

Exposure Draft Revisions to CFP Board's Code of Ethics and Professional Responsibility and Financial Planning Practice Standards

Certified Financial Planner Board of Standards, Inc. (CFP Board) seeks comments on the accompanying Exposure Draft Revisions (Exposure Draft) to its *Code of Ethics and Professional Responsibility (Code)* and *Financial Planning Practice Standards (Practice Standards)*.

The key features of the Exposure Draft are summarized and explained in this memo. The Exposure Draft is Attachment A. The Notice and Request for Comment is Attachment B. The current *Code* and *Practice Standards* are Attachment C.

Reasons for Revisiting the Code and Practice Standards

CFP Board's Board of Governors (the Board) regularly evaluates CFP Board's core functions, summarized by the Four "Es": education, experience, exam and ethics. In 2005, the Board began a review of its ethics-related functions. This Exposure Draft is one result of that review.

CFP Board's *Code* is modeled after other professional codes. It was introduced in 1993 and has changed very little since then. Its content is essentially unchanged in the Exposure Draft.

CFP Board's *Practice Standards*, on the other hand, has evolved since the first installments were created in 1995 by a committee of CFP[®] practitioners. Systematic additions continued after that, with the most recently added sections first effective in January 2002.

In 2003, a committee of CFP[®] certificants reviewed CFP Board's ethical standards to evaluate how effectively they worked. This committee proposed changes which were the starting point for the present review. While this review was taking place, the Board of Professional Review was also reporting challenges applying the *Practice Standards* to specific cases. So the review of the *Code* and *Practice Standards* was timely when the ethics "E" came up for evaluation.



Implementation Challenges with the Current *Code* and *Practice Standards*

These bodies, along with the Board and staff, identified a number of ways to improve CFP Board's ethical standards. These include:

- Clearing up repetitive and conflicting language.¹
- Closing a loophole that makes the *Practice Standards* hard to enforce.²
- Clarifying which ethical standards are aspirational and which are binding.³
- Re-ordering the content so it tracks the process certificants and clients typically follow.
- Making all the ethical standards apply to all individuals—and only individuals—over whom CFP Board has responsibility and authority (those with rights to use the marks). CFP Board will not apply its ethical standards to individuals or entities over whom CFP Board lacks authority or responsibility, including candidates,⁴ other professionals, and employers of certificants.
- Changing the name of the binding ethical standards to the more accurate title, *Rules of Conduct*.

Most Content Remains Unchanged

Nearly all of the content in the current *Code* and *Practice Standards* remains in the Exposure Draft, even with the changes in the organization, format and length of the standards.

The Exposure Draft makes some stylistic changes. It uses shorter sentences. It uses more present-tense sentences. It tries to avoid general or vague words.

The Exposure Draft, like the current documents, avoids imposing requirements on all individuals entitled to use the marks that are only appropriate for some of these certificants. The people CFP Board certifies practice in a wide range of settings. CFP Board has made every effort to create ethical standards that are

¹ Most of this repetition results from the fact that CFP Board's *Practice Standards* were systematically added to a set of rules it had previously adopted, the *Code*. The *Code* contained much of the same material as the *Practice Standards*, resulting in repetition and inadvertent inconsistencies between the two documents.

² Most of the current *Practice Standards* apply only to conduct that is labeled "financial planning." CFP Board is charged with protecting the marks, and its binding ethical standards therefore should govern anyone authorized to use those marks regardless of what label they apply to the work they undertake. This problem is one of the most serious with the current *Practice Standards* and has created unintended challenges for the Board of Professional Review when it has attempted to apply the *Practice Standards* to individuals who classify their activities as something other than "financial planning." The Exposure Draft makes clear that anyone with the right to use the marks is subject to the ethical standards elaborated in the Exposure Draft.

³ The Exposure Draft makes clear that the *Code* is aspirational while the *Rules of Conduct* are binding. Certificants risk losing their certification if they fail to comply with all of CFP Board's binding ethical standards, so it is important that both certificants and the public receive adequate direction as to which behaviors are allowed and which are forbidden of those entitled to use the marks. In the Exposure Draft, the *Code* still retains legal weight, as it is used to help interpret the more specific *Rules of Conduct*.

⁴ CFP Board has recently adopted *Candidate Character and Fitness Standards* for individuals seeking to become certified and those who have relinquished the rights to use the marks. The *Candidate Character and Fitness Standards* were developed to end CFP Board's current practice of holding candidates responsible for abiding by the *Code* and *Practice Standards* in their behavior prior to becoming certified, as CFP Board held no authority over those candidates at the time the behaviors occurred that would justify holding them accountable to the *Code* and *Practice Standards*.

fair and appropriate for anyone who enjoys the right to use its marks. As described below, however, CFP Board intends to fill some of these gaps by supplementing the *Rules of Conduct* with Best Practices and other guidance which can apply to subsets of certificants, such as those who provide financial advice to clients.

Certain Provisions Removed

A few provisions in the current ethical standards have been eliminated. Most of these governed behavior over which CFP Board lacks authority.

For example, the draft *Rules of Conduct* does not include language requiring certificants to notify CFP Board when they observe potential rule violations by other certificants. CFP Board can prohibit certificants from *assisting* in inappropriate behavior; it should not *require* certificants to do CFP Board's job of investigating potential rule violations by other certificants. Certificants, indeed, can get into legal trouble if they attempt to be vigilantes. Instead, the Exposure Draft creates a moral obligation for certificants to inform CFP Board of unprofessional behavior, a more appropriate balancing.

The Exposure Draft similarly does not include language requiring certificants to maintain the profession's public image. Certificants are responsible for insuring that their *own* behavior meets CFP Board's standards (which will have the effect of enhancing the image of the profession), but they do not have a separate and additional obligation to CFP Board to further the profession's public image.

The draft *Rules of Conduct* omits language specifying how certificants must behave with regard to *other* professional designations they hold. That behavior is outside CFP Board's authority to police. Similarly, the draft *Rules of Conduct* changes some of the language in the current standards that relates to certificants' relationships with employers and co-owners. These changes are designed to make clear that CFP Board is overseeing *the certificants*, and not attempting directly to police third parties.⁵

Finally, since one of the main premises of the existing ethical standards (and of the six-step process) is that certificants and clients mutually define the scope of the engagement, the draft *Rules of Conduct* leaves out a few short passages that conflict with this concept.⁶

⁵ CFP Board *can and does* have a direct impact on certificants' behavior with their employers and co-owners through enforcement of its standards, so this summary should not be read to imply that these relationships are of no importance to CFP Board. The difference is a subtle one—CFP Board imposes obligations directly on certificants that will affect what those certificants can do with their employers and co-owners, but CFP Board does not act as an arbitrator or judge between such parties because CFP Board does not have any direct authority over any party except certificants. Thus, for example, the draft *Rules of Conduct* requires certificants to tell their employers if they have been disciplined by the Board of Professional Review—this is an obligation imposed *on certificants* that affects the employer, but it does not put CFP Board between the parties as an arbitrator.

⁶ For example, the Exposure Draft deletes the “but are not limited to” words from Practice Standard 500-1: “The practitioner’s responsibilities may include, *but are not limited to* the following.” This contradicts one of the main themes of the *Practice Standards* that certificants and clients mutually define what the certificant’s responsibilities will be in each engagement. This language is not only unfair to certificants, it is dangerous—a grievant could point to it as justification for claiming a certificant owed services not included in the explicit agreement between the parties.

A Few New Provisions Added

Although small in number, the additions to the Exposure Draft are more significant than the deletions.

1) Most significantly, the draft *Rules of Conduct* requires certificants to indicate what legal standard will govern the agreement between them and their clients. If a certificant does not specify a legal standard, the default standard will be the fiduciary duty of care (defined in the Terminology section as, “in good faith, with the care an ordinarily prudent person in a like position would exercise under similar circumstances; and in a manner he or she reasonably believes to be in the best interests of the client”).

This default duty of care is designed to impose the fiduciary standard of care where it is most needed and avoid imposing it where it is either not needed or inappropriate. Regarding the latter, recall that the draft *Rules of Conduct* applies to everyone with a right to use CFP Board’s marks—this includes individuals who may, for example, be academics or government employees or media commentators and so forth. It would be inappropriate to impose a fiduciary standard on such individuals who do not have the information, role or responsibility for which that legal term is relevant.

Similarly, setting the fiduciary standard as the default duty of care allows individuals the freedom to create contracts that specify different legal standards for different services. Such contracts are increasingly common as more and more professional services are purchased company-to-company rather than individual-to-individual. The draft *Rules of Conduct* allows for parties to create their own agreements and specify their own legal standards, as long as these standards are part of the writing that will now be required of all client engagements (described below).

By having the fiduciary standard as a default standard, CFP Board targets those client situations most likely for abuse or misunderstanding—those where the client does not know enough to ask about or specify a legal standard. Under the draft *Rules of Conduct*, a certificant’s obligations to a client will either be those of a fiduciary or he or she will have to reveal in writing to the client what alternative standard applies.

2) The draft *Rules of Conduct* introduces the requirement that a contractual engagement between a certificant and client be evidenced by some kind of writing. The draft *Rules of Conduct* does not specify what that writing must look like, and it does not require that the writing be signed by the certificant. It is the Board’s sense that nearly all professional engagements are already captured in some form of written engagement or contract.

This provision has two main purposes. The first is to deter casual, verbal-only agreements where the parties do not fully understand each other’s obligations. Other professions that have imposed a similar

Similarly, the Exposure Draft deletes from 500-1 the statement that “The client is responsible for accepting or rejecting recommendations.” This also conflicts with the main theme of the *Practice Standards* that the client and the certificant mutually agree upon who is responsible for what. A client may wish to give a certificant total investment discretion and be relieved of the need to review recommendations, for example.

obligation have found that it (a) forces the parties to hash out the terms of their agreement more effectively and (b) reduces malpractice and other post-agreement litigation that arises out of fundamental misunderstandings about who is responsible for what.

The second reason to require a writing of some type is to ensure that there is a document that the Board of Professional Review can use to resolve disputes fairly. He said/she said differences over what each party was obliged to do are common grounds for dispute.

The draft *Rules of Conduct* provides a short list of basic terms which must be addressed in the writing. The draft *Rules of Conduct* also provides a separate list of subjects which certificants are encouraged to address as appropriate.

- 3) The draft *Rules of Conduct* expands the requirement that certificants keep clients' information secure to include reasonable electronic security.
- 4) The draft *Rules of Conduct* requires certificants to give clients a description of the ways in which the certificant may be compensated under the agreement. This provision is designed to get at some of the most common and fundamental conflicts of interest and uneven levels of information confronted by certificants and clients.
- 5) Finally, the draft *Rules of Conduct* also makes clear certificants must provide professional supervision or direction to third parties to whom they delegate responsibility for client services. This deters certificants from disclaiming responsibility for the behavior of others who perform services on their behalf for the certificants' clients.

Supplementary Best Practice Guidance in Development

To fill the gap between *Rules of Conduct* that must remain general enough to apply to all individuals entitled to use the marks, and the need for more specific guidance applicable to the regular activities engaged in by subsets of certificants, CFP Board plans to begin supplementing the *Code* and *Rules of Conduct* with a third level of guidance. This new body of "Best Practices" will be similar in some ways to the Standards of Practice that guide specialized medical practices.

This guidance may take a variety of forms, from checklists to advisory opinions (of which two already exist) to sample engagement letters for specific purposes. We anticipate that some of the first Best Practices will provide examples of how the default fiduciary duty of care applies to specific situations. We also anticipate that much of the activity-specific content of the current *Practice Standards*, which very usefully follows the six-step financial planning process, will be included in the Best Practices materials. It is expected that a substantial amount of this guidance will relate to the large subset of certificants who provide financial advice to individual clients, an area that cannot be adequately addressed with the more general *Rules of Conduct*.

In addition, CFP Board is working to create Sanctions Guidelines to give more guidance to those in CFP Board's professional review process and those who wish to avoid being part of that process. So the Exposure Draft is best viewed as only one of many initiatives CFP Board is undertaking to fulfill the ethics obligations of its Mission.

Next Steps

A separate Notice and Request for Comment describes the process and timeline CFP Board is following to solicit stakeholder and public opinion on this Exposure Draft.