



Getting the full picture

The emerging best interest and fiduciary duty patchwork

August 21, 2019

CFP Board's New Standard of Conduct

Introduction

On March 29, 2018, the Certified Financial Planner Board of Standards, Inc. (the CFP Board) adopted a revised Code of Ethics (the Code) and Standards of Conduct (the Standards) that require a certified financial planner (CFP) to act as a fiduciary.¹ Pursuant to this new fiduciary standard, and as discussed more fully below, the CFP must act in the best interest of the client at all times when providing financial advice.

The new Code and Standards become effective on October 1, 2019. However, on July 16, 2019, the CFP Board announced that it would not enforce the new Code and Standards until June 30, 2020.² The revised enforcement date aligns with the effective date of the SEC's new Regulation Best Interest, which was adopted by the US Securities and Exchange Commission (SEC) on June 5, 2019, and imposes a "best interest" standard on broker-dealers and their natural associated persons when making certain securities recommendations to retail customers.

While broker-dealer and investment adviser firms are not themselves CFPs, such firms frequently permit, and in some cases encourage and even financially support, their registered representatives and supervised persons to obtain the CFP designation. As a result, the CFP Board's new standards have caused many broker-dealers and investment advisers to consider how this CFP fiduciary standard fits within their existing supervisory framework, and whether any action by the firm is called for.

Background on Standards

New Code of Ethics

The Code sets forth principles that guide the behavior of CFPs, with elaboration provided in the Standards.³ Under the Code, a CFP must (1) act with honesty, integrity, competence, and diligence; (2) act in the client's best interest; (3) exercise due care; (4) avoid, or disclose and manage, conflicts of interest; (5) maintain the confidentiality and protect the privacy of client information; and (6) act in a manner that reflects positively on the financial planning profession and the CFP certification.

New Standards of Conduct

The Standards are divided into six sections: Section A addresses duties owed to clients; Section B provides the definition of financial planning and triggers for the financial planning process; Section C outlines the Practice Standards that apply to the financial planning process; Section D addresses duties owed to firms and subordinates; Section E addresses the duties owed to the CFP Board; and Section F addresses the prohibition on circumvention. We summarize the significant changes to the Standards below.

1 CFP Board's Code of Ethics and Standards of Conduct (March 2018), available at <https://www.cfp.net/docs/default-source/for-cfp-pros---professional-standards-enforcement/cfp-board-code-and-standards.pdf?sfvrsn=23>

2 CFP Board Press Release (July 16, 2019), available at <https://www.cfp.net/news-events/latest-news/2019/07/16/directors-of-cfp-board-set-enforcement-date-for-new-code-and-standards>

3 CFP Board, *Roadmap to the Code of Ethics & Standards of Conduct* (effective Oct. 1, 2019).

1. The Fiduciary Duty

Under the current Standards of Conduct, a CFP's fiduciary duty obligations are limited to the CFP's financial planning activities. However, the revised Standards require a CFP to act as a fiduciary when providing Financial Advice⁴ to a Client,⁵ which includes recommendations related to developing or implementing a financial plan. A CFP's fiduciary duty under the revised Standards includes a duty of loyalty, duty of care, and duty to follow client instructions.

Under the duty of loyalty, a CFP professional must (1) place the interests of the Client above the interests of the CFP or his or her firm; (2) avoid Material Conflicts of Interest (which are discussed below), or fully disclose Material Conflicts of Interest to the Client, obtain the Client's informed consent, and properly manage the conflict; and (3) act without regard to the financial or other interests of the CFP, his or her firm, or any individual or entity other than the Client.

Under the duty of care, a CFP must act with the care, skill, prudence, and diligence that a prudent professional would exercise in light of the Client's goals, risk tolerance, objectives, and financial and personal circumstances. The duty to follow Client instructions requires a CFP to comply with all objectives, policies, restrictions, and other terms of the Engagement⁶ and all reasonable and lawful directions of the Client.

2. Disclose and manage conflicts of interest

When providing Financial Advice, a CFP must make full disclosure of all Material Conflicts of Interest with the Client that could affect the professional relationship. A "Conflict of Interest" exists when (1) a CFP's interests (including the interests of his or her firm) are adverse to the CFP's duties to a Client or (2) a CFP has duties to one Client that are adverse to another Client. A Conflict of Interest is "Material" when a reasonable Client or prospective Client would consider the information important in making a decision. In order to satisfy the disclosure obligation, the CFP must provide the Client with sufficiently specific facts so that a reasonable Client would be able to understand the CFP's Material Conflicts of Interest and the business practices that give rise to the conflicts, and provide informed consent to the conflicts or reject them. Prior to providing Financial Advice that involves a Material Conflict of Interest with a Client, a CFP must make full disclosure and obtain the consent of the Client.

In determining whether disclosure of a Material Conflict of Interest to a Client is sufficient to infer that the Client has provided informed consent to the Material Conflict of Interest, the CFP Board will evaluate whether a reasonable Client would have understood the conflict and how it could affect the advice provided by the CFP. The CFP Board notes that it is less likely to infer informed consent absent clear evidence of informed consent, when the potential harm the conflict presents to a Client is greater and the more a business practice giving rise to the conflict departs from commonly accepted practices among CFPs. Additionally, the CFP Board notes that ambiguity in disclosures will be interpreted in favor of the Client. Finally, we note that while written consent to Material Conflicts of Interest is not required, evidence of oral disclosure of a conflict will be given such weight as the CFP Board deems appropriate.

3. Providing information to a client when providing financial advice

When providing Financial Advice to a Client that does not require Financial Planning, a CFP professional must provide certain information to the Client. The information must be provided prior to or at the time of the Engagement, and the CFP professional must document that the information has been provided to the Client. The CFP must provide (1) a description of the services and products to be provided; (2) how the Client pays for the products and services, and a description of the additional types of costs the Client may incur, including product management fees, surrender charges, and sales loads; (3) how the CFP, the CFP's firm, and any related party are compensated for providing the products and services; (4) the existence of any public discipline or bankruptcy, and the location(s), if any, of the webpages of all relevant public websites of any governmental authority, self-regulatory organization, or professional organization that sets forth the CFP professional's public disciplinary history or any personal bankruptcy or business bankruptcy where the CFP professional was a control person; (5) the information required under Section A.5.a. (Conflict of Interest Disclosure); (6) the information required under Section A.9.d. (Written Notice Regarding Non-Public Personal Information); (7) the information required under Section A.13.a.ii. (Disclosure of Economic Benefit for Referral or Engagement of Additional Persons); and (8) any other information about the CFP or the CFP's firm that is Material to a Client's decision to engage or continue to engage the CFP or his or her firm.

4 "Financial Advice" is defined as (a) a "communication that, based on its content, context, and presentation, would reasonably be viewed as a recommendation that the Client take or refrain from taking a particular course of action with respect to: 1. The development or implementation of a financial plan; 2. The value of or the advisability of investing in, purchasing, holding, gifting, or selling Financial Assets; 3. Investment policies or strategies, portfolio composition, the management of Financial Assets, or other financial matters; 4. The selection and retention of other persons to provide financial or Professional Services to the Client; or (b) the exercise of discretionary authority over the Financial Assets of a Client." In contrast, "Financial Planning" is defined as "a collaborative process that helps maximize a Client's potential for meeting life goals through Financial Advice that integrates relevant elements of the Client's personal and financial circumstances." See CFP Board, Glossary, *Code of Ethics and Standards of Conduct for CFP Professionals* (effective Oct. 1, 2019).

5 "Client" is defined as "[a]ny person, including a natural person, business organization, or legal entity, to whom the CFP professional provides or agrees to provide Professional Services pursuant to an Engagement." See CFP Board, Glossary, *Code of Ethics and Standards of Conduct for CFP Professionals* (effective Oct. 1, 2019).

6 "Engagement" is defined as an "oral or written agreement, arrangement or understanding." See CFP Board, Glossary, *Code of Ethics and Standards of Conduct for CFP Professionals* (effective Oct. 1, 2019).

4. Providing information to a client when providing financial planning

When providing Financial Planning to a Client, a CFP professional must provide certain additional information. The information must be provided in one or more written disclosures prior to or at the time of the Engagement and must include (1) almost all of the information required when providing Financial Advice (as set forth in the prior section); and (2) the terms of the Engagement between the Client and the CFP or his or her firm, including the Scope of Engagement⁷ and any limitations, the period(s) during which the services will be provided, and the Client's responsibilities. Importantly, the Standards note that a CFP is responsible for implementing, monitoring, and updating the Financial Planning recommendation(s) unless this is specifically excluded from the Scope of Engagement.

5. Updating information

Under the Standards, a CFP has an ongoing obligation to provide the Client with any Material updates or changes to the information required to be provided to the Client. In addition, a CFP must disclose any Material changes and updates to public disciplinary history or bankruptcy information within 90 days, together with the location(s), if any, of the webpages of all relevant public websites of any governmental authority, self-regulatory organization, or professional organization that sets forth the CFP's public disciplinary history or any personal bankruptcy or business bankruptcy where the CFP was a control person.

6. Recommending, engaging and working with additional persons

When engaging or recommending the selection or retention of additional persons to provide financial or professional services for a Client, the Standards require a CFP to (1) have a reasonable basis for the recommendation or Engagement based on the person's reputation, experience, and qualifications; (2) disclose to the Client, at the time of the recommendation or prior to the Engagement, any arrangement by which someone who is not the Client will compensate or provide some other material economic benefit to the CFP, the CFP's firm, or a related party for the recommendation or Engagement; and (3) when engaging a person to provide services for a Client, exercise reasonable care to protect the Client's interests.

Additionally, when working with another financial or professional services provider on behalf of a Client, a CFP professional is required to (1) communicate with the other provider about the scope of their respective services and the allocation of responsibility between them; and (2) inform the Client in a timely manner if the CFP has a reasonable belief that the other provider's services were not performed in accordance with the scope of services to be provided and the allocation of responsibilities.

Applying the new Code and Standards

1. Triggering the standards of care

From time to time, CFPs may be required to comply with federal and state laws that conflict with the Code and Standards. Even when these laws have requirements that overlap with some of the requirements in the Code and Standards, they may be triggered in different ways. For example, a CFP must comply with the Standards when providing Financial Advice to Clients. At the same time, a supervised person of an investment adviser owes clients a fiduciary duty when providing investment advice, including advice about investment strategies, and engaging a sub-adviser. Under the Investment Advisers Act of 1940, as amended (the Advisers Act), an investment adviser is a fiduciary and owes its clients a duty of loyalty and a duty of care. Under the Code and Standards, a CFP is required to act as a fiduciary and in the Client's best interest at all times, including fulfilling a duty of loyalty and duty of care. Therefore, a CFP who is a supervised person of an SEC registered investment adviser will be required to comply with similar standards of conduct under federal law and the Code and Standards.

In contrast, a registered representative must comply with Regulation Best Interest when making a recommendation of any securities transaction or investment strategy involving securities to a retail customer or prospective retail customer. Regulation Best Interest will require a registered representative to act in the best interest of a retail customer at the time a recommendation of any securities transaction or investment strategy involving securities is made, without placing the financial or other interest of the broker-dealer ahead of the interests of the retail customer. Under the Code and Standards, however, a CFP will be required to act as a fiduciary and in the Client's best interest at all times. Among other things, the CFP will have to satisfy a duty of loyalty and a duty of care, which include an obligation to provide a significant amount of information not required by Regulation Best Interest, an obligation to update this information, and an obligation to provide ongoing monitoring and updates to financial plans (unless excluded from the scope of an Engagement). Compliance with Regulation Best Interest will not satisfy a CFP's fiduciary duties under the Code and Standards.

2. Conflicts of interest

As noted above, the Code and Standards require a CFP professional to avoid conflicts of interest, or to disclose *and* manage conflicts of interest.⁸ The Advisers Act requires an investment adviser to eliminate, or at least expose through full and

⁷ "Scope of Engagement" is defined as "[t]he Professional Services to be provided pursuant to an Engagement." See CFP Board, Glossary, *Code of Ethics and Standards of Conduct for CFP Professionals* (effective Oct. 1, 2019).

⁸ See CFP Board, Glossary, *Code of Ethics and Standards of Conduct for CFP Professionals* (effective Oct. 1, 2019).

fair disclosure, all conflicts of interest that might incline an adviser to render advice that is not disinterested.⁹ Under the Advisers Act, an adviser is required to eliminate or mitigate conflicts of interest only when the adviser cannot fully and fairly disclose the conflict of interest to a client, such that the client can provide informed consent.¹⁰ As a result, a CFP who is a supervised person of an investment adviser will be required to also manage any conflicts of interest that he or she chooses not to avoid, even if the conflict is fully and fairly disclosed to the client and consented to by the client.

Under Regulation Best Interest, a registered representative will be required to address conflicts of interest by establishing, maintaining, and enforcing policies and procedures reasonably designed to identify and fully and fairly disclose material facts about conflicts of interest, and mitigate, or altogether eliminate certain conflicts.¹¹ As noted above, the Code and Standards require a CFP to avoid conflicts of interest, or to disclose *and* manage the conflict. As a result, a registered representative who is a CFP will be required to also manage any conflicts of interest that he or she chooses not to eliminate, even if the conflict is fully and fairly disclosed to the Client. On the other hand, that registered representative will be required to altogether eliminate certain conflicts of interest under Regulation Best Interest, including “sales contests, sales quotas, bonuses, and non-cash compensation that are based on the sales of specific securities or specific types of securities within a limited period of time.”¹²

3. Disclosures

Regulation Best Interest. Under Regulation Best Interest’s Disclosure Obligation, prior to or at the time of a recommendation, a broker-dealer (or associated person) must provide full and fair disclosure in writing of all material facts relating to the scope and terms of the relationship with the retail customer. Compliance with the disclosure provisions in Regulation Best Interest would not satisfy a CFP’s obligation to disclose the various items under the Standards that are discussed above.

Form CRS. Form CRS will require investment advisers and broker-dealers to provide a Form CRS relationship summary to retail investors that contains succinct disclosures addressing the following topics: (1) an indication that brokerage and investment advisory services and fees differ, and that it is important for a retail investor to understand the differences between these two types of services and fees; (2) a description of the relationships and services offered to retail investors, including a discussion of whether the firm provides monitoring services, its potential investment authority, any limitations on investment offerings, and account minimums and other requirements; (3) detailed descriptions about the fees and costs that retail investors will pay; (4) any conflicts of interest; and (5) the applicable standard of conduct, disclosures of disciplinary information, and additional information about the brokerage or investment advisory services it offers and contact information. Compliance with the obligations of Form CRS would not satisfy a CFP’s obligation to disclose the various items under the Standards that are discussed above.

Form ADV. Investment advisers registered with the SEC are required to provide certain disclosures under Part 2A and Part 2B of Form ADV. Part 2A requires an adviser to disclose the following in narrative form: the advisory business, compensation, types of clients, disciplinary information, financial industry activities and affiliations, code of ethics and participation or interest in client transactions and personal trading, brokerage practices, account reviews, client referrals, custody of client funds and securities, investment discretion, voting client securities, and financial information. Part 2B requires disclosure about certain supervised persons of an investment adviser, including educational background, business experience, disciplinary information, outside business activities, compensation, and supervision. Compliance with the disclosure obligations of Form ADV generally would not satisfy a CFP’s obligation to disclose the various items under the Standards that are discussed above.

Enforcement implications

How will the CFP Board enforce its new standards?

Broker-dealers and investment advisers do not have any obligation to supervise or enforce the CFP Board’s Code or Standards. Rather, the Code and Standards are primarily enforced by the CFP Board through its own internal disciplinary process. Investigations begin with a complaint about a CFP professional initiated by a customer or sometimes a competitor. CFP Board counsel (i.e., CFP staff attorney) then reviews the complaint to determine whether further investigation, including document requests and interviews, is warranted based on the allegations in the complaint. Upon completion of an investigation, if the CFP Board counsel determines there is probable cause to believe grounds for discipline exist, a formal complaint will be issued against the CFP professional. There is then a hearing on the merits in front of three CFP professionals, at least one of whom must be a member of the CFP Board’s Disciplinary and Ethics Commission. If the panel determines there has been a violation, the possible sanctions against the CFP professional include suspension or revocation of the CFP designation.

9 SEC, Commission Interpretation Regarding Standard of Conduct for Investment Advisers, 84 Fed. Reg. 33669, 33671 (July 12, 2019).

10 SEC, Commission Interpretation Regarding Standard of Conduct for Investment Advisers, 84 Fed. Reg. 33669, 33677 (July 12, 2019).

11 SEC, Regulation Best Interest: The Broker-Dealer Standard of Conduct, 84 Fed. Reg. 33318 (July 12, 2019). Under Regulation Best Interest, a “Conflict of Interest” is defined as “an interest that might incline a broker-dealer—consciously or unconsciously—to make a recommendation that is not disinterested.” Exchange Act Rule 15l-1(b)(3).

12 Exchange Act Rule 15l-1(a)(2)(iii)(D).

Will the SEC or FINRA enforce the CFP Board's Code and Standards?

The SEC and the Financial Industry Regulatory Authority, Inc. (FINRA) do not enforce the CFP Code or Standards. FINRA, however, could bring a disciplinary action against a CFP professional alleging violations of FINRA's "just and equitable" principles rules for violations of the new Code or Standards. For example, FINRA has disciplined a registered individual for violating FINRA Rule 2010 by misappropriating funds of a local organization for which the individual served as treasurer. Moreover, if a firm implements new internal policies and procedures to address how to supervise its registered representatives who carry the CFP designation, the SEC or FINRA might be able to bring an action against it for failure to follow its own internal policies.

Will private litigants enforce the CFP Board's new standards?

While the new Code and Standards do not create a private right of action, it is likely that claimants will identify the new fiduciary standard as the applicable duty for any duty-based claims (e.g., negligence, breach of fiduciary duty). Therefore, any deviation from that fiduciary standard of care may be able to be used to show a violation of the CFP professional's duty for those claims.

Compliance policies and procedures

Broker-dealers and investment advisers will need to consider whether to take any action to assist with compliance with the CFP Board's Code and Standards for any associated persons who are CFP professionals. While there are explicit supervision obligations placed on firms to ensure their associated persons comply with the SEC's new Regulation Best Interest, there are no equivalent requirements for the Code and Standards.

However, the Code and Standards do reference certain policies and procedures that firms may wish to maintain. For instance, Section A.9 of the Standards provides that CFPs must, either directly or through their firm, adopt policies regarding the protection of certain non-public personal information. In addition, Section D.2 of the Standards provides that CFP professionals will be disciplined by the CFP Board for violating the firm's policies and procedures so long as the firm's policies and procedures are consistent with the Standards.

Perhaps more important, broker-dealers and investment advisers will need to consider whether they want to leave it to the individual CFP professionals to handle compliance with the Code and Standards, or whether the firms want to restructure their own policies and procedures to reflect the expanded CFP fiduciary duty.

Conclusion

The CFP Board's new Code and Standards, requiring that a CFP act as a fiduciary at all times when providing advice, go into effect on October 1, 2019. Although the CFP has announced that it would not enforce the new requirements until June 30, 2020, broker-dealers and advisers will want to begin considering whether they should take any action to help ensure that their associated persons who are CFP professionals comply with the new fiduciary standard.

Contacts

For more commentary regarding the emerging landscape related to the standards of conduct for investment professionals, visit Eversheds Sutherland's www.secfiduciaryrule.com.

If you have any questions about this Legal Alert, please feel free to contact any of the attorneys listed below or the Eversheds Sutherland attorney with whom you regularly work.

Clifford Kirsch, *Partner*

T: +1 212 389 5052

cliffordkirsch@eversheds-sutherland.com

Brian Rubin, *Partner*

T: +1 202 383 0124

brianrubin@eversheds-sutherland.com

Adam Pollet, *Counsel*

T: +1 202 383 0812

adampollet@eversheds-sutherland.com

Michael Koffler, *Partner*

T: +1 212 389 5014

michaelkoffler@eversheds-sutherland.com

Ben Marzouk, *Counsel*

T: +1 202 383 0863

benmarzouk@eversheds-sutherland.com

Bria Adams, *Associate*

T: +1 202 383 0810

briaadams@eversheds-sutherland.com

Related people/contributors

- Eric Arnold
- Susan Krawczyk
- Holly Smith
- Nicholas Rinaldi
- Wilson Barmeyer
- Carol McClarnon
- W. Mark Smith
- Sarah Sallis
- Bruce Bettigole
- S. Lawrence Polk
- John Walsh
- Amber Unwala
- Adam Cohen
- Stephen Roth
- Issa Hanna
- Pooja Kohli
- Olga Greenberg
- Cynthia Shoss

eversheds-sutherland.com

© Eversheds Sutherland Ltd. 2019. All rights are reserved to their respective owners. Eversheds Sutherland (International) LLP and Eversheds Sutherland (US) LLP are part of a global legal practice, operating through various separate and distinct legal entities, under Eversheds Sutherland. For a full description of the structure and a list of offices, please visit eversheds-sutherland.com. US10027_082119