Ron A. Rhoades, B.S., J.D., CFP®
2450 N. Citrus Hills Blvd., Hernando, FL 34442-5348
Phone: 352.746.4460   Toll-Free: 866.746.4460
E-mail: rrhoades@josephcapital.com

July 31, 2006

Via e-mail to: mail@CFPBoard.org

Certified Financial Planner Board of Standards, Inc.
c/o Tim Stifel
1670 Broadway, Suite 600
Denver, CO 80202-4809

Re: Alternate Draft, CFP® Rules of Professional Conduct

Dear Mr. Stifel:

Alternate Draft Presented for "CFP® Rules of Professional Conduct." I believe it is incumbent upon those who oppose the direction taken by the CFP Board to also suggest an alternative proposal to the standards of conduct which should govern CFP® Certificants. In the present instance I seek to demonstrate to the CFP Board that it is possible to develop reasonable standards of conduct based upon fiduciary principles. Hence, I enclose alternate proposed draft of CFP® Rules of Professional Conduct for consideration by the CFP Board during its upcoming deliberations and for purposes of fostering discussion of these important principles.

The Key Issue Of The Fiduciary Standard As Applying To All Financial Planning Activities. I previously commented, by letter dated July 27, 2006, and in that correspondence[1] I set forth the legal rationale behind the imposition of the fiduciary standard upon all CFP® Certificants who are providing financial planning advice.[2] The issue of fiduciary status for all CFP® Certificants engaged in financial planning activities is the paramount issue before the CFP Board, and its resolution will determine not only the content of the Rules of Conduct but, perhaps, as well, the very existence of financial planning as a discrete profession in the years ahead and the future existence of the CFP Board of Standards, Inc.

---

[1] A copy of prior comment letter can be found at my firm's web site at www.JosephCapital.com under "Resources" and then under "SEC Comments.

[2] For the reasons given in my prior comment letter, I disagree with the proposal to grant to CFP® certificants the ability to renounce or disclaim fiduciary status, for important reasons relating to the development of financial planning as a profession, the need to protect clients who do not possess the knowledge to protect themselves from those in a far superior position of knowledge and expertise in those situations in which a close relationship based upon trust and confidence arises, and due to public policy concerns.

Candid Discussions Should Follow. I am aware that many of the Rules which I advance, which provide greater specificity in the guidance of conduct of CFP® Certificants than the CFP Board's proposed revised rules of conduct, may be controversial. This draft is presented to foster discussion of these important issues with the view to enabling the practice of the Certified Financial Planner™ to move forward as a profession based upon fiduciary principles. All who seek to participate in the debate and discussion ahead should welcome the advancement and discussion of different points of view with the goal of encouraging the continued development of the profession and the advancement of the public good.

Request To The CFP Board For Referral Of Exposure Draft, and This Alternate Draft, Back to Committee. Attached hereto is a preliminary alternate draft of **CFP® Model Rules of Professional Conduct**. I urge the CFP Board to undertake the following actions:

- Adopt fiduciary principles, for the sake of the profession of financial planning, the clients we serve, and the general public, to the effect that financial planning services should and must always be performed by CFP® Certificants under the protective umbrella of the fiduciary standard of conduct.

- Refer the CFP Board's Exposure Draft back to a committee for the purpose of formulation of a "First Amended Exposure Draft" based upon fiduciary principles, for later presentation to the CFP Board and subsequent release to the public for commentary. In this regard, it is self-evident that no one has a monopoly on the judgment and insight that such a comprehensive evaluation of professional standards demands. Sessions of a committee charged with formulation of an Amended Exposure Draft should be open both intellectually and in the physical sense of an open town meeting. Anyone who wants to share their views should need only to ask. Many others, representing specific areas of expertise or particularly crucial and controversial points of view, should be invited to attend committee meetings and to share their time, skill and expertise. Additionally, a wide variety of resources on standards of conduct should be reviewed, including but not limited to the following rules and standards (from which much of the enclosed text was compiled and derived):
    A. Investment Advisers Act of 1940 and Rules Promulgated By the S.E.C.
    B. Certified Financial Planner Board of Standards: Financial Planning Practice Standards
    C. Certified Financial Planner Board of Standards: Code of Ethics and Professional Responsibility
    D. International Organization for Standardization - Uniform Standards of Conduct (in development)
    E. FPA's Code of Ethics
    F. NAPFA's Code of Ethics and Fiduciary Oath
    G. AICPA's Statements on Responsibilities in Personal Financial Planning Practice
    H. CFA Centre for Financial Market Integrity's Asset Manager Code of Professional Conduct
    I. Investment Adviser Association - Best Practices for Investment Adviser Codes of Ethics
    J. Center for Fiduciary Studies and related organizations and resources

- Then publish a "First Amended Exposure Draft" for purposes of commentary and discussion. Comments which are submitted should be made publicly available as a means of fostering discussion.

Great Care and Deliberation Is Required; No Rush Should Be Undertaken To Adopt Revised Rules of Conduct. The adoption of revised rules and standards governing the conduct of CFP® Certificants is not a process to be rushed or hurried. Other professional organizations have proposed codes of conduct, only to have them substantially re-written and then re-proposed, often time and time again, over many years. Hence, it is incumbent upon the CFP Board to refer the current draft back to a committee of experienced CFP® Certificants and other skilled participants, with guidance from the CFP Board that fiduciary principles are always to be followed.

Even though any code or rule can be amended following its actual adoption, it is highly important to "get it right" the first time, in order to demonstrate and affirm to the securities industry, state and federal regulators, and the general public that the Certified Financial Planner Board of Standards, Inc. is the leading organization in the United States, and the world, with respect to the establishment of practice standards for the emerging profession of financial planning. While, in the end, every ethical rule must be tested against real situations, through care and diligence the fundamental principles of the profession of financial planning can be firmly established.

Preserve The Future Of Our Profession and That Of the CFP Board. There are important questions facing the CFP® Certificant community. "What environment do we want to create?" "What environment do we want to work in?" I fear for the continued viability of the CFP Board should fiduciary principles not be embraced, as many CFP® Certificants would likely turn to other or new organizations which do adopt fiduciary principles to govern their conduct as professionals. I would again urge the CFP Board to set the tone for application of fiduciary duties to all CFP® Certificants, to adopt standards of conduct which elaborate upon these important principles, and to provide guidance to all Certificants as they go about the profession of financial planning.

Thank you again for the opportunity to submit these comments. I appreciate the hard work of the CFP Board as its seeks to tackle these all-important and extraordinarily complex issues.

Very truly yours,

Ron A. Rhoades, B.S., J.D., CFP®

Enclosure: **Proposed (Alternate) Draft,**
CFP® Rules of Professional Conduct

Copy with enclosures to:
Daniel B. Moisand, CFP®, President, Financial Planning Association (FPA)
Ms. Ellen S. Turf, Chief Executive Officer, National Association of Personal Financial Advisors (NAPFA)

Preliminary Comment Regarding the Format of These Proposed CFP® Rules of Professional Conduct: No Separate "Code of Ethics" or "Best Practices." The CFP Board's Exposure Draft envisions a three-part approach of: (1) *Code of Ethics and Professional Responsibility* (aspirational in nature); (2) *Rules of Conduct*; and (3) *Best Practices*. I have adopted a different layout and format for the proposed draft CFP® Rules of Professional Conduct enclosed. This format falls in line with other professional practice standards, such as the American Bar Association's "Model Rules of Professional Conduct." This approach reflects the views that:

(A) Separate aspirational standards results in duplication of language with other parts of the actual mandatory rules of conduct and/or disciplinary provisions;

(B) A CFP® Certificant's verbal or written statement that he or she complies with the CFP Board's Code of Ethics might be viewed misleading, given the aspirational and non-mandatory nature of the Code of Ethics;

(C) Clients can easily be confused by the existence of one code which is aspirational only, while another code or set of rules with similar language imposes mandatory obligations; and

(D) Ethical considerations may be viewed by courts and other tribunals or disciplinary bodies as setting forth obligations under the law which lie beyond those required by the actual CFP® Rules of Professional Conduct..

Hence, I have instead adopted a *"Commentary"* below each of the draft CFP® Rules of Professional Conduct. I believe this is the appropriate place to elaborate on each proposed Rule's meaning and its potential applicability to different situations. Hence, under each proposed Rule is text explaining the meaning and/or legal basis of the proposed Rule and its application to one or more situations.

It is further my belief that "best practices," which may incorporate non-binding elements as well as binding elements, and which evolve over time, are best suited for advancement through continuing educational materials and publications, hopefully authored by experienced CFP® Certificants who are willing to share their views, observations, and insights and who will seek to advance the profession as such. For example, one such publication might be an "Annotated CFP® Rules of Professional Conduct," to be authored and published by the CFP Board itself. Such a publication might include a detailed discussion of each Rule's meaning, application and interpretation, with citations to cases, disciplinary proceedings, and ethics opinions, references to articles in the *Journal of Financial Planning* and other periodicals and books, and the relevant sections of the Restatements of the Law which may be pertinent to the subject matter. As a precursor to such an effort, I have sometimes added *"Annotations"* of my own to the enclosed draft CFP® Rules of Professional Conduct. I do this an aid to any committee in further discussions. However, I suggest that such annotations would properly cite to case law, including prior ethics opinions of the CFP Board, disciplinary proceedings, and other sources, in a true "Annotated" rules publication.

Additional Preliminary Comment: My Focus On The Fiduciary Duties of Certificants. In presenting this draft, I have intentionally focused on those rules which relate to the fiduciary duties of Certificants. Accordingly, I have left much of the draft incomplete, in order to not duplicate the efforts on the remaining sections nor detract from the focus of these comments.

- PROPOSED DRAFT -

CFP® MODEL RULES OF PROFESSIONAL CONDUCT

Preliminary draft submitted to the
Certified Financial Planner Board of Standards, Inc.
by Ron A. Rhoades, B.S., J.D., CFP®

July 31, 2006

CFP® RULES OF PROFESSIONAL CONDUCT (July 31, 2006 Draft)

Table of Contents.

Preamble and Scope 7

Rule 1. Terminology. 8

Rule 2. Professionalism. 10
- 2.1. Knowledge of Applicable Laws, Regulations, and Standards of Conduct 10
- 2.2. Truthfulness 12
- 2.3. Acting With Integrity 12
- 2.4. Role of Certificant As An Advisor 13

Rule 3. Fiduciary Duty of Loyalty to Clients 14
- 3.1. General Duty of Loyalty To Clients 14
- 3.2. Reasonable Avoidance of Conflicts of Interest 21
- 3.3. Disclosure and Proper Management of Non-Avoided Conflicts of Interest 23
- 3.4. Addressing Conflicts of Interest Arising From Duties Owed To Multiple Distinct Clients 28
- 3.5. Relationship With Clients Possessing Diminished Capacity 29
- 3.6. Non-Waiver of Duty of Loyalty 29

Rule 4. Fiduciary Duty of Due Care To Clients 31
- 4.1. Standard of Due Care 31
- 4.2. Achieving and Maintaining Professional Competence 32
- 4.3. When Consultation Required With Other Professionals 33
- 4.4. Diligence in the Delivery of Services 33
- 4.5. Duty To Gather Necessary Facts 33
- 4.6. Suitability As To Recommendations of Investment Products 33
- 4.7. Reasonableness of Total Fees and Costs Borne By Client 34
- 4.8. Proper Consideration of Tax Reduction Strategies 35
- 4.9. Due Diligence In Investment Product Selection 36

Rule 5. Fiduciary Duty of Confidentiality to Clients 37
Rule 6. Defining The Nature and Scope of The Engagement 37
Rule 7. Securing Client's Property 37
Rule 8. Relationships Between Certificant And His Or Her Firm 38
Rule 9. Obligations of Certificant to the CFP Board 40

CFP® RULES OF PROFESSIONAL CONDUCT

Preamble and Scope

The CFP® Rules of Professional Conduct govern the performance of professional financial planning services by individuals who are currently certified by Certified Financial Board of Standard, Inc. ("CFP Board") as a Certified Financial Planner™ and certain others. The CFP Board promulgates these CFP® Rules of Professional Conduct. Those who utilize the Certified Financial Planner™ designation or CFP® mark are bound to adhere to these CFP® Rules of Professional Conduct.

The CFP® Rules of Professional Conduct were adopted by the CFP Board to provide guidance and rules to all CFP® Certificants – those in public practice, in industry, in government, and in education, in the performance of financial planning services. Compliance with the CFP® Rules of Professional Conduct, as with all standards in an open society, depends primarily on the understanding and voluntary actions of CFP® Certificants, secondarily on reinforcement by peers and public opinion, and ultimately on disciplinary proceedings, when necessary, against CFP® Certificants who fail to comply with the Rules.

The CFP® Rules of Professional Conduct establish a minimum level of professionalism required of CFP® Certificants. The CFP® Rules of Professional Conduct are binding on CFP® Certificants regardless of their title, position, type of employment or method of compensation, and govern all those who have the right to use CFP Board's marks, whether or not those marks are used. Violations of the CFP® Rules of Professional Conduct may give rise to CFP Board disciplinary causes of action. While they are not designed to be a basis for legal liability to third parties, CFP Board and CFP® Certificants must expect that the CFP® Rules of Professional Conduct might be used by third parties for such liability and other purposes.

The ethical principles which underlie the CFP® Rules of Professional Conduct express the profession's recognition of its responsibilities to the public, to clients, and to colleagues. They guide CFP® Certificants in the performance of their professional responsibilities, call for an unswerving commitment to honorable behavior, and elevate the best interests of the client as paramount among any competing considerations. Consistent with their professional role, CFP® Certificants possess a continuing responsibility to cooperate with each other to improve the profession of financial planning, to enhance and maintain the public's confidence in the profession, and to carry out the profession's responsibilities for self-governance.

The Certified Financial Planner Board of Standards, Inc. continues to pursue its goal of assuring the highest standards of professional competence and ethical conduct.

Rule 1. Terminology.

(a) "Belief" or "believes" denotes that the person involved actually supposed the fact in question to be true. A person's belief may be inferred from circumstances.

(b) "Certificant" denotes individuals who are currently certified by CFP Board and individuals who have been certified by CFP Board in the past but are not currently certified and have any entitlement, direct or indirect, to the CFP® certification marks. This includes individuals who have relinquished their certification and who may apply for reinstatement without being required to pass the current CFP® Certification Examination.

(c) "CFP Board" denotes the Certified Financial Planner Board of Standards, Inc.

(d) "Client" denotes a person, persons, or entity who engages a certificant and for whom professional services are rendered for compensation. Where the services of the certificant are provided to an entity (corporation, trust, partnership, estate, etc.), the client is the entity acting through its legally authorized representative.

(e) "Commission" denotes the compensation generated from a transaction involving a product or service and received by an agent or broker from a party other than the client, usually calculated as a percentage on the amount of his or her sales or purchase transactions.

(f) "Compensation" is any non-trivial economic benefit, whether monetary or non-monetary, that a certificant or related party receives from performing his or her professional activities.

(g) "Conflict(s) of interest" exists when a certificant's financial, business, property and/or personal interests, relationships or circumstances reasonably may impair his/her ability to offer objective advice, recommendations or services.

(h) "Fee-only." A certificant may describe his or her practice as "fee-only" if, and only if, all of the certificant's compensation from all of his or her client work comes exclusively from the clients in the form of fixed, flat, hourly, percentage or performance-based fees. A certificant may describe an individual agreement with an individual client as a fee-only arrangement if the certificant's compensation for that client comes exclusively from fees paid by the client in flat, hourly, fixed, percentage or performance-based fees. A certificant who has both fee-only and non-fee-only client compensation agreements may not refer to him or herself as a fee-only certificant.

(I) A "financial planning engagement" exists when a client signs a binding written agreement under which a certificant performs some type of financial planning service.

(j) "Firm" denotes the Certificant's employer (whether it is a broker-dealer firm, insurance agency or broker or company, registered investment adviser, or other form of business or non-profit organization, and regardless of whether the Certificant is an employee or independent contractor of the organization.

(k) "Knowingly," "known," or "knows" denotes actual knowledge of the fact in question. A person's knowledge may be inferred from circumstances.

(l) "Material conflicts of interest" denote those conflicts of interest which a reasonable disinterested Certificant would take it into account in exercising judgment or making a decision.

(m) "Personal financial planning" or "financial planning" denotes the process of determining whether and how an individual can meet life goals through the proper management of financial resources. It is not necessary to provide a written financial plan to engage in financial planning.

(n) "Personal financial planning process" or "financial planning process" denotes a process for providing any type of financial planning service which typically includes, but is not limited to, one or more of these six elements:

- establishing and defining the client-planner relationship;
- gathering client data including goals;
- analyzing and evaluating the client's current financial status;
- developing and presenting financial planning recommendations and/or alternatives;
- implementing the financial planning recommendations; and
- monitoring the financial planning recommendations.

(o) "Personal financial planning subject areas" or "financial planning subject areas" denotes the basic subject fields that may be covered, all or in part, in the financial planning process, which typically include, but are not limited to, financial statement preparation and analysis (including cash flow analysis/planning and budgeting), investment planning (including portfolio design, i.e., asset allocation and portfolio management), income tax planning, education planning, risk management, retirement planning and estate planning.

(p) "Reasonable" or "reasonably" when used in relation to conduct by a Certificant denotes the conduct of a reasonably prudent and competent Certificant.

(q) "Reasonable belief" or "reasonably believes" when used in reference to a Certificant denotes that the Certificant believes the matter in question and that the circumstances are such that the belief is reasonable.

(r) "Writing" or "written" denotes a tangible or electronic record of a communication or representation, including handwriting, typewriting, printing, photostating, photography, audio or videorecording and e-mail. A "signed" writing includes an electronic sound, symbol or process attached to or logically associated with a writing and executed or adopted by a person with the intent to sign the writing.

Rule 2. Professionalism.

2.1 Knowledge of Applicable Laws, Regulations, and Standards of Conduct. Certificants must understand and comply with all applicable laws, regulations, and standards of conduct (including but not limited to the CFP® Rules of Professional Conduct) of any government, government agency, regulatory organization, licensing agency, or professional association governing their professional activities. In the event of conflict, Certificants must comply with the more strict law, regulation, or standard of conduct, provided that in all events Certificants shall not violate any law. Certificants must not knowingly participate or assist in and must dissociate from any violation of such laws, rules, or standards of conduct.

Commentary. CFP® Certificants should also consult, if applicable, the laws and regulations falling within the purview of the U.S. Securities and Exchange Commission, the laws and regulations promulgated by various state or territorial securities administrators, the regulations promulgated by the National Association of Securities Dealers (NASD) and other self-regulatory organizations and exchanges, any other governmental agency or organization which may regulate the CFP® Certficant and her or his actions, and the ethical standards of other professional organizations to which the CFP® Certificant may belong. Additional laws may apply to the financial planning activities of CFP® Certificants, including Regulation S-P (privacy requirements) and anti-money laundering requirements.

Standard of conduct are collectively to the rules the laws, government regulations, professional association ethical rules and internal principles of a firm that guide the structure, systems, procedures, and day-to-day decisions of the CFP® Certificant. They also include the rights and entitlements of individuals established by contract or the assumption of a certain status under the law. Hence, the CFP® Rules of Professional Conduct are but one part of a larger puzzle each Certificant must apply to his or her conduct.

It is the view of the CFP Board of Standards, Inc. that financial planning is a profession and should be regulated as such. The CFP Board acknowledges that the varying standards of conduct which are applicable to the same functional activities, including financial planning activities, has generated much discord between investment advisers and broker dealers, and is the subject of much demonstrated concern by consumer groups. This controversy became the central focus of the SEC's recent rule-making relating to defining what constitutes "solely incidental" investment advice for purposes of fee-based brokerage accounts. These CFP® Rules of Professional Conduct are not designed to enter into that fray. Rather, the purpose of the CFP® Rules of Professional Conduct is to promote the practice by Certificants as a profession, and an essential aspect of professionalism is the application of positive duties to those who seek to practice in the profession. As stated by John G. Bruhn , Gary Zajac , Ali A. Al-Kazemi , Loren D. Prescott Jr., in their paper “Moral positions and academic conduct: Parameters of tolerance for ethics failure” (Journal of Higher Education, Vol. 73, 2002):

> A profession is defined as an occupation that regulates itself through systematic, required training and collegial discipline; that has a base in technical, specialized knowledge; and that has a service rather than profit orientation, enshrined in a code of ethics (Reader, 1966). Wilson (1942) has suggested six criteria as the framework for a profession: (1) prolonged and specialized training, (2) rigorous standards of licensure, (3)

competency tests cannot be simply deduced, (4) absence of contractual terms of work (5) limitation upon the self-interest of the practitioner and an insulation from extraneous matters, (6) positive obligations to the profession and its clientele.

Achieving and maintaining certificate status with the CFP Board by Certificants is voluntary. By entering into agreements with the CFP Board, the Certificant assumes an obligation of self-discipline above and beyond the requirements of laws and regulations.

Annotations. Various different laws may apply to the conduct of Certificants. Just a few are discussed below.

On June 22, 2000, the Securities and Exchange Commission ("SEC") issued its final rule regarding the obligation of broker-dealers, investment companies and SEC-registered investment advisers to protect the financial privacy of their consumers. The rule, Regulation S-P, implements the privacy requirements of the Gramm-Leach-Bliley Act. Regulation S-P is identical in virtually all essential respects to the privacy rules adopted by the federal banking regulators and the Federal Trade Commission ("FTC"). The FTC privacy rule also applies to state-registered investment advisers. All references to the "privacy rule" in this overview apply to both the SEC and FTC rules on privacy. The rule embodies two core principles – notice and the right to opt out. All investment advisers and broker-dealers, among others, must deliver initial and annual privacy notices that describe in general terms the firm's information sharing and collecting practices. Firms that share nonpublic personal information about consumers with nonaffiliated third parties, unless covered by one of the rule's exceptions, must also provide consumers with an opt out notice and a reasonable period of time for the consumer to opt out (30 days). A further discussion of confidentiality requirements, including a sample privacy notice and suggestions for obtaining client consent to various disclosures which Certificants may be obligated to make, can be found in the annotations to Rule 5, "Fiduciary Duty of Confidentiality to Clients."

The Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001 ("USA PATRIOT Act"), or USA PATRIOT Act, extended the regulations applying the antimoney laundering provisions of the Bank Secrecy Act ("BSA") beyond banks and certain other institutions that offer bank-like services or that regularly deal in cash to financial institutions, such as registered and unregistered investment companies. Money laundering has been defined as a criminal activity that occurs when money from illegal activity is moved through the financial system to make it appear that the funds come from legitimate sources. Money laundering also supports terrorism and terrorist organizations. Money laundering involves three stages: 1. placement – placing funds/cash into the financial system; 2. layering – distancing the illegal funds from their criminal source through complex layers of financial transactions; and 3. integration – illegal funds appear as derived from a legitimate source. In the US anti-money laundering legislation came into existence in 1970 with the Bank Secrecy Act, strengthened in 1986 with the Money Laundering Control Act and brought center stage with the USA PATRIOT Act of 2001, after 9/11/2001. The CFP Board expects all Certificants to adopt reasonable measures to combat money laundering. In the current climate, not making basic anti-money laundering efforts can expose a business to significant risk to reputation regardless of whether antimoney laundering rules are technically applicable.

The requirements of ERISA may apply to Certificants who deal with certain employee benefit plans. ERISA is generally shorthand for the fiduciary rules that apply to private employee benefit plans and certain tax-qualified retirement/savings accounts. In other words, ERISA can refer to either the fiduciary provisions under Title I of ERISA or the prohibited transaction rules under the Code. Fiduciary standards of care (prudence, loyalty, diversification, plan document, bonding, co-fiduciary responsibility, trust requirement, indicia of ownership) beyond those set forth in these CFP® Rules of Professional Conduct may apply to a Certificant by ERISA.

2.2. Truthfulness. Certificants must not knowingly make any misrepresentations relating to investment analysis, recommendations, actions, or other professional activities.

Commentary. All oral and written statements made by Certificants, including those made to clients, prospective clients, their representatives, other advisors of the client, other third parties, or the media, must be professional, accurate, balanced, and not misleading in any way.

2.3. Acting With Integrity. Certificants must not engage in any professional conduct involving dishonesty, fraud, or deceit or commit any act that reflects adversely on their professional reputation, integrity, or competence.

(a) ***Dealings With Third Parties.*** **In the course of representing a client a Certificant shall not knowingly make a false statement of material fact or law to a third person, nor fail to disclose a material fact to a third person when disclosure is necessary to avoid assisting a criminal or fraudulent act by a client.**

(b) ***Prohibitions Designed To Protect Integrity of The Capital Markets.*** **Certificants who possess material nonpublic information that could affect the value of an investment must not act or cause others to act on the information. Certificants must not engage in practices that distort prices or artificially inflate trading volume with the intent to mislead market participants.**

Commentary. Certificants should not defraud such client in any manner. Certificants should not mislead any client, whether by affirmative statement or by making a statement that omits material facts. Certificants should not engage in any act, practice or course of conduct which operates or would operate as a fraud or deceit upon a client. Certificants should not engage in any manipulative practice with respect to a client.

As to third parties, Certificants should not assist any client in the undertaking of a criminal or fraudulent act or practice. Nor should Certificants mislead third parties, whether by affirmative statement or by making a statement that omits material facts.

Certificants should not engage in any manipulative practice with respect to securities, including price manipulation or insider trading.

To maintain and broaden public confidence, Certificants should perform all of their professional responsibilities with the highest sense of integrity. Integrity is an element of character fundamental to professional recognition. It is the quality from which the public trust derives and the benchmark against which a member must ultimately test all decisions.

Integrity requires a Certificant to be, among other things, honest and candid within the constraints of client confidentiality. Service and the public trust should not be subordinated to personal gain and advantage. Integrity can accommodate the inadvertent error and the honest difference of opinion; it cannot accommodate deceit or subordination of principle.

Integrity requires a Certificant to observe the fiduciary duties of loyalty and of due care owed to all clients.

Ethical codes, including the CFP® Rules of Professional Conduct, are limited in nature. The Rules greatly oversimplify the hard questions which may confront the Certificant. In the mind of the Certificant, issues of professional responsibility should not be resolved as if they were issues of statutory construction. Rather, integrity is measured in terms of what is right and just. In the absence of specific rules, standards, or guidance, or in the face of conflicting opinions, a Certificant should test decisions and deeds by asking: "Am I doing what a person of integrity would do? Have I retained my integrity?" Integrity requires a member to observe both the form and the spirit of technical laws, regulations and rules of professional conduct; circumvention of laws, regulations or rules of professional conduct constitutes subordination of judgment.

Annotations. The antifraud provisions of Section 206 of the Advisers Act [15 U.S.C. 80b-6] and the rules adopted by the SEC thereunder apply to any person who is an investment adviser as defined in the Advisers Act, whether or not the person is required to be registered with the SEC as an investment adviser. Sections 206(1) and (2) of the Investment Advisers Act of 1940, upon which many state antifraud provisions are patterned, make it unlawful for an investment adviser, directly or any indirectly, to "employ any device, scheme, or artifice to defraud client or prospective client" or to "engage in any transaction, practice, or course of business which operates as a fraud or deceit upon any client or prospective client." As the U.S. Supreme Court stated in Securities and Exchange Commission v. Capital Gains Research Bureau, Inc., its seminal decision on the fiduciary duty of an adviser under the Investment Advisers Act of 1940:

> The Investment Advisers Act of 1940 reflects a congressional recognition of the delicate fiduciary nature of an investment advisory relationship as well as a congressional intent to eliminate, or at least to expose, all conflicts of interest which might incline an investment adviser—consciously or unconsciously—to render advice which was not disinterested.

2.4 Role of Certificant As An Advisor. **In representing a client a Certificant shall exercise independent professional judgment and render candid advice. In rendering such advice a Certificant may refer not only to core competencies achieved by the Certificant but to other considerations such as moral, health, economic, familial, social and political factors that may be relevant to the client's situation.**

Rule 3. Fiduciary Duty of Loyalty to Clients.

3.1. General Duty of Loyalty To Clients. A Certificant, who is given the highest degree of trust and confidence by the Certificant's client, is a fiduciary and possesses the duty of undivided loyalty to the client. A Certificant shall at all times act in the best interests of his or her clients, in utmost good faith, honestly and without intimidation.

Commentary. Fiduciaries have a duty, created by undertaking certain types of acts, to act primarily for the benefit of another in matters connected with such undertaking. We utilize the term "fiduciary" 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, as 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 "entrustor" or "client" were the fiduciary's own.

The greater the knowledge, experience and required degree of expertise of the fiduciary, relative to the knowledge and experience of the client, the more significant the fiduciary association becomes as a protector of the client's interest. Clients in receipt of financial planning services will nearly always start off, in their discussions with CFP certificants, from a position of contractual weakness and, as to the complexities of tax law, financial planning issues, estate planning issues, insurance, risk management issues, and investments, from the position of relative ignorance. Fiduciary status is thereby imposed by the law upon the party with the greater knowledge and expertise, in this instance the Certificant, in recognition by the law that the client is in need of protection and care.

Each party to a fiduciary relationship possesses the opportunity to consent to the relationship or to terminate the relationship. Fiduciary rules therefore reflect a consensual arrangement covering special situations in which fiduciaries promise to perform services for clients and receive substantial power to effectuate the performance of the services in circumstances in which the clients cannot efficiently monitor the fiduciaries' performance.

The duty of loyalty is a duty imposed upon a Certificant, as the Certificant possesses a fiduciary relationship to his or client. Certificants must take only those actions that are within the best interests of the client. The fiduciary should not act in the fiduciary's own interest. Engaging in self-dealing, misappropriating a client's assets or opportunities, having material conflicts of interest, or otherwise profiting in a transaction that is not substantively or "entirely fair" to the client may give rise breaches of the duty of loyalty. High standards of conduct are required when advising on *other people's money*.

Traditionally, the duty of good faith has been closely related to the concept of loyalty. However, reckless, irresponsible or irrational conduct – but not necessarily self-dealing conduct – will implicate concepts of good faith and cause a Certificant to be in breach of this Rule.

Honesty is fundamental to the role of the fiduciary. It means that the Certificant must act bona fide in the interests of the client. In exercising the Certificant's discretion, the Certificant should act only to promote and advance the interest of the client.

Certificants shall not engage in heavy-handed sales pressure or intimidation with either clients or prospective clients who seek financial planning services.

Annotations. The U.S. Securities and Exchange Commission's comments regarding the necessity for imposition of fiduciary duties on those who provide comprehensive financial advice upon learning the details of a client's financial affairs should not go unnoticed:

> The record discloses that registrant's clients have implicit trust and confidence in her. They rely on her for investment advice and consistently follow her recommendations as to the purchase and sale of securities. Registrant herself testified that her clients follow her advice 'in almost every instance.' This reliance and repose of trust and confidence, of course, stem from the relationship created by registrant's position as an investment adviser. *The very function of furnishing investment counsel on a fee basis – learning the personal and intimate details of the financial affairs of clients and making recommendations as to purchases and sales of securities – cultivates a confidential and intimate relationship and imposes a duty upon the registrant to act in the best interests of her clients and to make only recommendations as will best serve such interests*. In brief, it is her duty to act in behalf of her clients. Under these circumstances, as registrant concedes, she is a *fiduciary*; she has asked for and received the highest degree of trust and confidence on the representation that she will act in the best interests of her clients.

[*Emphasis added.*] [*In re: Arleen W. Hughes*, Exchange Act Release No. 4048 (Feb. 18, 1948). Note that Ms. Hughes was dually registered as both a broker and an investment adviser under the federal securities laws.]

Understanding the historical antecedents of fiduciary duty helps in understanding its function in the financial planning community. For example, common law antecedents of the legal nature of fiduciary investment adviser and fiduciary CFP® Certificant include "agent., "trustee," and "managing partner".

The term "fiduciary" comes to us from Roman law, and means "a person holding the character of a trustee, or a character analogous of a trustee, in respect to the trust and confidence involved in it and the scrupulous good faith and candor which it requires." [Black's Law Dictionary, 5th Edition (1979)]. Indeed, the Latin root of the word fiduciary – fiduciarius - means one in whom trust – fiducia - reposes. Legal usage in many jurisdictions also developed an overlay - an implication of a particular relationship of confidence between the fiduciary and those who had placed their trust in that person.

At the beginning of the nineteenth century, in *Gibson*, 31 Eng. Rep. 1044 (1801), the court, while explaining the decision to rescind the sale of an annuity by an attorney to his client, announced that "[one] who bargains in matter of advantage with a person placing confidence in him is bound to sh[o]w, that a reasonable use has been made of that confidence; a rule applying to trustees, attorneys or anyone else." The courts eventually settled on "fiduciary" to denominate relationships

of trust and confidence and denominated the doctrine (applied in *Gibson*) regulating these confidential relationships as "constructive fraud." By the mid-nineteenth century, the doctrine of constructive fraud was said to arise from some peculiar confidential or fiduciary relation between the parties.

In the U.S., the "triad" of fiduciary duties is most commonly referred to as the duties of due care, good faith and loyalty. However, under English law, from which the U.S. system of jurisprudence was initially derived, it is reasonably well established that fiduciary status gives rise to five principal duties: (1) the no conflict rule preventing a fiduciary placing himself in a position where his own interests conflict or may conflict with those of his client or beneficiary; (2) the no profit rule which requires a fiduciary not to profit from his position at the expense of his client or beneficiary; (3) the undivided loyalty rule which requires undivided loyalty from a fiduciary to his client or beneficiary; (4) the duty of confidentiality which prohibits the fiduciary from using information obtained in confidence from his client or beneficiary other than for the benefit of that client or beneficiary; and (5) the duty of due care, to act with reasonable diligence and with requisite knowledge, experience and attention.

Fiduciary relationships are relationships in which the fiduciary provides to the client a service that public policy encourages. When such services are provided, the law recognizes that the client does not possess the ability, except at great cost, to monitor the exercise of the fiduciary's powers. In this regard, the client may be incapable of understanding the (often multiple) conflicts of interest which the person with greater knowledge and expertise will possess, and may not understand the potential ramifications of such conflicts of interest. Moreover, usually the client cannot afford the expense of engaging separate counsel or experts to monitor the conflicts of interest the person in the superior position possesses, as such costs might outweigh the benefits the client receives from the relationship with the fiduciary.

Fiduciary duties are imposed by law when public policy encourages specialization in particular services, such as financial planning or law, in recognition of the value such services provide to our society. For example, the provision of financial planning services by Certificants under fiduciary duties of loyalty and due care encourages sound planning decisions to be made by clients, thereby leading to more secure financial futures for (potentially) hundreds of millions of Americans. Hence, in order to promote public policy goals - such as having the children of our clients possess the means to attend higher education, and having our clients live a more secure retirement – as the government would desire, the law requires the imposition of fiduciary status upon the party in the dominant position. Through the imposition of such fiduciary status the client is thereby afforded various protections. These protections serve to reduce the risks to the client which relate to the service, and encourage the client to utilize the service. Fiduciary status thereby furthers the public interest.

The imposition of fiduciary obligation facilitates the efficient allocation of resources by protecting the beneficiary of the fiduciary relationship from overreaching by the provider of services. Typically, that provider is a professional who specializes in the provision of that service. The specialization of function forces individuals to rely on others to produce goods and services on fair terms. That reliance has necessarily afforded the opportunity for specialists to act in a self-interested fashion at the expense of the client by using their superior knowledge or skills. Accordingly, the fiduciary standard is applied to minimize the transaction costs of regulating specialized exchanges. To promote the efficiency gains of specialization, society imposes special regulations on occupational groups having the greatest latitude to drive hard

bargains, such as those in confidential relationships with clients. The activities of the fiduciary are, therefore, policed by imposing certain duties upon the specialist-fiduciary; these duties are imposed to avoid the inefficiencies resulting from specialist overreaching. Accordingly, the fiduciary's duty of loyalty requires the fiduciary to follow the course of conduct the beneficiary would have chosen if the beneficiary had either the same expertise as the fiduciary or had consulted another fiduciary.

A review of the history of securities regulation, and the need for regulators (including the CFP Board of Standards, Inc.) to adopt a regulatory vision based upon long-established fiduciary principles was set forth by John H. Walsh:

> In the years since, as illustrated by Professor Manne, the role of morality in public policy has fallen ever lower. Perforce, when its role is to serve as distraction, sham, or refuge for the intellectually bankrupt, it is safe to say that the age of moral purpose in regulation is over.
>
> Despite current opinion, the important role moral purpose played in creating modern regulatory institutions should not be forgotten. To understand the regulatory regimes our predecessors created and bequeathed to the modern age, one must understand the fundamental impulses that inspired them. Now ignored, or even disavowed, moral purpose once served as such an impulse. This is an area where history has something to offer the law. The greater the modern age's subjective distance from the regulatory vision of an earlier era, the more law needs history to explain what our predecessors thought they were doing. Moral purpose played a fundamental role in creating the federal regulatory regime for the securities industry. Indeed, in many respects, even though federal regulation was a product of the 1930s, it reflected an orthodox Progressive sensibility. This was no accident ... In August 1932, [Franklin Delano Roosevelt] turned to a moral policy vision. His purpose, he decided, was to ensure the character of the people who composed the securities industry ... FDR's moral purpose was a deliberately chosen policy and, once chosen, that it played an important role in the creation of the federal regulatory regime ...
>
> FDR's proposals for implementing his vision—fiduciary duties and a simple code of ethics—also speak to modern times. Commentators have recognized that fiduciary duties provide a legal basis for a justifiable expectation of trustworthiness. FDR's code should be seen in the same light. As an effort to restore public trust in financial intermediaries—why else make it simple enough for the public to understand?—it represents a practical solution to a vexing problem. How does public policy produce trust? More specifically, how does public policy produce trust on a sufficient scale to influence an entire economy? The idea of a simple code, containing basic ethical principles, propagated across an entire industry, is a serious approach to the problem.

John H. Walsh, J.D., Chief Counsel in the Office of Compliance Inspections and Examinations of the United States Securities and Exchange Commission, "A Simple Code of Ethics: a History of the Moral Purpose Inspiring Federal Regulation of the Securities Industry," 29 Hofstra Law Review 1015 (2001).

Why would a person take on the role of a fiduciary and Certificant and be subject to fiduciary duties? Specifically, why would a person desire to become a Certificant, knowing that his or her conduct will be subject to a high degree of scrutiny? The law imposes on a fiduciary duties of loyalty and due care which limit the freedom of the fiduciary and/or require

certain additional actions to be undertaken by the fiduciary for the client. However, the benefit of the assumption of fiduciary status is the increased marketability of the fiduciary. By endowing fiduciaries, such as Certificants, with a reputation for honesty backed by strict adherence to fiduciary standards of conduct and rigid enforcement by the CFP Board, the Certificant is the recipient of a greater ability to promote and market his or her services. The client of a Certificant is encouraged to enter into the advisory relationship under the CFP® Rules of Professional Conduct's assurance that the fiduciary, who possesses superior knowledge as to the subject matter on which advice will be given, will not exploit the client. The Rule thereby promotes security for each party to the fiduciary relationship - security to the client in terms of the increased duties and protections afforded, and security to the Certificant in terms of marketing power.

Most Certificants will be fiduciaries not only under these CFP® Rules of Professional Conduct by providing financial planning services and use of the CFP® mark, but also by virtue of the application of the Investment Advisers Act of 1940 and the rules promulgated thereunder. As stated by the SEC in Release Nos. 34-51523; IA-2376; File No. S7-25-99, "Certain Broker-Dealers Deemed Not To Be Investment Advisers":

> Under rule 202(a)(11)-1(b)(2), a broker-dealer would not be providing advice solely incidental to brokerage if it provides advice as part of a financial plan or in connection with providing planning services and: (i) holds itself out generally to the public as a financial planner or as providing financial planning services; or (ii) delivers to its customer a financial plan; or (iii) represents to the customer that the advice is provided as part of a financial plan or financial planning services. As a result, when the advice described above is provided, a broker-dealer that advertises (or otherwise generally lets it be known that it is available to provide) financial planning services must register under the Act (unless an exemption from registration is available). Further, a broker-dealer that provides such advice and delivers a financial plan to a customer or represents to a customer that its advice is provided as part of a financial plan or in connection with financial planning services must also register under the Act (unless another exemption from registration is available) and treat that customer as an advisory client.
>
> Financial planning services typically involve assisting clients in identifying long term economic goals, analyzing their current financial situation, and preparing a comprehensive financial program to achieve those goals. A financial plan generally seeks to address a wide spectrum of a client's long-term financial needs, including insurance, savings, tax and estate planning, and investments, taking into consideration the client's goals and situation, including anticipated retirement or other employee benefits. Typically, what distinguishes financial planning from other types of advisory services is the breadth and scope of the advisory services provided. Although most financial planners are registered under the Advisers Act or similar state statutes, financial planners today belong to a distinct profession, and financial planning is a separate discipline from, for example, portfolio management. This development has occurred only relatively recently, over approximately the last twenty-five years – well after the enactment of the Investment Advisers Act in 1940 ....
>
> We do not believe that financial planning, as it is understood today, necessarily follows as a consequence of rendering brokerage services. Instead, it is a relatively new service that many brokers provide in a manner essentially independent of their brokerage services. That being said, and as we acknowledged in the Reproposing

> Release, elements of financial planning have been, are, and should be a part of every broker-dealer's considerations as to the suitability of their recommendations. We have concluded that it would be unwise for us to attempt to distinguish when a suitability analysis ends and financial planning begins, and we do not want to interfere in any way with a broker-dealer's fulfillment of its suitability obligations. We have determined instead to rely primarily on how a broker-dealer holds itself out to the public and its customers in distinguishing the advice provided in connection with financial planning from other types of investment advice, such as transaction specific advice, which may be solely incidental to brokerage. Our experience generally informs us that investors understand financial plans and financial planning to mean something different from brokerage ....
>
> Under the rule, a broker-dealer would be subject to the Advisers Act if it portrays itself to the public as a financial planner or as providing financial planning services, whether it uses those particular terms or not. And it must treat as advisory clients all those customers to whom it delivers a financial plan, regardless of what it chooses to call the plan. While we have recognized there are some common elements in a financial plan and a broker-dealer's advice based on its understanding of a customer's needs and objectives, which is incumbent in its suitability analysis, we do no not consider this broker-dealer advice alone as constituting a financial plan.
>
> The broker-dealer must also treat as advisory clients those customers to whom it represents that its advice is part of a financial plan even if it uses some other term to describe the plan. Whether a particular document is, under the rule, a financial plan will turn on whether the document or representation bears the characteristics of a financial plan. Whether a communication represents that the services provided are financial planning services will depend on how a reasonable investor would understand the services described in the communication.

Also, note that the provision of investment advice, to which the Investment Advisers Act of 1940 (and its application of fiduciary duties) applies, was broadly construed by the SEC in its prior release, *Applicability of the Investment Advisers Act to Financial Planners*, SEC Release No. IA-1092, 52 Fed. Reg. 38,400 (Oct. 15, 1987) [hereinafter SEC Release IA-1092]:

> Whether a person providing financially related services of the type discussed in this release is an investment adviser within the meaning of the Advisers Act depends upon all the relevant facts and circumstances. As a general matter, if the activities of any person providing integrated advisory services satisfy the elements of the definition, the person would be an investment adviser within the meaning of the Advisers Act, unless entitled to rely on one of the exclusions from the definition of investment adviser in clauses (A) to (F) of Section 202(a)(11) ...
>
> Under section 202(a)(11), an investment adviser is one who, for compensation (1) engages in the business of advising others as to the value of securities or as to the advisability of investing in, purchasing, or selling securities, or, alternatively, (2) issues or promulgates reports or analyses concerning securities as part of a regular business. Each of these two alternatives in the statutory definition of investment adviser contains a business test -- one involves "engaging in the business" of advising others while the other involves issuing reports about

> securities as "part of a regular business." While the "business" standards established under Section 202(a)(11) are phrased somewhat differently, it is the staff's opinion that they should be interpreted in the same manner. In both cases, the determination to be made is whether the degree of the person's advisory activities constitutes being "in the business" of an investment adviser. The giving of advice need not constitute the principal business activity or any particular portion of the business activities of a person in order for the person to be an investment adviser under Section 202(a)(11). The giving of advice need only be done on such a basis that it constitutes a business activity occurring with some regularity. The frequency of the activity is a factor, but is not determinative.
>
> Whether a person giving advice about securities for compensation would be "in the business" of doing so, depends upon all relevant facts and circumstances. The staff considers a person to be "in the business" of providing advice if the person: (I) holds himself out as an investment adviser or as one who provides investment advice, (ii) receives any separate or additional compensation that represents a clearly definable charge for providing advice about securities, regardless of whether the compensation is separate from or included within any overall compensation, or receives transaction based compensation if the client implements the investment advice, or (iii) on anything other than rare, isolated and non-periodic instances, provides specific investment advice. For the purposes of (iii) above, "specific investment advice" includes a recommendation, analysis or report about specific securities or specific categories of securities (e.g., industrial development bonds, mutual funds, or medical technology stocks). It includes a recommendation that a client allocate certain percentages of his assets to life insurance, high yielding bonds, and mutual funds or particular types of mutual funds such as growth stock funds or money market funds. However, specific investment advice does not include advice limited to a general recommendation to allocate assets in securities, life insurance, and tangible assets.

"The SEC staff views a person as holding himself out as an adviser if he advertises as an investment adviser or financial planner, uses letterhead indicating activity as an investment adviser, or maintains a telephone listing or otherwise lets it be known that he will accept new advisory clients, or hires a person to solicit clients on their behalf." [Robert E. Plaze, Associate Director, Division of Investment Management, United States Securities and Exchange Commission, "The Regulation of Investment Advisers by The Securities and Exchange Commission," a white paper presented at the Private Investment Funds Conference, International Bar Association - American Bar Association, February 28, 2005].

The first and overriding responsibility any financial professional has is to the participants of the market – the client. This primary obligation is required in order to maintain the perception and reality that the market is a fair game and thus encourage the widest possible participation in the capital allocation process. The premise of the U.S. capital market is that the widest possible participation in the market will result in the most efficient allocation of financial resources and, therefore, will lead to the best operation of the world-wide economy. Putting the client first actually protects and promotes the best interests of the entire financial community, and, therefore, society as a whole. The concept is operationalized by requiring that financial professionals place the interests of their clients ahead of all other concerns. Responsibilities to employers, colleagues and selves are all placed in a descending order of importance so that the financial markets can be best served. All relevant information must be disclosed to clients and all decisions made with their interests first in mind.

<u>3.2. Reasonable Avoidance of Conflicts of Interest.</u> Certificants must use reasonable care and judgment to achieve and maintain independence and objectivity in their professional activities. Certificants must reasonably act to seek to avoid conflicts of interest. Certificants must not charge an excessive fee. Certificants must not offer, solicit, or accept any gift, benefit, compensation, or consideration that reasonably could be expected to compromise the Certificant's own or another's independence and objectivity.

Commentary. A fiduciary cannot serve two masters. The existence of conflicts of interest, 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, which otherwise could have been reasonably avoided by the Certificant, could lead to not only an erosion of the Certificant's relationship with the client, but also an erosion of the reputation of the profession of financial planning. Hence, Certificants shall reasonably act to seek to avoid conflicts of interest.

Certificants should maintain objectivity and be free of conflicts of interest in discharging professional responsibilities. Objectivity is a state of mind, a quality that lends value to a member's services. It is a distinguishing feature of the profession. The principle of objectivity imposes the obligation to be impartial, intellectually honest, and free of conflicts of interest. Independence precludes relationships that may appear to impair a member's objectivity in rendering financial planning services.

Fees charged or incurred by clients should not be excessive in light of the extent and nature of the services provided, the skill and expertise required of the Certificant, the risks assumed by the Certificant in connection with the advice and services provided, and the benefits obtained by the Client.

Many types of compensation are permissible under the CFP® Rules of Professional Conduct, including commission-based, a percentage of assets under management, a flat or retainer fee, hourly fees, or some combination thereof. However, the term "independence" requires that the Certificant's decision is based on the best interests of the client rather than upon extraneous considerations or influences that would convert an otherwise valid decision into a faithless act. A Certificant would not be independent if the Certificant is dominated or beholden to or affiliated with an individual or entity interested in the transaction at issue and is so under their influence that the Certificant's discretion and judgment would be sterilized.

A Certificant should not charge a fee for termination of a Certificant-client financial planning relationship, as such would give rise to a breach of fiduciary duty.

A conflict of interest occurs when the personal interests of the Certificant or the Certificant's firm interferes or could potentially interfere with the Certificant's responsibilities to the firm and its clients. Hence, Certificants should not accept inappropriate gifts, favors, entertainment, special accommodations, or other things of material value that could influence their decision-making or make them feel beholden to a person or firm. Similarly, Certificants should not offer gifts, favors, entertainment or other things of value that could be viewed as overly generous or aimed at influencing decision-making

or making a client feel beholden to the firm or the supervised person. *De minimis* gifts are excluded, as they would not materially affect the relationship with the client or third parties.

Annotations. The rules applicable to fiduciaries under the common law include the no conflict rule which prevents a fiduciary placing himself or herself in a position where his or her own interests conflict or may conflict with those of the client. The common law rules applicable to fiduciaries also include the no profit rule which requires a fiduciary not to profit from his position at the expense of his or her client. The no profit rule has been strictly enforced, even to the point of overturning transactions between fiduciaries and their clients where no extra profit was derived by the fiduciary above that which other market participants would have derived.

Chief Judge Cardozo of the Court of Appeals of the State of New York, in an often quoted passage from his opinion in *Meinhard v. Salmon*, 249 N.Y. 458, 164 N.E. 545, 546 (1928), described a fiduciary's duty of loyalty as follows:

> Many forms of conduct permissible in a workaday world for those acting at arm's-length, are forbidden to those bound by fiduciary ties. A trustee is held to something stricter than the morals of the market place. Not honesty alone, but the punctilio of an honor the most sensitive, is then the standard of behavior. As to this there has developed a tradition that is unbending and inveterate. Uncompromising rigidity has been the attitude of courts of equity when petitioned to undermine the rule of undivided loyalty by the 'disintegrating erosion' of particular exceptions. Only thus has the level of conduct for fiduciaries been kept at a level higher than that trodden by the crowd.

As alluded to by Judge Cardoza, fiduciaries, including Certificants, are simply held to a higher standard. Adherence to this higher standard must dictate the manner in which business is developed by the Certificant. For the financial planning profession to advance to serve the best interests of the investment public, fiduciaries should eliminate (and not just disclose) conflicts of interest wherever reasonably possible. Only in those instances where removal of a material conflict of interest would not be reasonably possible should the Certificant seek to fully disclose the conflict of interest. Even then, proper management of the conflict of interest is required of the Certificant in order to keep the best interests of the client paramount.

Most financial planners will also practice as investment adviser representatives and will be governed by the Investment Advisers Act of 1940, the regulations promulgated thereunder, and state laws and regulations. As stated in U.S. Supreme Court's landmark decision, *SEC vs. Capital Gains Research Bureau*, 375 U.S. 180 (1963), the Congressional committee reports accompanying the Investment Advisers Act of 1940 "indicate a desire to ... eliminate conflicts of interest between the investment adviser and the clients as safeguards both to 'unsophisticated investors' and to 'bona fide investment counsel." In essence, the intent of Investment Advisers Act of 1940 was to create a new profession, one in which seeking investment advice would be counseled by objective, trusted investment fiduciaries. The financial planning profession possesses the same goal.

Termination fees for the termination of a Certificant-client relationship should not be charged, other than reasonable fees normally charged by custodians to all customers of the custodian. *See National Deferred Compensation* (pub. avail. Aug.

31, 1987) ("an adviser may not fulfill its fiduciary obligations if it imposes a fee structure penalizing a client for deciding to terminate the adviser's service or if it imposes an additional fee on a client for choosing to change his investment"). Additionally, as stated in *Constellation Financial Management LLC* (No-Action Letter under Investment Advisor Act of 1940 - Section 206, dated January 9, 2003):

> Sections 206(1) and 206(2) of the Advisers Act make it unlawful for any registered or unregistered investment adviser to employ any device, scheme, or artifice to defraud, or to engage in any transaction, practice, or course of business, that operates as a fraud or deceit on clients or prospective clients. As a fiduciary, an adviser is held to the highest standards of conduct and must act in the best interests of its clients. We have taken the position that certain fees that may have the effect of penalizing a client for ending the advisory relationship, or that may make the client reluctant to terminate an adviser, may be inconsistent with the adviser's fiduciary duty, and may violate Section 206.

3.3. Disclosure and Proper Management of Non-Avoided Conflicts of Interest. **Certificants shall disclose to clients all material conflicts of interest which remain following Certificants' reasonable efforts undertaken to avoid conflicts of interest. However, disclosure of conflicts of interest does not defeat the continuing duty to act in the best interests of the client. Accordingly, Certificants shall adopt and adhere to reasonable policies and procedures for the management of remaining conflicts of interest in order that Certficants continue to act in the best interests of the client. This includes, but is not limited to, the adoption and periodic revision of a Code of Ethics, appropriate compliance policies and procedures, and sound client engagement practices.**

Commentary. Despite the best efforts of a Certificants to eliminate material conflicts of interest, all Certificants will still possess one or more material conflicts of interest in relation to the recommendations which may be made to their clients. Certificants must address these remaining conflicts of interest by: (1) First, undertaking full and complete written disclosure of material conflicts of interest to the client; and (2) continuing to act in the best interests of the client by properly managing the conflict of interest and by not permitting the client's best interests to become subservient to the interests of the Certificants. *It is emphasized that disclosure of a conflict of interest does not defeat the continuing duty of the Certificants to act in the best interests of the client.*

Annotations. The U.S. Securities and Exchange Commission has placed a great deal of emphasis in recent years on full and complete disclosure of conflicts of interest. For example, in relation to registered investment advisers, the SEC stated: "Fundamental to the Advisers Act is an adviser's fiduciary obligation to act in the best interests of its clients and to place its clients' interests before its own. As part of its fiduciary duty to clients, an adviser has an affirmative obligation of utmost good faith and full and fair disclosure of all material facts to clients. Advisers are required to disclose any facts that might cause the adviser to render advice that is not disinterested. When an adviser fails to disclose information regarding potential conflicts of interest, clients are unable to make informed decisions about entering into or continuing the advisory relationship." ["Letter From the Office of Compliance Inspections and Examinations: To Registered Investment Advisers, on Areas Reviewed and Violations Found During Inspections," dated May 1, 2000.]

A conflict of interest is inherent in the relationship between the client and the Certificants when the Certificants is compensated by commissions on the sale of financial products. In such circumstances, the Certificants must affirmatively disclose to the client, in writing and prior to the purchase of the product by the client, the amount of all compensation paid in association with the sale of the product and the placement of the product to the Certificants or the Certificant's firm, including but not limited to commissions, payment for shelf space, commissions paid upon securities transactions within a mutual fund by the investment adviser of that fund to the firm, expense allowances, and bonuses. In all cases the compensation received by the Certificants must be reasonable in light of the services provided by the Certificants.

Just because a financial advisor works on a fee-only basis (as opposed to commission-based compensation) does not mean that he or she has no potential conflicts of interest. Nearly every fiduciary has one conflict of interest - negotiating with the client the amount to be paid to the fiduciary for the fiduciary's services. Certificants should seek to ensure that each new and existing client will receive significant value from the services and advice provided by the Certificants, commensurate with the amount of fees and costs paid or incurred by the client.

In recent years, the financial services industry has discovered how profitable asset management fees are, and many registered-representatives of broker-dealer firms have transitioned from transaction-generated commissions to asset management fees (i.e., fees based on a percentage of assets under management). In general, such fees increase as the size of the client's portfolio increases. While there has been some criticism that fees should not be substantially higher when the time and effort expended are not commensurately higher, there exist at least three major reasons justifying a percentage of assets under management approach. First, there is certainly a greater personal and firm risk (in terms of potential liability) as the amount of managed assets increases. This often directly translates into increased costs, especially as to E&O insurance premiums for the Certificant or his or her firm. Second, in terms of benefit to the client, a Certificant benefits more greatly the client who has a greater level of assets under management. The time that is spent by a Certificants undertaking investment research and due diligence, and reviewing the academic research promulgated by others, benefits all clients, but perhaps benefits the wealthier client the most. Third, Certificants may choose to provide services to those who possess lower amounts of managed assets than would otherwise be accepted by the Certificants, as a means of benefitting the public good. While this justification may be controversial, the higher fees paid by some clients enable Certificants to serve those of limited resources but who nevertheless possess financial planning needs. Certificants thereby are better equipped to serve the public good, while still permitting the Certificants to maintain a reasonable level of professional practice income.

Percentage fees can be set substantially lower for clients, as a percentage of the investment portfolio, as the size of the client's portfolio grows. This is one way of adjusting the compensation to fit the effort required, while still compensating for the added risk of greater managed assets or the greater benefit to the client.

Charging a "flat fee" to all clients, regardless of the level of managed assets or the client's overall wealth, would remove virtually all remaining potential conflicts of interest. In the fee-only investment community, it is known as being "pure." It better ensures that the Certificants does not have a financial incentive to take an inordinate amount of risk with the client's investment portfolio in pursuit of unnecessarily high returns, fails to recommend that the client convert managed

financial assets to non-managed or non-financial assets, or pay off debt, even when such is better for the client, and does not advise against spending the clients' money or giving it away as part of the clients' estate planning. However, a pure "flat fee" or retainer does not compensate the advisor for the added risk associated with the management of larger accounts, nor for the added benefits to the client related to larger accounts. Moreover, flat fees may meet resistance from clients, just as any other fee structure would.

There are financial planners who firmly believe in hourly fee arrangements. Certificants should be encouraged to enter into hourly-based financial planning arrangements when appropriate. However, criticism by hourly-only Certificants of other compensation structures should be resisted, as an hourly fee only model for the financial planning profession may not be appropriate in all cases, as this commonly repeated story reveals:

> A woman was strolling along a street in Paris when she spotted Picasso sketching at a sidewalk café. The woman asked Picasso if he might sketch her, and charge accordingly. Picasso obliged. In just minutes, there she was: an original Picasso. "And what do I owe you?" she asked. "Five thousand francs," he answered. "But it only took you three minutes," she politely reminded him. "No," Picasso said. "It took me all my life."

Despite the efforts to avoid conflicts of interest, and regardless of the form of compensation, some conflicts of interest will continue to exist. Proper management of remaining conflicts of interest is essential to preserving the Certificant's ability to act in the best interests of the client. A sample policy relating to management of conflicts of interest by a firm operating under a percentage-of-assets under management fee philosophy follows:

1. *Conflicts of Interest Relating To Our Compensation; The Reasonableness of Our Fees.* At all times our fees shall be reasonable, in order to adhere to our fiduciary duty to the client. Each new client's investment advisory agreement and financial information shall be reviewed by the Chief Compliance Officer or his designee to ensure that the client is provided with a value-added service, relative to that which the client would receive from non-fiduciary advisers (or, if the client already invests on their own, relative to what the client has been doing). We recognize that our services may not be suitable for all clients. For example, an investor who desires all of their assets in fixed income investments, and is sophisticated in the employment of a laddered approach to high-quality fixed income investments, may be better served through working (by themselves) with discount brokerage firms or with knowledgeable and experienced and ethical registered representative of a wirehouse firm.

2. *Debt Pay-Down vs. Additional Managed Assets.* We will counsel clients to pay down debt unless:
   a. The client has a clear need for liquidity (that can not otherwise be obtained by other means, such as a home equity line of credit) (this need for liquidity would be rare); 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 should document this decision in the client's investment policy.

3. *Our Attendance At 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 from time to time. There is generally no cost related to the educational presentation itself or the materials handed out, and on occasion meals 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 influence our independent professional judgment.

4. *Private Equity Investments (Closely Held Businesses, Real Estate) vs. Managed Assets*. At times 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 the sophisticated clients' investment portfolio. We will counsel the client as follows: (a) Illiquidity Concerns. The client should be able, from a financial perspective, to shoulder the risks inherent with illiquid investments. The clients should possess sufficient other liquid investments to meet all future needs in the next 5-10 years. (b) Real Estate Risks. The client should be aware of the risk of being cash flow negative with regard to real estate. The client should also be able to properly evaluate the real estate investment. The client should also be able to personally manage the property (or have employed at reasonable fees a property manager). We will counsel clients that private equity real estate investments should possess a long-term expected rate of return of 8% or greater, with most of this return generated by rental income and some represented by price appreciation at a rate usually equal to or greater than that of inflation. While private equity real estate investments generally possess greater price stability than stock portfolios, such stability is not guaranteed. Furthermore, no investment return is guaranteed in any real estate investment. Investments in non-income producing property (other than the primary residence) should be discouraged for most individual clients, as the potential for price appreciation could be viewed as speculative, especially over the short-term. While price appreciation has occurred in recent years in real estate, there have been in the past, and will be in the future, long periods of time when price appreciation does not occur in various real estate markets, and there may well be times ahead when substantial price depreciation occurs due to over-valuations in some real estate markets at present.

5. *Closely Held Business Interests.* We recognize that closely held business interests are substantial contributors to the U.S. economy and the means by which many of our clients will, over their lifetimes, generate significant wealth from their own skills. We will counsel clients that, due to the risks inherent (illiquidity, specific business risk, and many others), that the monetary capital should receive an expected return on investment of 18% or more. We will counsel clients that human capital (i.e., their own contributions) should receive adequate compensation, at least equal to that which the client could command if working for another firm. We will

encourage clients to pursue, with part of the investment portfolio, private equity investments, provided: (1) the client is entrepreneurial (and not with a view toward speculation); (2) the client possesses the requisite skills of their own accord; (3) the client possess significant financial assets; and (4) the client expresses a desire. We will provide this advice even though it may result in a lower level of managed assets.

6. *Other Conflicts of Interest May Arise; Disclosure; Continue To Act In The Client's Best Interests*. We will seek to identify and avoid conflicts of interest. When material conflicts of interest are identified which cannot be avoided, such as those set forth above, we will disclose the conflict of interest to the individual client (or, if it is a conflict of interest which may affect many clients, we will disclose it in our ADV). We will always place the bests interests of the client first and foremost when dealing with situations involving conflicts of interest. Any questions regarding the propriety of advice in the presence of a conflict of interest should be directed to the Chief Compliance Officer and/or to other senior members of the firm for due consideration of proper management of the conflict.

7. *Disclosure of Material Conflicts of Interest.* In our ADV, Part II, we affirmatively disclose those material conflicts of interest, common to all or to most of our clients, which we cannot avoid. Client-specific material conflicts of interest should be disclosed in writing to that particular client. Currently our ADV, Part II provides, in the narrative section, the following disclosure:

A Candid Discussion of Conflicts of Interest (and Disclosure of Additional Compensation)

a. Proper Management of Conflicts of Interest Relating To The Fees We Receive From You. The vast majority of our clients pay our firm fees based upon a percentage of the assets we advise upon. This is a very common form of compensation for registered investment advisory firms and avoids the multiple inherent conflicts of interests associated with commission-based compensation (our firm does not accept commission-based compensation of any nature). Asset-advised-upon percentage compensation methods of compensation can still at times lead to conflicts of interest between our firm and our client as to the advice we provide. For example, conflicts of interest may arise relating to the following financial decisions in life: incur or pay down debt; gift funds to charities or to individuals; purchases of a (larger) home or cars or other non-investment assets; the purchase of a lifetime immediate annuity; and the amount of funds to place in non-managed cash reserve accounts. We have adopted internal policies to properly manage these and other potential conflicts of interest. Our goal is that our advice to you remains at all times in your best interests, disregarding any impact of the decision to be undertaken upon us or our firm.

b. We Seek To Avoid Material Conflicts of Interest. To avoid material conflicts of interest, generally neither our firm nor its investment adviser representatives nor its team members receive any third party direct monetary compensation (i.e., commissions or other fees) from brokerage firms (custodians) or mutual fund companies. However, some additional services and non-direct monetary or other forms of compensation are offered and provided to our firm as a result of its relationships with custodian(s) and/or providers of mutual fund

products. Our firm believes that the services and benefits provided to it by brokerage firms (custodians) and mutual fund providers do not materially affect the investment management recommendations made to our clients. However, in the interest of full disclosure of any potential conflicts of interest a discussion follows in this Paragraph F regarding the services these organizations may offer or provide to our firm ... (then discuss specific circumstances in succeeding paragraphs).

c. Our Relationships With Custodians and Investment Product Providers. Our firm will continue to avoid certain relationships with custodians (brokerage firms, etc.) and investment product providers which it believes might materially hamper its independence in its providing advice to its clients or result in clients paying higher mutual fund management, administrative or other product-related fees and costs. For this and other reasons, our firm does not participate in the client referral programs which may be sponsored by such custodians, nor does our firm currently recommend to its clients any mutual funds or exchange-traded funds (ETFs) manufactured by affiliates of such custodians (although our firm may in the future recommend such funds if our firm, after a process of due diligence, concludes that such mutual funds are the best funds in that particular asset class or which otherwise will best meet the client's objectives).

3.4. Addressing Conflicts of Interest Arising From Duties Owed To Multiple Distinct Clients. Certificants shall reasonably seek to not favor the interests of any one client over the interest of another client. Since situations may arise in which the Certificant's ability to treat all of the Certificant's clients with equal fairness is compromised, or where it may appear that the interest of one client is favored over the interest of another client, Certificants shall inform clients in writing and in advance of the limitations which Certificants possesses and how the Certificants will address the situation.

Commentary. Most fiduciaries (agents) act for more than one client (principal). Conflicts of interest may arise where the Certificant has reason to favor the interests of one client over another client (e.g., larger accounts over smaller accounts, accounts compensated by performance fees over accounts not so compensated, accounts in which employees have made material personal investments, accounts of close friends or relatives of supervised persons). While favoritism of one client over another client should be avoided wherever possible, as such would constitute a breach of fiduciary duty, situations arise (such as a sudden major stock market value decline) in which the Certificant may find that the Certificant is unable to serve all of the Certificant's clients equally well due to scarce resources. Certificants should therefore, in advance of such situations, inform clients of Certificant's limitations and the policies which the Certificant has adopted to treat clients as fairly as possible.

3.5. Relationship With Clients Possessing Diminished Capacity.

(a) **When a client's capacity to make adequately considered decisions in connection with a representation is diminished, whether because of minority, mental impairment or for some other reason, the Certificant shall, as far as reasonably possible, maintain a normal financial planner - client relationship with the client.**

(b) **When the Certificant reasonably believes that the client has diminished capacity, is at risk of substantial physical, financial or other harm unless action is taken and cannot adequately act in the client's own interest, the Certificant may take reasonably necessary protective action, including consulting with individuals or entities that have the ability to take action to protect the client and, in appropriate cases, seeking the appointment of a guardian ad litem, conservator or guardian.**

(c) **Information relating to the representation of a client with diminished capacity is protected by the general rule governing client confidentiality. Notwithstanding this general rule, when taking protective action pursuant to paragraph (b) above, the Certificant is impliedly authorized under Rule to reveal information about the client, but only to the extent reasonably necessary to protect the client's best interests or to fulfill the duties owed by the Certificant to the client.**

3.6. Non-Waiver of Duty of Loyalty. The duty of a Certificant to act in the best interests of a client is not waivable by the client.

Commentary. Fiduciary status does not result from the negotiations of parties to a proposed contract. While entry into a relationship by the parties is voluntary, the CFP® Rules of Professional Conduct and public policy play a crucial role in the imposition of fiduciary status and the relationships which follow from it. Fiduciary status is imposed by the CFP® Rules of Professional Conduct upon the Certificant-client relationship due to the parties' different knowledge and expertise. Fiduciary status is imposed, in part, because the client is not capable of negotiating, contractually, the protections which the client should be afforded.

Annotations. In order to waive the application of the fiduciary standard, a client must be able to undertake, autonomously, an informed waiver. Given the complexity of the financial planning and securities industries and the complexity of the fiduciary concept in general, it is highly unlikely that the typical client will possess the knowledge to make such an informed, intelligent decision.

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." As this study indicates, 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.

Moreover, characterizing a fiduciary's duties of due care and loyalty as "default rules" that can be cast aside by contractual choice too easily equates fiduciary law with contract law. Information asymmetries between a Certificant and her or his client make it unlikely express waivers incorporated in an engagement contract would reflect the client's judgment that the provision would be value maximizing. Labeling fiduciary duties as "default rules" also threatens to strip fiduciary rules of their moral content. Fiduciary duties are most effective when they function both as legal rules and moral norms. A label that equates the duty of loyalty with, say, a UCC provision allocating risk of loss undermines the duty's normative force. The erosion of the social norm may create significant external costs for all future Certificants and their clients. [*See* Melanie B. Leslie, "Trusting Trustees: Fiduciary Duties and the Limits of Default Rules," Benjamin N. Cardozo School of Law, Jacob Burns Institute for Advanced Legal Studies, Working Paper No. 111 (2005). While some academics have argued that certain fiduciary duties should be waivable, even the vast majority of these academics stress that fiduciary duties should not be waivable in situations where fiduciaries are advising on *other people's money*.

The fiduciary duty of loyalty "is not specifically set forth in the Act, established by SEC rules, nor a result of a contract between the adviser and the client (and thus it cannot be negotiated away). Rather, a fiduciary duty is imposed on an adviser by operation of law because of the nature of the relationship between the two parties." [Robert E. Plaze, Associate Director, Division of Investment Management, United States Securities and Exchange Commission, "The Regulation of Investment Advisers by The Securities and Exchange Commission," a white paper presented at the Private Investment Funds Conference, International Bar Association - American Bar Association, February 28, 2005].

Rule 4. Fiduciary Duty of Due Care To Clients.

4.1 Standard of Due Care. A Certificant shall, in the performance of services for a client, act with the due care expected of prudent Certificants in like situations, applying the requisite knowledge, experience and attention to the engagement.

Commentary. The quest for excellence is the essence of due care. Due care requires a member to discharge professional responsibilities with competence and diligence. It imposes the obligation to perform professional services to the best of a member's ability with concern for the best interest of those for whom the services are performed and consistent with the profession's responsibility to the public.

The fiduciary duty of due care requires the Certificant to possess knowledge, utilize care, and act diligently. Knowledge requires that the Certificant possess the necessary education and skills to discharge the Certificant's duties owed to the client. While Certificants cannot be experts in all aspects of the complex tax laws, financial, estate and risk management issues, and financial markets that exist, they should not try to represent themselves as such. However, Certificants should strive to expand their expertise in areas which will best serve their clients.

A lack of knowledge or expertise is, in itself, not a violation of the Rule. However, advising a client in areas where such knowledge is required, or not consulting with others in those areas, would be a violation of the Rule. The Rule requires Certificants to provide advice only in areas in which they fully and reasonably understand the technical implications.

Annotations. The duty of care has been considered to involve both *process* and *substance*. That is, in reviewing the conduct of a Certificant in adherence to the Certificant's fiduciary duty of due care, a court would likely review whether the decision made by the Certificant was informed (procedural due care) as well as the substance of the transaction or advice given (substantive due care). Procedural due care is often met through the application of an appropriate decision-making process, and judged under the standard, not (necessarily) by the end result. Substantive due care pertains to the standard of care and the standard of culpability for the imposition of liability for a breach of the duty of care.

Substantive Due Care. Under the Investment Advisers Act of 1940, the duty of due care is measured by the ordinary negligence standard, and the CFP Board expects that the duty of due care imposed by this Rule would likewise be measured by the same ordinary negligence standard. However, the standard of prudence is relational, and it follows that the standard of care for CFP® Certificants is the standard of a prudent CFP® Certificant. By way of explanation, the standard of care for professionals is that of prudent professionals; for amateurs, it is the standard of prudent amateurs. For example, Restatement of Trusts 2d § 174 (1959) provides: "The trustee is under a duty to the beneficiary in administering the trust to exercise such care and skill as a man of ordinary prudence would exercise in dealing with his own property; and if the trustee has or procures his appointment as trustee by representing that he has greater skill than that of a man of ordinary prudence, he is under a duty to exercise such skill." Case law strongly supports the concept of the higher standard of care for the trustee representing itself to be expert or professional. *See* Annot., "Standard of Care Required of Trustee Representing Itself to Have Expert Knowledge or Skill", 91 A.L.R. 3d 904 (1979) & 1992 Supp. at 48-49.

Note, however, that the courts recognize that it is simply not possible for a fiduciary to be aware of every piece of relevant information before making a decision on behalf of the principal, and a fiduciary cannot guarantee that a correct judgment will be made in all cases. Due to the difficulty of evaluating the behavior of fiduciaries, most often courts turn to an analysis not of the advice that was given but rather to the process by which the advice was derived. Nevertheless, while adherence to a proper process is also necessary, at each step along the process the Certificant is required to act prudently with the care of the prudent CFP® Certificant. In other words, the Certificant must at all times exercise good judgment, applying his or her education, skills, and expertise to the financial planning issue before the Certificant. Simply following a prudent process is not enough if prudent good judgment (and the Certificant's requisite knowledge, expertise and experience) is not applied as well.

Procedural Due Care. This discussion reveals that one must evaluate the duty of care, unlike the duty of loyalty, by the process the fiduciary undertakes in performing his functions and not the outcome achieved. The very word "care" connotes a process. One associates caring with a condition, state of mind, manner of mental attention, a feeling, regard, or liking for something. How else may one determine whether a financial adviser who regularly achieves below average returns, or an attorney who loses most cases, has performed his duty of care? It is only through evaluating the steps the fiduciary took while doing his job, and not whether they resulted in success, that one may judge whether the fiduciary has breached his duty.

Much has been written about the prudent investment process. There exists controversy regarding whether the prudent investment process should be codified within the CFP Board's standards of conduct. Rather than discuss the prudent processes which might be followed by a Certificant in this draft proposal, I refer the reader to the following texts:

Tim Hatton, *The New Fiduciary Standard, The 27 Prudent Investment Practices* (Bloomberg Press, 2005);
W. Scott Simon, *The Prudent Investor Act, A Guide to Understanding* (Namborn Publishing Co., 2002); and
Don Trone / Fiduciary360, *Prudent Practices for Investment Advisors* (Center for Fiduciary Studies).

The extent to which prudent practices should be codified as part of these CFP® Rules of Professional Coduct is a subject for further discussion and deserves much attention.

4.2 Achieving and Maintaining Professional Competence. A Certificant shall provide services to clients competently. A Certificant is competent only when he or she has attained and has maintained an adequate level of knowledge, skill and experience, and is able to apply that knowledge skill and experience effectively in providing services to clients.

Commentary. Competence is derived from a synthesis of knowledge, skill and experience. It begins with a mastery of the common body of knowledge required for designation as a Certified Financial Planner™. Due to ever-changing laws, regulations, and the development of new strategies, services, and products, the maintenance of competence requires a commitment to learning and professional improvement that must continue throughout a Certificant's professional life. Maintaining competency is a Certificant's individual responsibility. In all engagements and in all responsibilities, each Certificant should undertake to achieve a level of competence that will assure that the quality of the Certificant's services meets the high level of professionalism required by these Principles.

4.3. When Consultation Required With Other Professionals. Consultation or referral by the Certificant with other professionals shall be required when a professional engagement exceeds the personal competence of the Certificant and the competencies of others who might support the Certificant from within the Certificant's firm.

Commentary. Competence represents the attainment and maintenance of a level of understanding and knowledge that enables a member to render services with facility and acumen. It also establishes the limitations of a member's capabilities by dictating that consultation or referral may be required. Each member is responsible for assessing his or her own competence – of evaluating whether education, experience, and judgment are adequate for the responsibility to be assumed.

4.4. Diligence in the Delivery of Services. Certificants shall be diligent in discharging responsibilities to clients, employers, and the public. Diligence imposes the responsibility upon Certificants to render services reasonably promptly and carefully and with a reasonable level of thoroughness.

Commentary. Diligence is the provision of services in a reasonably prompt and thorough manner. Diligence also includes proper planning for, and supervision of, the rendering of professional services.

Diligence requires Certificants to discharge their duties in a timely manner and to maintain full records of decisions and actions. Timeliness is necessary so that opportunities will not be lost due to inaction. Violations of ethical behavior can be caused by inaction when action would have been required, or by lack of thoroughness in evaluating the financial planning issue confronting the client.

4.5. Duty To Gather Necessary Facts. The certificant should gather necessary factual information regarding the client which is necessary and appropriate to provide the recommendations.

4.6. Suitability As To Recommendations of Investment Products. In recommending securities or investment products to clients the Certificant must determine that the security or investment product is suitable for that customer in light of the customer's financial status and investment objectives.

Comment. The duty of suitability in the making of investment product recommendations is a minimal, but important duty. The fiduciary duty of due care requires greater effort and even more sound judgment to be applied, however, as illustrated by Rules 4.7 and 4.8 below.

4.7. Reasonableness of Total Fees and Costs Borne By Client. A Certificant shall reasonably ensure that the total fees and costs borne by the client in connection with the Certificant's services and recommendations are reasonable.

Commentary. Fiduciary status requires Certificants to pay close attention to the total fees and costs which a client will bear in connection with the advisory services, including the total fees and costs of recommended investment products. Since a Certificant has the objective of putting the client's interests first, and since fees and costs borne by the client's will affect the results obtained by the Client, it is obvious that any costs passed on to clients must be spent wisely. 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.

Certificants should acquire a full knowledge of the fees and costs associated with various securities or investment products or types of accounts, prior to their recommendation to any client. For example, many costs associated with investing in mutual funds and ETFs are not reflected in the sales loads or the fund's annual expense ratio.

Annotations. "A fiduciary must always act in the client's best interest (even when it is not in his or her own best interests). Therefore, it may be a breach of fiduciary duty to recommend a S&P 500 mutual fund with a 5% load when you know of a fund with an equivalent track record that is no-load and has low annual expenses." Donald Moine, Are You A Fiduciary?, From the August 13, 2000 MorningstarAdvisor.com, available at http://www.prudentinvestoract.com/ Are%20You%20a%20Fiduciary.pdf.

The Prudent Investor Rule goes a large step further is discussing the duties of a fiduciary with regard to costs. As adopted in Florida, and as set forth in Section 518.11(1)(f), *Florida Statutes* (2003): "The circumstances that the fiduciary may consider in making investment decisions include, without limitation ... the general economic conditions, the possible effect of inflation, the expected tax consequences of investment decisions or strategies, the role each investment or course of action plays within the overall portfolio, the expected total return, including both income yield and appreciation of capital, and the duty to incur only reasonable and appropriate costs." [Emphasis added.] As stated in the commentary to the UPIA, "[I]t is important for trustees to make cost comparisons, particularly among similar products of a specific type being considered for a trust portfolio." In other words, to act prudently a fiduciary must act to reduce costs. Like any investor, a fiduciary should be informed of the total costs of the investment, and should consider alternatives. Higher costs should be incurred only when there is a legitimate reason to do so - such as higher expected returns or the need to engage an investment advisor to assist the fiduciary." [Comment to Section 7, UPIA. See Appendix C.]

For example, as part of the Certificant's due diligence efforts in mutual fund selection, Certificants should undertake a reasonable review of the total costs of the investment product recommended. For a reference article as to how Certificants might discerning the "total fees and costs" of U.S. stock mutual funds, *see* Comments of Ron A. Rhoades on SEC's Proposed Rule, Mutual Fund Governance, dated June 26, 2006, available at http://www.sec.gov/rules/proposed/ s70304/s70304-273.pdf, to which is attached the working paper, "Estimating the Total Costs of Stock Mutual Funds."

4.8. Proper Consideration of Tax Reduction Strategies. **Certificants shall reasonably consider and recommend to the client such strategies and investment products which may reduce the tax burdens imposed upon the client over time.**

Commentary. In recommending investments to clients and undertaking financial planning, taxes also play an important role and must be taken into account by the Certificant. The Certificant is required to possess a reasonable knowledge of tax reduction strategies. Given the complexity and breadth of tax laws, the Certificant should seek out tax advice from appropriate tax professionals where appropriate to meet the needs of the Certificant's client and as a means of supplementing the Certficant's own expertise in financial and tax planning. A Certificant is not permitted to disavow the duty to consider taxes in the furnishing of financial planning services to the client; however, a Certificant may delegate or assign the necessary provision of tax advice to a qualified tax professional, provided a qualified tax professional is actually engaged by the Certificant or the client in connection with the financial planning advice which is rendered.

The duty of due care imposed by the broad fiduciary duty applicable to Certificants extends to a consideration of the tax effects of financial planning decisions. Given the importance of tax reduction in financial planning activities, no Certificant may state that he, she or their firm does not provide tax advice, unless the Certificant places the financial planning recommendations provided to the client placed in writing and has them reviewed by a competent tax professional.

Annotations. How important is this attentiveness to taxation? According to an SEC study, investors in actively managed mutual funds lose an estimated 2.5% a year in annual returns to taxes. Another study by accounting firm KPMG Peat Marwick for the Congressional Joint Economic Committee found that the annual impact of taxes ranged from zero for the most tax-efficient funds to 5.6 percentage points for the least. Combined with actively managed stock mutual fund costs (both "disclosed" and "hidden") that average 2.8% or more per year, taxes and costs can combine to eliminate 50% or more of an investor's expected annual return. On a compounded basis, that 50% loss can equate to an erosion of the vast majority of the returns the capital markets have to offer to individual investors.

For another example, as to the issue of whether variable annuities are suitable from a tax and cost perspective for clients, especially retirees, *see* Comments of Ron A. Rhoades on NASD's Notice of Filing Amendment No. 2 to Proposed Rule Relating to Sales Practice Standards and Supervisory Requirements for Transactions in Deferred Variable Annuities, available at http://www.sec.gov/rules/sro/ nasd/nasd2004183/srnasd2004183-181.pdf).

<u>4.9. Due Diligence In Investment Product Selection.</u> **The Certificant should undertake due diligence as to investment products recommended to the client, seeking to select those investments which best meet the client's needs.**

Commentary. Consistent with the nature and scope of the engagement, the Certificant shall undertake a reasonable investigation regarding the financial products recommended to clients. Such an investigation may be made by the Certificant or by others provided the Certificant acts reasonably in relying upon such investigation.

Factors the Certificant should address in such an investigation include, but are not limited to: (1) the historical and expected returns of the investment product and its asset class; (2) the risks posed by the product as to price volatility, terminal value, or otherwise; (3) the effect of the addition of the product to the investment portfolio of the client and its expected risks and returns; (4) the fees and costs associated with the acquisition, holding, or potential sale of the product; (5) the tax attributes of the product in light of the client's situation (both as to tax benefits and tax detriments); and (6) whether any guarantees offered by the product will likely provide a meaningful benefit to the client in light of their costs.

Rule 5. Fiduciary Duty of Confidentiality to Clients. Certificants shall keep all information about clients (including prospective clients and former clients) in strict confidence, including the client's identity, the client's financial circumstances, the client's security holdings, and advice furnished to the client by the firm, unless the client consents otherwise.

Commentary. The fiduciary duty of confidentiality which prohibits the fiduciary / Certificant from using information obtained in confidence from his client or beneficiary other than for the benefit of that client or beneficiary. Other laws and regulations, including Regulation S-P (privacy requirements), and other professional standards of conduct, may impose upon a Certificant the duty to safeguard each client's confidential and personal information.

A Certificant shall not disclose any confidential client information without the specific consent of the client. However, this rule shall not be construed to affect in any way a Certificant's obligation to comply with a validly issued and enforceable subpoena or summons, or to prohibit a Certificant's compliance with applicable laws and government regulations, or prohibit review of a Certificant's professional practice by the CFP Board of Standards, Inc. or other regulatory bodies or professional organizations, or to preclude a Certificant from initiating a complaint with, or responding to any inquiry made by, the CFP Board of Standards, Inc.

Certificant's employees and third-party-vendors who are provided with access to confidential client information should sign a statement agreeing to adhere to the Certificant's privacy policy or otherwise protecting any confidential client information which is received.

In the event of the sale of a Certificant's practice or portion thereof, a Certificant must take appropriate precautions (for example, through a written confidentiality agreement) so that the prospective purchaser does not disclose any information obtained in the course of the review, since such information is deemed to be confidential client information. Likewise, Certificants reviewing a practice in connection with a prospective purchase or merger shall not use to their advantage nor disclose the other Certificant's confidential client information that comes to their attention.

Annotation. A Certificant may desire to consider the following language in its published Privacy Policy:

> We are committed to maintaining the confidentiality, integrity and security of the personal information that is entrusted to us. Federal law requires that we notify you annually of our Privacy Policy, in writing. The categories of nonpublic information that we collect from you may include information about your personal finances, personal taxes, personal estate planning, information about your health to the extent that it is needed for the financial, tax, estate, and asset protection planning process, and information about transactions between you and third parties (such as financial product providers, etc.).
>
> We may disclose limited information to attorneys, accountants, trust officers, mortgage lenders and other advisors or firms with whom you have established a relationship. You may opt out from our sharing information with these non-affiliated third parties by notifying us at any time by telephone, mail, fax, email, or in person.

We may also share a limited amount of information about you with your brokerage firm or other custodian in order to assist you in establishing accounts, transferring accounts, facilitating cash or other transfers, executing securities transactions, and voting proxies.

We may also share a limited amount of information about you with our portfolio reporting firm (to be selected) and our account aggregation firm and portfolio reporting firm.

We maintain a secure office to ensure that your information is not placed at unreasonable risk. We employ a firewall barrier and authentication procedures in our computer environment. We do not provide your personal information to mailing list vendors or to solicitors. We require strict confidentiality in our agreements with unaffiliated third parties that require access to your personal information, including auditors, consultants, and other financial services companies. Federal and state regulators (such as the U.S. Securities and Exchange Commission and/or and the State of Florida Department of Financial Services) and professional organizations with whom we affiliate (such as the CFP Board of Standards, Inc.) may review our company records and your personal records as permitted by law; this is for your protection. While we possess a policy of strict confidentiality as to our clients' matters, under certain circumstances we may be required by law to make disclosures to government agencies and to third parties, such as upon receipt of a subpoena.

Personally identifiable information about you will be maintained while you are a client, and for the required period thereafter that records are required to be maintained by federal and state securities laws and regulations. After that time, information may be destroyed. We will notify you in advance if our privacy policy is expected to change.

A Certificant should request that Certificant's clients and prospective clients, prior to the initial receipt of substantial confidential information or upon any material change to the Certificant's disclosure policies, sign a written statement accepting the disclosures which are authorized in the Certificant's privacy policy.

A Certificant who is also an attorney admitted to practice before the Bar of any state, or who holds himself or herself out as an attorney, may likewise consider the following addition to the Certificant's privacy policy: "(Name of Certficant's financial planning firm) does not provide legal services and its files are not afforded such protection under the attorney-client privilege."

Rule 6. Defining The Nature and Scope of The Engagement.
[TO BE DEVELOPED.]

Rule 7. Securing Client's Property.
[TO BE DEVELOPED.]

Rule 8. Relationships Between Certificant And His Or Her Firm.

8.1. Consent of Employer To Use of CFP® Mark. No use of the CFP® mark shall be made by a Certificant in association with financial planning activities without employer consent in writing.

8.2. Informing Employer of Material Events. A certificant must advise his or her current employer of any public censure or certification suspension or revocation he or she receives from CFP Board, and of any material complaint received from a client.

8.3. A Certificant Shall Reasonably Resolve Any Conflicts Between Duties Owed To Clients and Duties Owed To Employers In Favor Of The Client.

Commentary. A Certificant is required to assess, in her or his individual judgments, whether an activity of their employer with respect to the Certificant's client is consistent with the Certificant's role as a professional. For example, an employer of a Certificant may promote the sale of a particular security through a sales contest or other means under which additional compensation would be paid to the Certificant beyond that provided normally in connection with product sales; the fiduciary duty of loyalty owed to the client by the Certificant would require that the Certificant not participate in such a sales contest as it would likely interfere with the independent judgment of the client.

There are circumstances, however, where the client's interests cannot be promoted by the Certificant over that of his or her employer or prior employer. An example would be prohibitions established by contract between the Certificant and his or her employer prohibiting the Certificant from soliciting clients of the firm other employees of the firm to depart the firm, prohibiting competition within a reasonable geographical area and for reasonable period of time, and prohibiting the Certificant from seizing trade secrets of the firm.

8.4. Responsibilities of Certificant In Connection With Delivery of Financial Planning Services by Employees. A Certificant in a firm who individually or together with other Certificants possesses comparable managerial authority in a firm shall make reasonable efforts to ensure that the firm has in effect measures giving reasonable assurance that all employees assisting the Certificant in the delivery of financial planning services to the Certificant's clients conform to the CFP® Rules of Professional Conduct and that the actions of those employees in the delivery of financial planning services are compatible with the other professional obligations of the Certificant.

Rule 9. Obligations of Certificant to the CFP Board.

9.1. Adherence to Agreements With CFP Board. Certificants must abide by the terms of their agreements with CFP Board, including, but not limited to, proper usage of the CFP® certification marks, full cooperation with CFP Board's trademark and professional review operations and requirements, and keeping CFP Board apprised of current contact information.

9.2. Addressing Violations of the CFP® Rules of Professional Conduct By Other Certificants. A Certificant who knows that another Certificant has committed a violation of the CFP® Rules of Professional Conduct that raises a substantial question as to that other Certificant's honesty, trustworthiness or competency:

(a) may counsel the other Certificant who committed the violation, including but not limited to advice on how to effect remedial action, further education which the Certificant may pursue; and

(b) if the Certificant reasonably believes that the other Certificant will not undertake proper remedial action or may in the future cause harm to other the same or other clients of the other Certificant or the profession, the Certificant shall inform the appropriate professional authority.

Commentary. The term "substantial" refers to the seriousness of the possible offense and not the quantum of evidence of which the Certificant is aware.

If a Certificant were obliged to report every violation of the CFP® Rules of Professional Conduct, the failure to report any violation would itself be a violation. Such a requirement is unenforceable. This Rule limits the reporting obligation to those offenses that a self-regulating profession must vigorously endeavor. The reporting obligation is designed to either seek to rectify harm already caused to a client of the other Certificant or to prevent harm to be caused in the future to that other Certificant's same client or other potential clients. A measure of judgment is, therefore, required in complying with the provisions of this Rule.

A report about misconduct is not required where it would involve violation of the Rule regarding preservation of the reporting Certificant's client's confidences. However, in such circumstances the reporting Certficant should encourage a client to consent to disclosure where investigation and prosecution of the report would not substantially prejudice the client's interests.

9.3. Right To Use Marks Conditional Upon Meeting and Maintaining Requirements. Certificants must meet all CFP Board requirements, including continuing education requirements, to retain the right to use the CFP® certification marks.

[END OF DRAFT PROPOSAL]