Financial Planner® or other investment fiduciary. The stakes for our country are too high. The CFP Board and other organizations and their leaders need to continue to pave the way for a better future for all Americans through adoption of the highest standards of conduct – those of a fiduciary – for all financial and investment advisory activities.

The CFP Board, in promulgating its *Second Exposure Draft*, is not alone in advocating the best interests of the client standard of conduct for those who provide financial and investment planning services. I note the recent support of the Financial Planning Association's Board of Directors in its actions approving further exploration of the application of the best interests standard to financial planning activities. The National Association of Personal Financial Advisors continues with its very successful "Focus on Fiduciary" campaign. The NASAA, many of the individual state securities regulators, the Consumer Federation of America, the AARP, and many other groups have expressed broad support for public policies which promote the application of fiduciary duties to all financial and investment advisory services.

The CFP Board, by *its Second Exposure Draft*, does not suggest that there is not a place for different compensation methodologies. Nor does the CFP Board suggest that fee-only financial planners do not possess conflicts of interest of their own; there will always be conflicts relating to compensation and these must be both fully disclosed and properly managed in order to keep the best interests of the client paramount. However, the CFP Board has, in this *Second Exposure Draft*, added to the growing tide of voices demanding professionalism from all those who seek to advice consumers of financial planning and investment advisory services. For this service to the public the CFP Board deserves much praise.

<u>C.2. 501(c)(3) Status of the CFP Board and Adherence To Its Mission.</u> As stated by the CFP Board to the U.S. Congress in May 2006: "Certified Financial Planner Board of Standards, Inc. (CFP Board) is a 501(c)(3) educational/certifying body a with a public mission. CFP Board owns the certification marks CFP®, CERTIFIED FINANCIAL PLANNER™ and federally registered CFP (with flame logo) in the U.S. and awards use of those marks to more than 50,000 people who have successfully completed initial and ongoing certification requirements designed to ensure that those certified are capable of providing competent and ethical financial planning services. CFP Board's mission also includes a public focus: to create awareness of the importance of financial planning and the value of the financial planning process and to help underserved populations have access to competent and ethical financial planning."

Given the mission of the CFP Board and its mandate to serve the public interest, it could easily be concluded that the CFP Board would not be serving the public interest if, given the recent developments in the common law, if it failed to adopt the "best interests of the client" standard and the "fiduciary duty of due care" standard for its Certificants. Hence, I congratulate the CFP Board for continuing to adhere to its mission "to help people benefit from competent, professional and ethical financial planning" by the development of uniform standards of conduct for all Certificants, which standards of conduct are in line with the requirements of the common law.

D. Specific Recommendations.

While there are likely to be many good specific recommendations regarding phrasing of various Rules, my recommendations are specific to the processes which may follow adoption of the Rules of Conduct, as the Rules are implemented and interpreted and as further guidance regarding the Rules is provided to Certificants.

<u>D.1. Enable the CFP Board's Legal Team to Respond To The Challenges Ahead.</u> The profession of financial planning, just a few decades removed from its roots at a famous meeting of 13 individuals in 1969, has evolved rapidly through the contributions of so many of its members over the years. The application of fiduciary standards of conduct to the profession of financial planning is in its infancy. As the CFP Board and its various disciplinary and other committees seek to apply the "best interests of the client" standard in the years ahead to the conduct of Certificants, it is important that the CFP Board "gets it right." To this end, fiduciary duties are derived from a combination of: (1) analogy (from duties identified from other professions); (2) continued reference to underlying principles of agency, tort and trust law; and (3) practical experience and sound reasoning. Given the likely volume of requests for interpretation and for advisory opinions over the coming years, I believe the CFP Board should look to expand (if it has not already done so) its already high-caliber legal team, in order to provide due

consideration of the legal principles involved whenever the CFP Board or its committees are required to address the Rules of Conduct. It is extremely important that fiduciary principles be applied correctly to the activities of financial planners, and that inappropriate exceptions not be permitted to erode the "highest standard under the law."

Fiduciary duties are befuddling to many, especially those who lack the ability or the foresight to fully understand their meaning and importance or who are predisposed by their own economic interests to deny the existence of fiduciary duties and their profound impact upon the financial advisor – client relationship. Evidence of the lack of understanding of fiduciary principles and the great protection afforded to clients of fiduciary financial advisors can be found in recent statements by SIFMA and the NASD ("Although brokers are regulated differently than are investment advisers, it is misleading to suggest that they are regulated less stringently. Investors receive robust protections from both." - Marc Lackritz, President and CEO, SIFMA, *Investment News*, April 16, 2007; "[T]he FPA's arguments reflect a widespread belief that an adviser's fiduciary duty provides a much greater level of protection to investors than broker-dealer rules. However, a careful analysis of the relative regulatory standards shows that the substantive protections afforded broker-dealer customers are equivalent to, and in many cases exceed, those afforded to adviser customers." - Mary L. Schapiro, Vice Chairman and President, Regulatory Policy and Oversight, NASD, comment letter to the SEC, April 4, 2005.) Query as to why SIMFA and its members resist the application of fiduciary duties so much, if they believe that no additional substantive protection is provided to their investor customers. Indeed, I find it alarming that SIFMA and NASD should so completely lack an understanding of fiduciary duties – "the highest duties under the law" and by far the greatest protection for investors. SIFMA's resistance to the application of the "best interests of the client" standard to broker-dealer firms is indicative of what may constitute its true agenda – the avoidance of high standards of conduct for broker-dealer firms and their registered representatives, knowing that the imposition of fiduciary standards would affect the excessive profits of its member firms through a consequential reduction in agency costs. One can only wonder if traditional large broker-dealer firms, with their myriad of affliliates and substantial conflicts of interest, are but "dinosaurs," and whether the alarming statements promulgated by SIFMA and the NASD are just the death throes of a conflict-ridden product-sales system as the next great extinction event approaches.

Fiduciary law finds its roots in "constructive fraud," which it turn finds it roots in agency and trust law, which in turn finds its roots in various legal principles derived from codes of antiquity. Understanding fiduciary law, and its nuances, is essential to its proper application to the activities of financial planners. Hence, I would encourage the CFP Board to empower its legal team to formulate a reference of "fiduciary law" as it applies to financial planners, which might include a library of various case law, Restatements of the Law (Agency, Trusts), SEC speeches and administrative law judge and other decisions applying fiduciary principles, academic articles (law journals, etc.), and other source material. Incorporation of the work of other organizations, such as the FPA® Fiduciary Task Force's "Preliminary Report" dated February 15, 2007 (found on the Financial Planning Association's web site) may also be helpful in the construction of a better understanding of fiduciary principles as they apply to financial planners, generally, and the CFP Board's Certificants, specifically.

<u>D.2. Further Development of the Rules of Conduct.</u> The CFP Board should seek to undertake further development of the professional rules of conduct. Alternatively, the CFP Board could award grants to

qualified recipients to further explore the development of professional standards of conduct, or could join with other organizations (FPA, NAPFA, IAA, etc.) to explore further development (with specificity) of the professional standards of conduct. A more specific enumeration of fiduciary duties would better serve to guide the CFP Board's Certificants.

D.3. Consider Adding "Commentary" To The Rules of Conduct. The various written explanations found in the "Q&A" accompanying the release of the *Second Exposure Draft*, and the many verbal comments of the members of the Ethics Task Force from the March 30, 2007 conference, could serve as a foundation for "commentary" to the Rules of Conduct. As exist in many professional codes of conduct, "commentary" following each rule serves to permit greater understanding of each rule by providing further explanation and, where appropriate, the context behind a rule's adoption.

D.4. Consider Publishing "Annotated Rules of Conduct" Periodically. While I am in favor of defining by expansion of the written rules various more specific Rules of Conduct, such as those which may address due diligence in investment product recommendations, duties with respect to proper consideration of fees, costs and taxes, etc., I also support the CFP Board's additional development of the Rules of Conduct through advisory opinions on hypothetical fact scenarios and the application of the Rules of Conduct to specific fact patterns in the context of enforcement proceedings. I would urge the CFP Board to empower its legal team to compile, update and periodically publish an "Annotated Rules of Conduct" for the benefit of its Certificants, in order that Certificants can more easily study and review the Rules of Conduct and better understand how they may apply to their practices.

D.5. Consider Fostering Educational Efforts Of Certificants. The CFP Board has long been a supporter of programs to foster greater understanding by financial consumers of financial planning and investment comments, and these efforts are laudatory and should continue. However, the complexity of today's financial world, with a complicated maze of tax laws, investment theories, securities and insurance products, and financial planning decisions, will dictate that the vast majority of consumers will require the hand of a trusted, objective financial planner. If the CFP Board were to more directly foster advanced educational efforts for financial planners, such as the development of a set of "best practices," and by doing so further educate half of its Certificants, those 25,000+ Certificants could each positively impact the lives of perhaps 100 or more clients apiece. In other words, in addition to ongoing efforts to provide financial education to the public, the CFP Board could support efforts which seek to educate its Certificants in such matters as how to undertake better due diligence in the analysis of investment products, how to reduce the tax burden for individual investors over their lifetimes (and for heirs), and how to better manage various risks which Americans face over their lifetime. This could lead to a potential positive impact upon the lives of millions of Americans. I would encourage the CFP Board to continue its work with other organizations, such as the FPA, NAPFA, and IAA, to foster greater understanding of the Rules of Conduct and the promulgation of "best practices" for financial planners.

D.6. Consider Requiring Tax-Specific Continuing Education. Given the important role income taxes play in financial planning and investment decisions, I suggest that the CFP Board consider amending its continuing education requirements to require a minimum number of hours for Certificants in approved individual income tax educational sessions.

D.7. Continue To Support Public Policy Initiatives. Within the limits of its charter, and in furtherance of its mission, the CFP Board should seek to continue to advocate on behalf of its constituency (consumers of financial planning services), the proper application of fiduciary duties to all financial planning and financial advisory activities, and to all those who hold themselves out as "financial planners," "financial consultants," "financial advisors," "estate planners," "wealth managers," "asset protection planners," "wealth consultants," and similar terms. I hope to submit, within the next several weeks, additional comments as to a direction in which further initiatives might be directed.

In conclusion, I again thank the CFP Board for the opportunity to submit these commits, and for the dedication, foresight, and diligence undertaken in the development of the *Second Exposure Draft*. The courage shown by the CFP Board is to be applauded, and as set forth herein its decisions to adopt the bests interests standard and fiduciary standard of care for its Certificants rest upon sound legal principles. I thank the CFP Board for its ongoing service to the emerging profession of financial planning, on behalf of the best interests of all Americans.

If I can be of assistance, please contact me. Thank you.

Very truly yours,

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