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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: Comment regarding CFP Board's Proposed
Code of Ethics and Professional Responsibility
and Financial Planning Practice Standards

Dear Mr. Stifel:

I wish to thank the members of the CFP Board for their diligent hard work on the revisions to the Code of Ethics and Practice Standards applicable to CFP® certificants. Given the ongoing development of the profession of financial planning, and concurrent developments affecting registered investment advisers and the securities industry as a whole, the CFP Board is to be commended for seeking to address the tough and extremely complex issues of today. Thank you as well for permitting CFP® certificants the opportunity to comment on the proposals.

In this comment letter¹ I address the key issue confronting the CFP Board - whether to permit CFP® certificant holders to choose which legal standard (i.e., fiduciary or non-fiduciary) will be applicable to their financial planning activities. I urge the CFP Board to undertake *substantial changes* to the provisions of the proposal as they relate to the *fiduciary status* and the *fiduciary duties* of CFP certificants.

¹ Ron A. Rhoades, BS, JD, CFP® serves as Director of Research and Chief Compliance Officer of Joseph Capital Management, LLC, a fee-only registered investment adviser serving as private wealth manager to high net worth individuals, most of whom are retirees. Ron is the author of *The Science of Investing: How To Use Academic Research To Reduce Risks and Enhance Returns* (2003) and numerous articles regarding tax planning, estate planning, investment due diligence, financial planning, and risk management planning. He has frequently commented on the SEC's "Merrill Lynch Rule," as to the application of fiduciary duties to the activities of registered representatives providing services via fee-based brokerage accounts. While the principles set forth in this correspondence relating to the nature of fiduciary status, and while strict adherence to fiduciary duties are followed at Joseph Capital Management, LLC, this correspondence is submitted by Ron A. Rhoades personally and not on behalf of his firm.

A. Overview of Relevant Portions of The CFP Board's Proposal and a Summary of Its Flaws.

While many aspects of the proposed changes to the CFP Board's *Code of Ethics and Professional Responsibility and Financial Planning Practice Standards* (hereafter "Proposal") implicate the fiduciary status and fiduciary duties (including both the duties of loyalty and duties of due care) of a Certified Financial Planner™ (hereafter "CFP" or "CFPs" or "certificant"), the following content of the Proposal are most relevant to the discussion set forth in this comment letter:

1. Code of Ethics Proposal. As stated in the *Introduction* to the Proposal, the Code of Ethics "principles are aspirational in nature and intended to help guide all certificants, regardless of practice area, and to help certificants interpret and understand the spirit of the Rules of Conduct and the Disciplinary Rules." Stated differently, these are the "standards which certificants should strive to meet." The Principle which is most relevant to this discussion is set forth hereafter:

Principle 2 – Objectivity

Certificants should provide professional services *objectively*. Objectivity requires *intellectual honesty* and *impartiality*. Regardless of the particular service rendered or the capacity in which a certificant functions, Certificants *should* protect the integrity of their work, *maintain objectivity* and *avoid subordination of their judgment*.

[*Emphasis added.*] In essence, because the Code of Ethics are aspirational in nature, a CFP certificant could state to a client that he or she abides by the Code of Ethics of the CFP Board, when in fact there is no *requirement* to act objectively, with intellectual honesty and impartially, and in a manner in which the certificants' judgment is not suborned by the multiple conflicts of interest which are so pervasive in segments of the securities industry. This will lead to many instances of misrepresentation and fraud, as clients will be led to believe that they are protected by legal standards applicable to those who are required by law to render objective, impartial advice, when in fact the client is not so protected. I suggest that the CFP Board clearly note, with a footnote or explanation to this section, that certificants are only permitted to advise clients of the CFP's Code of Ethics and their adherence to same if they accept fiduciary duty status, as discussed in the pages following.

2. Rules of Conduct Proposals. As stated in the *Introduction*, the “Rules of Conduct establish a minimum level of professionalism required of certificants. The Rules of Conduct are binding on 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.” The portion of the Rules of Conduct which are most relevant to this discussion include:

1. Scope, Nature and Content Of The Engagement

1.1. The certificant and the client shall mutually agree upon the client’s personal financial goal(s) that are relevant to the services to be provided by the certificant under the agreement between the client and the certificant. The certificant or the certificant’s employer shall then enter into a binding written agreement with the client governing those services. This agreement may consist of multiple written components and must specify: ...

e. *Whether the certificant will be held to the duty of care of a fiduciary under the agreement.* It will be presumed that the duty of care of a fiduciary is to be applied to the professional judgments made by the certificant pursuant to the agreement unless the parties specify in their agreement a different legal standard governing these actions ...

1.2 Prior to entering into a written agreement, the certificant and the client must discuss as appropriate: ...

e. Whether the certificant will be held to the duty of care of a fiduciary under the agreement.

[*Emphasis added.*] In essence, the CFP Board’s new rules of conduct requires CFP certificants to indicate, in writing, what legal standard will govern the agreement between them and their clients. If no legal standard is designated, the default standard will be the fiduciary duty. Accordingly, the CFP Board proposes to create two vastly different standards of conduct for CFP certificants.

Troubling to this author is the lack of understanding of the fact that fiduciary status is imposed by law as a means of protecting those individuals who, due to inadequate knowledge and bargaining power, are unable to protect themselves. **The CFP Board attempts to navigate around the fiduciary status issue by having unsophisticated clients negotiate the legal standards applicable to their relationship. This negotiation, as will be seen in the discussion which follows, is something which clients are ill-equipped to do.**

Another Rule of Conduct states:

2.2 Prior to entering into an agreement, a certificant must provide a prospective client in writing: ...

b. A general summary of the ways in which the agreement likely *could present a conflict of interest* between the client and the certificant, the certificant's employer or any affiliates or third parties, including, but not limited to, information about any familial, contractual or agency relationship of the certificant or the certificant's employer that has a potential to materially affect the relationship.

[*Emphasis added.*] In the comments that follow I suggest that all *material* conflicts of interest be required to be disclosed in writing. I also provide suggested language which may be utilized by fee-only financial planners and registered investment advisers in discussing the conflicts of interest which, despite best efforts to minimize conflicts of interest, remain present and must be properly managed.

The key Rule of Conduct in the Proposal states:

6. Obligations to Clients

- 6.1 *A certificant must be able to answer clients' questions about the legal standards against which the certificant's professional behavior under the agreement will be measured.*
- 6.2. A certificant must provide professional supervision or direction to any subordinate or third party to whom the certificant delegates responsibility for any client services.
- 6.3 *A certificant must exercise reasonable and prudent professional judgment in providing professional services to clients.*
- 6.4 A certificant must make and/or implement only recommendations which are *suitable* for the client.
- 6.5 A certificant must advise his or her current clients of any certification suspension or revocation he or she receives from CFP Board.

[*Emphasis added.*] I suggest that very few CFP certificant truly understand the nature of fiduciary status and the many obligations it imposes, and hence are not equipped to answer questions about the differing legal standards.

Additionally, there is no mention that a CFP certificant who is acting as a fiduciary is held to a higher standard than that of mere “product recommendation” suitability - i.e., the fiduciary duties of due care and loyalty and the requirement to act in the *best interests of the client*.

Is the Proposal an improvement over the language of prior Rule 202, “A financial planning practitioner shall act in the interest of the client.” Under prior Rule 202 it was unclear if a financial planner must act in the “worst,” “reasonable,” or “best” interests of a client? (The word “best,” being dropped from the sentence by those who drafted or approved prior Rule 202, in essence rendered this language meaningless.) The proposed Rule of Conduct 6 also lacks the application of a clear standard of conduct applicable to all certificants. Moreover, the new Rule of Conduct 6 guts the prior rules completely. At least, under the prior rule, it could be inferred (as would be proper, given the close relationship between financial planner and client and their disparate level of knowledge) that a fiduciary standard applied to the certificant - client relationship.

The all-important new Rule of Conduct 6 sets forth the main standards of conduct governing CFP certificants when dealing with clients. Despite the importance of Rule of Conduct 6, it omits the requirement that (even when acting as fiduciary to a client under a written arrangement) the CFP certificant must act in the best interest of the client. Instead, Rule of Conduct 6 seems to apply the far-lower standard of suitability, and implies that such is all that is required. While not perfect, the approach of the prior rules, in highlighting at times the registration and/or other requirements imposed upon registered investment advisers, would be preferable.

This central provision of the Rules of Conduct therefore contains a gross omission. It should clearly state that all CFP certificants are required to act in the best interests of their clients. Even if the CFP Board adopts two different legal standards for certificants, this central provision of the Rules of Conduct should still clearly state that a CFP certificant, when acting as a fiduciary either pursuant to written agreement with the client or as determined by application of law, must act in the best interests of the client at all times.

3. Definitions. In the definition section of the Proposal is the following troubling definition of “fiduciary”:

“Fiduciary.” In good faith, with the care *an ordinarily prudent person in a like position* would exercise under similar circumstances; and in manner *he or she* reasonably believes to be in the best interests of the client.

[*Emphasis added.*] With respect, this is not the definition of a fiduciary, nor a correct recitation of the fiduciary duties of due care and loyalty. The duty of care requires that financial planners exercise reasonable care, prudence, and diligence in the performance of their professional duties. Fiduciaries are required to act on an informed basis, in good faith, and in the honest belief that the action taken or professional advice given is in the best interests of the client.

Moreover, the standard of care is not that of “an ordinarily prudent person in a like position” but rather the higher standard of “a prudent financial planning professional” - given the fact that CFP certificants are holding themselves out to be professionals and possessing the requisite knowledge, skill and experience to deliver financial planning services as a fiduciary and in accordance with the fiduciary’s duty of utmost due care. This aspect of the definition is unclear as written, and it should be made clear with better language.

By way of further explanation, the standard of prudence is relational, and it follows that the standard of care for professional financial planners is the standard 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.

The proposed definition in essence seeks to lower the true standards which govern conduct as a fiduciary, a result which, if adopted, may cause harm to millions of individual consumers of financial planning services. Additionally, such an adoption may cause the slow, inevitable decline of the universal fiduciary standard - which is, and should remain, the highest standard under the law. We should not permit erosion of the fiduciary aspects of professions. As stated by Chief Judge Cardozo of the Court of Appeals of the State of New York:

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.²

B. Application of the Rules of Conduct to All Financial Planning Activities. Before proceeding to the analysis section of this comment letter, I note for purposes of reference and accolades that a “financial planning engagement” is defined to exist “when a client signs a binding written agreement under which a certificant performs *some type* of financial planning service.” [*Emphasis added.*] Moreover, the definitions provide:

“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.

[*Emphasis added.*] I applaud the CFP Board to take the position that the performance of a service in any one area, including the discrete areas of portfolio design or asset allocation, will invoke the application of the Rules of Conduct to the activity. Accordingly, it does not appear to be necessary that “comprehensive financial planning” be undertaken for the Rules of Conduct to apply, a result that makes sense.

² *Meinhard v. Salmon*, 249 N.Y. 458, 164 N.E. 545, 546 (1928).

C. Understanding the Nature of Fiduciary Status. One cannot understand the absolute necessity for the CFP Board to insist upon fiduciary status without understanding the basis under the law for the imposition of fiduciary duties upon those who act in a close, confidential and trusted relationship with their clients.

1. The Knowledge Gap - Acknowledged By The Tully Report. In 1995 the Tully Report³ was issued by a "Committee on Compensation Practices" formed at the request of SEC Chairman Arthur Levitt to examine concerns about actual and potential conflicts of interest in the retail brokerage industry. In addition to recommending that sales contests for single products be eliminated and that identical commissions be paid to registered representatives of broker-dealer firms for sales of proprietary and non-proprietary products, the Committee also observed the following:

As a general rule, [registered representatives of broker-dealer firms] and their clients are separated by a wide gap of knowledge – knowledge of the technical and financial management aspects of investing. The pace of product innovation in the securities industry has only widened this gap. It is a rare client who truly understands the risks and market behaviors of his or her investments, and the language of prospectuses intended to communicate those understandings is impenetrable to many. This knowledge gap represents a potential source of client abuse, since uninformed investors have no basis for evaluating the merits of the advice they are given.

Understanding of this knowledge gap is central to understanding the nature of fiduciary status and the necessity for its imposition to financial planning professionals.

2. Understanding the "Knowledge Gap" and the "Nature of Fiduciary Status. 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."⁴ Fiduciaries have a duty, created by undertaking certain types of acts, to act primarily for the

³ Report of the Committee on Compensation Practices, April 10, 1995, Committee Chairman: Daniel P. Tully, Chairman and Chief Executive Officer, Merrill Lynch & Co., Inc.; Committee members also include: Thomas E. O'Hara, Chairman of the Board of Trustees, National Association of Investors Corporation; Warren E. Buffett, Chairman and Chief Executive Officer, Berkshire Hathaway, Inc.; Raymond A. Mason, Chairman and Chief Executive Officer, Legg Mason, Inc.; and Samuel L. Hayes, III, Jacob H. Schiff Professor of Investment Banking, Graduate School of Business Administration, Harvard University. The Tully Report may be found at <http://www.sec.gov/news/studies/bkrcomp.txt>.

⁴ Black's Law Dictionary, 5th Edition (1979).

benefit of another in matters connected with such undertaking.⁵ 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. In these relationships the person with the dominant position (hereafter the “fiduciary”) acts as if the interests of the other party (hereinafter the “client”)⁶ 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.

a. Clients Possess Weakness In Negotiating Contracts. In other words, clients 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. Just look at the passage rate for the CFP exam as evidence of the difficult knowledge hurdle which CFP certificants must achieve in order to serve their clients. Of course, other educational and experience requirements are also imposed upon CFP certificants, in recognition of the tremendous knowledge and expertise required to properly render financial planning advice. *Fiduciary status* is imposed by the law upon the party with the greater knowledge and expertise, in this instance the CFP certificant, in recognition by the law that the client is in need of protection and care.

b. Consensual Nature of the Relationship; But Not As To Imposition of Fiduciary Status. 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.

c. Public Policy Encourages Fiduciary Relationships. 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

⁵ *Id.*

⁶ A generic word to designate the party to whom a fiduciary obligation is owed might be “entrustor.” Terms applied in specific contexts include client, patient, beneficiary, shareholder, partner, and ward. I choose to utilize the word “client” as the best fit for an “entrustor” in the context of the financial planning relationship.

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 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.

d. Fiduciary Status Gives Rise To Marketability of the Fiduciary Services. Why would a person take on the role of a fiduciary, and be subject to fiduciary duties? Specifically, why would a person desire to become a Certified Financial Planner®, for example, knowing that the fiduciary's 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 CFP certificants, with a reputation for honesty backed by strict adherence to fiduciary standards of conduct and rigid enforcement by the CFP Board, the fiduciary is the recipient of a greater ability to promote and market his or her services. However, should the regulatory body, in this instance the CFP Board, permit the fiduciary duties to be eroded, or should the regulatory body permit others to undertake substantially the same services as those provided by the fiduciary without imposition of fiduciary

status, the increased marketability of the fiduciary is thwarted.⁷ This in turn leads to a degenerative cycle in which:

(1) The expert does not desire to enter into the profession of the fiduciary, as the same services can be performed under lesser standards (i.e., with greater freedom of action, and with less risk exposure to the fiduciary) under a functionally similar occupation. There is no clear benefit to the expert in terms of increased marketability of services, which might otherwise arise from the assumption of the fiduciary mantra.

(2) The client, who does not possess the knowledge and skill to discern the functional distinctions between the expert fiduciary and the expert non-fiduciary, and confronted with two persons which functionally provide the same services (i.e., under the Proposal, a CFP certificant who would choose to apply fiduciary standards to the relationship, versus one which would not), is unable to distinguish any increased benefit from those who possess fiduciary status. Even written disclosures,

⁷ Professor Macey in his 2002 article, which is extensively quoted from later in these comments, observed: "Each financial planner has incentive to develop and maintain a reputation for honesty and competence in order to increase the demand for his services. All financial planners suffer when the reputation of the profession suffers because consumers are unable to distinguish between high-quality services of ethical or competent financial planners and low-quality services of unethical or incompetent financial planners. This, in turn, reduces the market's demand and willingness to pay for financial planners. The practical implications of this basic problem, described by economists as "information asymmetry" because of the fact that consumers have less information than producers (and therefore the distribution of information between the sellers of services and the buyers of services is asymmetric) are important for the future of any industry or profession.

The general problem was first described in a famous article by George Akerloff, in which he showed what would happen to an industry if consumers were unable to distinguish between high quality producers and low quality producers [citing George A. Akerlof, *The Market for "Lemons": Quality Uncertainty and the Market Mechanism*, 84 Q. J. ECON. 488 (1970)]. The consequences of this problem are far more severe than may appear at first blush. The structure of the problem can be described with reference to the financial planning profession as follows: suppose, for the sake of clarity and simplicity, there are only three types of financial planners, excellent quality planners, whose work is worth \$900 per hour, medium quality financial planners, whose work is worth \$300 per hour, and low quality financial planners, whose work is worth minus \$300 per hour because of the costs that such planners impose on their clients through incompetence and fraud. Imagine further that consumers are unable to differentiate among these various types of financial planners until after they have received their services. They don't know whether the advice they are getting is of high, medium or low quality until they have purchased the advice. Where this is true, economists have shown that the products all will sell for the same price, because consumers who pay more than the standard market price still will be unable to increase the probability that they are receiving high quality advice." *Regulation of Financial Planners*, a white paper prepared for the Financial Planning Association by Jonathan R. Macey.

however detailed and prominent, cannot overcome the client's lack of knowledge, given the wide gap of knowledge which exists between the experts and the client. Often the client perceives that the expert non-fiduciary is supposed to act objectively and in the client's best interest (i.e., under fiduciary standards of loyalty and due care), when in fact this does not occur. Instead, the expert non-fiduciary possesses conflicts of interest, the nature and effect of which are seldom understood by the client until after harm results.

(3) The foregoing interplay leads to a downward spiral which results in the erosion of the reputation enjoyed by the fiduciary's profession. Functionally similar non-fiduciaries engage in conduct which results in harm, and such conduct is then attributed to the profession by consumers who fail to understand the distinctions between the fiduciary and non-fiduciary who perform the same services. Concurrently, clients become less trusting of CFP certificants and financial planners alike, and less likely to utilize the services which public policy sought to promote.

e. Law and Public Policy Play Important Roles As To Imposition of Fiduciary Status. In summary, 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 law and public policy play a crucial role in the imposition of fiduciary status and the relationships which follow from it. The law vests power and authority in the fiduciary, but requires the fiduciary to exercise that power and authority under strict standards of conduct for the client's benefit. The fiduciary's desire to assume the burdens of such strict standards of conduct results from the monopoly afforded to the fiduciary profession by the law.⁸ The client is encouraged to enter into the advisory relationship under the law'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 law 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 fiduciary in terms of marketing power.

⁸ The fiduciary is not afforded a monopoly himself or herself. Rather, the profession of the fiduciary - that of Certified Financial Planners™ - is afforded the monopoly. Within this profession the client, or consumer, will often possess a wide range of service choices. Despite the range of services which may be offered within the profession, each choice within that profession requires common fiduciary duties which are owed to the client.

3. The Macey Paper: An Unheeded Call To Clearly Define A Profession As Such. In 2002 the Financial Planning Association (FPA) issued a report⁹ authored by Professor Jonathan R. Macey regarding the regulation of financial planners. The report's observations include:

The financial planning community traditionally has been comprised of highly entrepreneurial individuals working in very small firms or as individual, sole proprietors. In the last decade this situation has changed. Large financial service conglomerates such as Merrill Lynch and Salomon-Smith-Barney are expanding the scope of their product offerings to include financial planning. Increasingly, it appears that *financial planning advice can be used as a platform from which to market a wide variety of financial services products* on a massive scale, including brokerage services, insurance services, annuity services, banking services, and retirement counseling. *The real concern* probably is not the expansion of the exemption from registration under the Investment Advisers Act so much as a concern about *the expansion of broker-dealers into the business of providing financial planning advice for a fee and at much lower consumer protection standards than required under the Advisers Act.*

One can only wonder if the failure by the CFP Board to adopt a fiduciary standard for the provision of financial planning advice is the result of this growth of the mega-firms and the lobbying efforts for “much lower consumer protection standards” than the standard of a fiduciary. The standard of a fiduciary is the proper standard for a true profession. As the size and complexity of the financial planning profession grows, competitive and market pressures may work to compromise the fiduciary and ethical principles that form the bedrock of the financial planning profession. Such pressures should be resisted by the CFP Board - the guardians of our profession, lest the bedrock be undermined and the profession fail to achieve or maintain its high level of distinction.

Professor Macey's report concluded in part:

Whether by state or federal regulation, *private sector oversight of standards*, or even through case law, the consolidation of, and changes within the financial services industry as a whole, requires not only the institution of generally recognized standards, for financial planning, but also a need to *clearly define the profession* so that its regulations may be efficiently and *fairly administered* for all concerned.

⁹ “Regulation of Financial Planners,” White Paper Prepared for the Financial Planning Association by Jonathan R. Macey, April 2002, available at <http://www.fpanet.org>, under “Government Relations” / “White Papers.”

[*Emphasis added.*] By permitting substantially different standards to apply to the provision of financial planning services by CFP certificants, the CFP Board has failed to “clearly define the profession.” Moreover, with completely different standards applying to different CFP certificant holders, as the Proposal promotes, there is no manner in which (in the real world) the Proposal “may be efficiently and fairly administered for all concerned.”

4. The 1994 Joint Report On Broker-Dealer Sales Practices: Protection of Clients Is Essential To Maintaining A Healthy Financial Planning Profession. In 1996 the NASD, NYSE, NASAA and SEC issued a report¹⁰ reviewing the sales practices of registered representatives of broker-dealer firms. The report observed: “The protection of customers from sales practice abuses or other financial harm is critical to maintaining a healthy securities industry.” Likewise, I submit that the protection of consumers of financial planning services is a critical role for the CFP Board to adopt and is critical to maintaining the health of financial planning as a profession.

5. The 2004 GAO Report: Individual Clients Do Not Possess the Knowledge and Means To Protect Themselves From Fraud. In October 2004 the General Accounting Office submitted a report to the U.S. Congress entitled “Industry Changes Prompt Need to Reconsider U.S. Regulatory Structure.”¹¹ An excerpt from the report follows:

Regulators protect individual investors who may not possess the information and expertise to protect themselves from fraud. "Generally, the United States relies on markets to promote the efficient allocation of capital throughout the economy so as to best fund the activities of households, business, and government. Financial services are subject to oversight for several reasons that relate to the inability of the market to ensure that the efficient allocation of capital will take place. Essentially, markets cannot ensure that certain kinds of misconduct, including fraud and abuse or market manipulation, will not occur and that consumers/investors will have adequate information to discipline institutions with regard to the amount of risk they take on ... In general, regulators help protect consumers/investors who may not have the information or expertise necessary to protect themselves from fraud and other

¹⁰ Report on the Joint Regulatory Sales Practice Sweep, prepared by the staff of the NASD, the NYSE, NASAA, and the Commission's Office of Compliance Inspections and Examinations (March 1996), at <http://www.sec.gov/news/studies/sweeptoc.htm>.

¹¹ GAO-05-61, “Financial Regulation: Industry Changes Prompt Need to Reconsider U.S. Regulatory Structure,” Report to the Chairman, Committee on Banking, Housing, and Urban Affairs, U.S. Senate, October 2004. The GAO's report may be found at <http://www.gao.gov/new.items/d0561.pdf>.

deceptive practices, such as predatory lending or insider trading, and that the marketplace may not necessarily provide. Through monitoring activities, examinations, and inspections, regulators oversee the conduct of institutions in an effort to ensure that they do not engage in fraudulent activity and do provide consumers/investors with the information they need to make appropriate decisions of financial institutions in the marketplace. *However, in some areas providing information through disclosure and assuring compliance with laws are still not adequate to allow consumers/investors to influence firm behavior.*

[*Emphasis added.*] In essence, the CFP Board is a regulator, although its powers are limited to those generally relating to the usage of the CFP marks. Nevertheless, the CFP Board must also recognize the very weak position of the consumer of financial planning services to negotiate the standard of legal conduct appropriate to the relationship. Understanding this inherent weakness, regulations should *impose* upon those who seek to enter into close, confidential relationships with clients the status of a fiduciary.

D. The Proposal Is Contrary to Law; Financial Planners Should Not Be Able To Choose Whether To Apply Fiduciary Status.

1. A CFP Certificant - Client Relationship Is One Based Upon Trust and Confidence. It is important to contrast the broker-client relationship, which is driven by contract and under which broad fiduciary duties are usually not imposed, with the financial planner-client relationship under which broad fiduciary duties are highly likely to be imposed by law, as will be seen in this section. The broker-client relationship is one in which the broker, or registered representative, acts as a “seller’s representative” and is generally compensated through the sale of products (hence the suitability rule, which applies to product sales, not the provision of other forms of advice). By contrast, relationships based upon trust and confidence, such as those of investment advisers or financial planners, are entered into by contract but the law imposes certain terms upon the contract. In such relationships based upon trust and confidence fiduciary duty status is not chosen by the parties; rather, fiduciary duties are imposed upon the investment advisor or financial planner by law and as a function of the relationship. Fiduciary law does not regulate the parties' behavior as to whether a relationship should be established. However, once the fiduciary and client enter into a relationship, the bargain concerning the duties owed by the fiduciary is governed not by contract but by law. This is because fiduciary status is imposed by law upon relationships in situations where the contracting parties possess vastly 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.

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.*]¹²

2. No Disclosures, Nor Sample Written Explanation of Fiduciary Status, Is Provided By The Proposal. The CFP Board's Proposal does not set forth any form of disclosure which should be provided to clients, in order that they are informed of the tremendous distinction between those CFP certificants who would operate under the standard of a fiduciary versus those who would operate as non-fiduciaries. No mandatory content in a written disclosure is required by the Standard of Conduct which is proposed. Nor does the CFP Board provide any standard explanation of the difference between the protections offered by fiduciary status and those under a lower standard, such as suitability. While such further disclosure standards or written explanations may be forthcoming, should the CFP Board adopt the Proposal in its current form the CFP Board should make, as part of the *required* Standards of Conduct, a separate written document which clearly describes for all consumers of financial planning services the vast distinction between fiduciary and non-fiduciary financial planners.

3. Can There Be An Intelligent Waiver of Rights Which Follow From Dealing With Fiduciaries? The Proposal simply instructs CFP certificants to have a discussion with clients to choose to not be afforded the fiduciary protections. The Proposal would, in essence, permit clients to waive¹³ fiduciary duties. While bargaining with the potential fiduciary on the issue of waiver, the clients must fend for themselves as

¹² *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.

¹³ Waive (vb.): [T]o abandon, renounce, or surrender (a claim, privilege, right, etc.); to give up (a right or claim) voluntarily. Black's Law Dictionary (7th Ed. 1999).

independent parties. Their right to rely on the *potential* fiduciary for objective, unbiased advice must be eliminated. In essence, the 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,¹⁴ it is highly unlikely that the typical client will possess the knowledge to make such an informed, intelligent decision.

It should be asked whether any intelligent individual seeking financial planning services, who is fully armed with an understanding of the protections afforded to the client by virtue of having a fiduciary (versus not having a fiduciary), would desire to waive such protections. In other words, a fully informed and rational client who seeks out objective, trusted financial planning advice would nearly always choose to possess a relationship with a fiduciary, wherein the fiduciary is legally required to act in that client's best interests. Rare if ever would be the case that a knowledgeable prospective client would choose that the financial planner be a non-fiduciary, held to a far lower standard and not legally required to act in the client's best interests.

4. Written Disclosures and Explanations Have Severe Limitations. As noted above, the quality of the client's consent via a contractual choice, is very doubtful. Moreover, given the many standard "forms" and "account disclosures" which are signed upon the commencement of most brokerage firm account relationships or the purchase of life insurance, any written disclosure of fiduciary or non-fiduciary status is unlikely to receive the scrutiny and contemplation it deserves by the client. Most individual investors are not lawyers, are unsophisticated as to Wall Street's terminology, and are highly unlikely to read and understand¹⁵ a highly

¹⁴ "PIABA believes that mandatory disclosures, warnings, and explanations are of little practical value in establishing investor protection in this area. This is particularly true in view of the complexity of the concepts at issue. It is unrealistic to expect that the average investor will be able to understand and evaluate a meaningful analysis of a brokerage firm's duties under the federal securities laws in contrast to an investment adviser's duties under the Advisers Act. Further, suggesting that investor confusion can be addressed by designating a person at the brokerage firm to explain the terminology ignores the implications of the obvious conflict of interest. Boilerplate disclosures for advisory accounts cannot be deemed a substitute for imposing the statutory duties otherwise applicable under the Advisers Act." *Comments of Laurence S. Schultz, Federal Legislation Committee Chairman, Public Investors Arbitration Bar Association, February 4, 2005, regarding the "Merrill Lynch Rule" (Investment Advisers Act applicability to fee-based brokerage accounts) before the SEC.*

¹⁵ 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:

important disclosure when confronted by a multitude of other forms and disclosures. In fact, most “plain English” brochures are anything but, as they blur the distinctions between fiduciary and non-fiduciary services.

A notable exception is the *Cutting Through the Confusion* brochure, available at <http://www.nasaa.org/content/Files/CuttingThroughTheConfusion.pdf>, and published as a joint effort of the CFA Institute, the FPA, the NASAA, the IAA, and the Consumer Federation of America. Query how this brochure would change if the CFP Board’s proposed changes would become effective? Query as well how many individual clients, not possessing a knowledge of financial planning concepts, would be able to make intelligent choices, even armed with this fairly well-written brochure.

Choosing fiduciary or non-fiduciary status is simply too much to ask of the client, 90% or more of whom do not know (and cannot reasonably be expected to quickly learn) of the enormous distinctions in the standards of conduct applicable to fiduciary and non-fiduciary financial planners.

5. Paternalism Is Necessary To Advance the Public Good. Does this sound paternalistic? Perhaps, but in many situations paternalism - the need to protect the client (entrustor) to advance the public good - is the reason behind imposition of fiduciary duties. As stated by Professor Frankel:

Paternalistic protections, that is, protections of members of a class regardless of their own express and clear intent, are not limited to fiduciary law. Such protections are grounded in many and diverse principles, and exist in the law of contracts as well. Paternalistic attitudes can derive from the observation that most members of a particular class lack competence or sufficient bargaining power and are therefore incapable of independent consent to waive their legal protections or bargain around them. Further, members of a protected class may be "rationally apathetic" and fail to protect themselves. If the disappointment of members of a class, such as investors, can affect the system, for example, by a "run" on the financial markets, the investors' waivers may be ignored ... Another reason for mandatory

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.” The article is available for a nominal fee at <http://papers.nber.org/papers/w12261>. 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. It is all-important for our industry to promote and advance the fiduciary standard.

fiduciary duties is the policy to provide fiduciaries with a level playing field, and to deter them from competing by dishonest treatment of entrustors or by providing less-than-acceptable quality of services. For example, the Securities Acts put market fiduciaries and contract actors on such a level playing field by prohibiting waivers of rights under the Acts.¹⁶

6. Clients Cannot Rely Upon Guidance From Non-Fiduciaries As to Whether Fiduciary Status Should Be Chosen or “Waived”. The Proposal from the CFP Board in essence forces the client into a situation where, lacking substantial knowledge of the many aspects of financial planning and securities laws and the nature of fiduciary duties, will be looking to the CFP certificant for advice. In essence, the CFP certificant, armed with enormous knowledge and power, becomes the client’s “surrogate decision-maker.” However, unless the surrogate decision-maker is himself or herself an independent fiduciary, without conflicts of interest, and governed by standards of conduct (which need to be further defined), this does not solve the problems associated with the Proposal’s bad idea of granting to clients the choice as to whether to “waive” the application of fiduciary duties to the upcoming relationship.¹⁷

7. Erosion of Fiduciary Principles Will Result. The Proposed Rule in essence seeks to provide a broad exception to the fiduciary duty requirements imposed upon those who provide comprehensive and/or ongoing financial planning advice to clients. This exception will erode the fiduciary aspects of the financial planning profession and may adversely affect other fiduciary professions as well. As stated by Chief Judge Cardozo of the Court of Appeals of the State of New York:

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

¹⁶ Frankel, *Fiduciary Duties as Default Rules*, 74 Or. L. Rev. 1209 (1995)

¹⁷ Again, it must be asked whether *any* person, acting as a surrogate decision-maker or advisor to a client as to whether to waive the fiduciary duties of one who desired to provide financial planning advice, could ever advise a client to forego the fiduciary duty. There is no advantage in the waiver of the legal requirement to act in the client’s best interests and as a fiduciary. This is because the same services could be obtained, for the same fees, from another advisor who chooses to be bound by the fiduciary duty. If a choice were to exist, there simply is no situation in which a knowledgeable person would advise a client to forego the fiduciary protections which could otherwise afforded to the client.

exceptions. Only thus has the level of conduct for fiduciaries been kept at a level higher than that trodden by the crowd.¹⁸

8. “Choice” or “Waiver” Of Fiduciary Status Does Not Make Sense. I submit that the effectiveness of the “waiver” which is suggested by the Proposal is highly doubtful. It is further doubtful that the Proposal regarding choice of fiduciary or non-fiduciary status of the financial planner can be “fixed,” as the concept of choice of fiduciary or non-fiduciary status is contrary to established legal principles governing the nature of fiduciary relationships.

9. Choice of Fiduciary Status Is Potentially Violative of the Investment Advisers Act of 1940. The CFP Board’s Proposal to permit clients to waive the application of fiduciary status by choice of contract terms is also potentially violative of the Investment Advisers Act of 1940, a federal legislation which due to the SEC’s broad interpretation of “investment advice” applies to most financial planning activities.¹⁹ This is because the concept of waiving fiduciary duties is very similar (if not essentially identical to) the concept of a “hedge clause” in investment advisory contracts. The basic test for determining the legality of a particular hedge clause is contained in an early release of the SEC. It is interesting to note that this release was written not only in the context of investment advisory agreements, but was also intended to address the use of hedge clauses by brokers and dealers. The release simply states that “the anti-fraud provisions of the Securities and Exchange Commission statutes are violated by the employment of any legend, hedge clause, or other provision which is likely to lead an investor to believe that he has in any way waived any right of action he may have....”²⁰ This test is consistent with Section 215(a) of the Investment Advisers Act of 1940 which states that “[a]ny condition, stipulation, or provision binding any person to waive compliance with any provision of this title or with any rule, regulation or order thereunder shall be void.” Furthermore, in determining whether a particular hedge clause does, in fact, mislead the client into believing that he has waived any state or federal right of action, it

¹⁸ *Meinhard v. Salmon*, 249 N.Y. 458, 164 N.E. 545, 546 (1928).

¹⁹ Under the Final Rule, Certain Broker-Dealers Deemed Not To Be Investment Advisers, available at <http://www.sec.gov/rules/final/34-51523.pdf>, the Investment Advisers Act of 1940 applies to broker-dealer registered representatives who hold themselves out generally to the public as a financial planner or as providing financial planning services, or delivers to its customer a financial plan, or represents to the customer that the advice is provided as part of a financial plan or financial planning services. As the Final Rule’s issuing release notes, most financial planners are registered under the Investment Advisers Act of 1940. Despite this, the CFP Board’s Proposal does not note that in situations covered by the Investment Advisers Act of 1940 that fiduciary duties are applicable at all times to the relationship, and are not capable of being waived contractually or otherwise.

²⁰ Release No. 40-58, (April 18, 1951), Fed. Sec. L. Rep. (CCH) para. 56,383-6.

should be remembered that any breach of an adviser's fiduciary duty to his client may, *ipso facto*, give rise to a fraud action under the securities laws. Along these lines, the SEC has noted that "[a]n investment adviser is a fiduciary. As such he is required by the common law to serve the interest of his client with undivided loyalty ... [A] breach of this duty may constitute a fraud within the meaning of clauses (1) and (2) of Section 206 of the Investment Adviser Act (as well as the anti-fraud provisions of the Securities Act of 1933 and the Securities Exchange Act of 1934)." ²¹

10. Choice of Fiduciary Status Is Contrary to Common Law Principles Applicable To Imposition of Fiduciary Status. Additionally, a financial planner's hedging of liability may also contravene common law standards of fiduciary responsibility. In other words, the mere attempt to have a client sign a form, in which the client would negate the application of fiduciary duties, would *in and of itself* be a violation of fiduciary duties imposed by common law upon professional relationships based upon trust and confidence.

E. Standards of Conduct, Applicable to Fiduciaries, Should Be More Clearly Defined In The Rules of Conduct. The Proposal advances a definition of fiduciary which appears, as I have previously discussed, to redefine the duties of a fiduciary toward a lesser standard. Fiduciary duties are defined by law, and as previously stated the all-important duties of due care and loyalty should not be diminished by the CFP Board.

Under English law, from which our 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. From these five broad duties,²² and other sources, can be derived the various standards of conduct which should be applicable to CFP certificants.

²¹ Release No. 40-40 (Jan. 5, 1945), Fed. Sec. L. Rep. (CCH) para. 56,374.

²² How many CFP certificants can recite these five broad duties? If they cannot, how can they conduct a meaningful discussion with a prospective client regarding whether the contractual relationship should be governed by fiduciary standards or not?

The CFP Board's Standards of Conduct should properly seek to further define and apply these fiduciary principles to the activities CFP certificants. For example, in applying the standard of due care, standards of conduct could include the following:

Standards of Conduct: Adherence To The Certificant's Firm's Duty of Due Care In the Provision of Services

1. The certificant should achieve and maintain the level of competence required to render the financial and/or investment advice being sought, either through the certificant's own efforts or through the adoption of a team approach with other professionals or firms.
2. The certificant should gather necessary factual information regarding the client which is necessary and appropriate to provide the recommendations.
3. 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.²³

Other standards of conduct can be discerned; the foregoing is not, by any means, a complete listing.

Following a prudent process is important in adherence to the duty of care. While there has been an increased emphasis on following a prudent process in recent years, and this is a welcome development and benefits the

²³ "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 fiduciary duty is not one which should be subjected to compromise.

For more commentary regarding the due diligence of financial planners and investment advisers in recommending mutual funds to clients, as to the issue of discerning the "total fees and costs" of these 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."

In recommending investments to clients and undertaking financial planning, taxes also play an important role and must be taken into account by the CFP certificant. Why else would the CFP exam place such an emphasis on the application of federal income tax law and regulations to financial planning for both individuals and business entities? For example, please refer to my comments on the application of tax planning concepts to the issue of whether variable annuities are suitable (from a tax and cost perspective) for clients (*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>).

training and education of CFP certificants, process alone is not sufficient. Substantive Rules of Conduct are also important.

The U.S. Securities and Exchange Commission has placed great emphasis on disclosure of conflicts of interest by registered investment advisers. **However, mere disclosure of conflicts of interest does not meet the obligation of the CFP certificant holder, acting under a fiduciary duty, to act in the best interests of the client at all times.** This central concept should be set forth in the Rules of Conduct applicable to CFP certificants.

Moreover, the Standards of Conduct should make it clear that fiduciary status should not be capable of being “turned on and off” by any person. Once fiduciary relationship is established, it should thereafter be continuously applied to all activities - since the individual consumer will not be able to discern between those activities which are “clearly advisory” in nature and those which are only “incidentally advisory” in nature.

Those who seek to provide comprehensive financial planning services under the auspices of the CFP designation and mark should embrace the necessity to act in the best interests of the client, not seek to lessen their fiduciary role.

F. Disclosure of All Material Conflicts of Interest Should Be Required. While the Proposal instructs certificants to provide a “general summary of the ways in which the agreement likely could present a conflict of interest between the client and the certificant,” no disclosure language is suggested. I believe the standard of disclosure should be changed to provide that *all material conflicts of interest must be disclosed in writing* to the client, prior to the inception of the client - certificant relationship. I further submit that the proposed language – which only requires a “general summary” of “the ways” in which the agreement “likely” could present a conflict of interest – is so vague as to render it meaningless and unenforceable.

The conflicts of interest possessed by most registered representatives and life insurance agents are numerous in quantity and quality, and challenge the very nature of acting in the best interest of the client. However, conflicts of interest also exist for fee-only advisors. To this end, I note that I have rarely seen disclosures of conflicts of interest by fee-only planners (in their Form ADV, Part II) in which there is adequate disclosure of material conflicts of interest. I suggest that fee-only financial planners consider the following language:

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

1. 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.

2. 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).

3. 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).

G. Conclusion and Recommendations.

At first glance, upon hearing the CFP Board's Proposal, I felt that those registered representatives and insurance agents who already availed themselves of the education and testing required to attain the CFP mark should not see their efforts be lost, and that the adoption of fiduciary status might be unfair to them. However, upon reflection (and it did not take long) I believe that the greater, long-term considerations (affecting the status of financial planning as a profession and affecting the important protections to which clients are clearly entitled) strongly prevail over the short-term concerns of CFP certificants who are either registered representatives or insurance agents and who may not desire to adhere to a fiduciary standard.

All of the efforts of the CFP Board of the past many years to obtain "professional status" for CFP certificants - the adoption of tough CE requirements, a Code of Ethics, and the requirement that new entrants (beginning in 2007) possess a Bachelor's degree,²⁴ may be wasted if the CFP Board permits CFP certificant holders to not adhere to the legal standard of the fiduciary. The CFP Board needs to ask its members this simple question - do you desire to be a member of a "profession" or a "trade"? If the answer is "members of a profession" - as I am certain the vast majority of members would respond - then the embracement of fiduciary status is altogether necessary for professional status to be attained.

There are powerful commercial forces at work in the securities world seeking to preserve the old and archaic system of selling products to customers. These forces seek to defeat the spread of the better model - a profession consisting of fiduciary purchaser's representatives and fiduciary advisors. The CFP Board must have *courage*,

²⁴ The requirement of a Bachelor's degree is a clear step undertaken to advance the practice of financial planning to professional status. In *Kuntz v. Muehler*, 603 N.W.2d 43, 47 (N.D. 1999), the North Dakota court emphasized that a CFP practitioner is not required to possess a college degree when ruling that a CFP certificant was not a professional for purposes of a statute of limitations. The decision stated in part: "A profession is a calling requiring specialized knowledge and often long and intensive preparation including instruction in skills and methods as well as in the scientific, historical, or scholarly principles underlying such skills and methods, maintaining by force of organization or concerted opinion *high standards of achievement and conduct*, and committing its members to continued study and to a kind of work which has for its prime purpose the rendering of a public service [This] definition stresses the long and intensive program of preparation to practice one's chosen occupation traditionally associated only with professions. *Jorgensen v. State National Bank & Trust Company*, 583 N.W.2d 331, 334-35 (Neb. 1998) (quoting Tylle, at 441 and holding "retirement planners" are not professionals)." [*Emphasis added.*]

in the face of continuous pressure from these powerful forces, to continue to promote CFP certificants as a profession and not as a mere commercial enterprise.

Without imposition of fiduciary status on all those who utilize the CFP mark, the wrong path will have been chosen by the CFP Board. The consequences of choosing this wrong path are severe:

- The CFP mark will lack meaning as a standard of both educational achievement and adherence to appropriate standards of professional conduct – the CFP® mark, which I utilize behind my other designations (B.S., J.D.), possesses *significance* only if CFP certificants are professionals who adhere to fiduciary standards (otherwise the CFP® mark lacks significance and I would be inclined to drop it entirely);
- The CFP mark will fail, due to a lack of marketability, over time;
- No incentives will exist for other financial planners to seek out the CFP mark as the standard for excellence;
- Individuals seeking out financial planning services will not receive the protections they deserve, given their lack of knowledge when entering into financial planning engagements;
- The organization known as the Certified Financial Planner Board of Standards, Inc. will become devoid of purpose and meaning; and
- Another professional organization (perhaps the FPA or NAPFA, or an organization not yet formed) will likely properly advance financial planning as a profession of fiduciaries (thereby rendering the CFP Board, as with other relics from the past, to the back room of an infrequently visited museum of history).

Perhaps another mark will be borne of the confusion created by the Proposal. For example – “Certified Fiduciary Financial Planner” (CFFP), anyone? If a “CFFP” designation were to be formed, then CFP would, over time, be considered the “light weight” mark, surely not a result intended by the CFP Board.

I fail to understand the reluctance of some CFP mark holders (and their employing firms) to embrace the fiduciary standard. Why would anyone in business today choose not to act in the best interests of their clients? The CFP Board should not participate in, nor foster, such a course of action by permitting CFP certificants to practice under a lower standard which is devoid of real substance and significant meaning.

Seventy years ago Supreme Court Justice Harlan Stone observed:

I venture to assert that when the history of the financial era which has just drawn to a close comes to be written, most of its mistakes and its major faults will be ascribed to the failure to observe the fiduciary principle, the precept as old as holy writ, that 'a man cannot serve two masters.' More than a century ago equity gave a hospitable reception to that principle and the common law was not slow to follow in giving it recognition. No thinking man can believe that an economy built upon a business foundation can permanently endure without some loyalty to that principle ... Yet those who serve nominally as trustees, but relieved, by clever legal devices, from the obligation to protect those whose interests they purport to represent ... suggest how far we have ignored the necessary implications of that principle. The loss and suffering inflicted on individuals, the harm done to a social order founded upon business and dependent upon its integrity are incalculable.²⁵

I cannot wonder if the Proposal, by failing to adopt the fiduciary standard as applicable to all financial planning activities of CFP certificants, is not contributing to an erosion of the legal protections which should properly be afforded to those clients who put their trust and confidence in our profession.

²⁵ 48 Harv. L. Rev. 1, 8 (1934).

In summary, I urge the CFP Board to act quickly and change direction. The CFP Board should ensure that we have a true profession in the future. The CFP Board should clearly state that fiduciary duties apply to CFP certificants whenever financial planning activities are being undertaken. Finally, the CFP Board should refer the Proposal back to an appropriate committee for the formulation of Rules of Conduct which fully reflect fiduciary standards and which provide substantial and detailed guidance to CFP certificants as to the conduct of their practices.

Thank you for the opportunity to submit these comments. Please contact me if I can be of service as the CFP Board re-considers these Rules of Conduct and, hopefully, seeks to develop and elicit the proper Rules of Conduct applicable to fiduciary financial planners.

Yours respectfully,

Ron A. Rhoades, B.S., J.D., CFP®