

# Ethical Issues

## Part I

©Commonwealth Schools of Insurance, Inc.



P.O. Box 22414

Louisville, KY 40252-0414

Telephone: 502.425.5987

Fax: 502-429-0755

Web Site: [www.commonwealthschools.com](http://www.commonwealthschools.com) Email: [info@commonwealthschools.com](mailto:info@commonwealthschools.com)

## **DISCLOSURE**

This booklet is intended to provide you with accurate and useful information, ideas and applications. However, the information contained herein is subject to change through legislation or from industry practice.

The sample codes presented herein were accurate as of the date this publication was created. However, any changes by the respective organizations may substantially affect the information presented.

This material is presented and distributed for educational purposes only. The material does not constitute legal, accounting, or other professional advice.

**©Commonwealth Schools of Insurance, Inc.**

## INTRODUCTION

*"To be trusted is a greater compliment than to be loved."*

Some people feel the moral and ethical fiber of our society is deteriorating rapidly. Others see both positive signs and disturbing signs, but feel optimistic. While there is room for a difference of opinion on this issue, most people agree on the importance of maintaining a high ethical standard in a society that is to survive and prosper.

Some would argue that it is even more important to maintain a high ethical standard in the insurance industry. What is there about the insurance transaction that makes a high ethical standard so important? Some of the unique aspects of the insurance industry combine to create this necessity.

### **Insurance is an Essential Product**

In our society, both individuals and businesses depend on the insurance product to provide essential services and protect them from financial disaster:

- Health insurance provides access to quality medical care.
- Life insurance proceeds support families, educate children, and assist in the perpetuation of a business.
- Property coverage is an integral part of every mortgage contract.
- Some casualty contracts (automobile and workers' compensation, for example) are required by law.

In modern society, insurance has become a necessity.

### **Insurance is a Financial Product**

If your travel agent does not do a professional job planning your vacation, she may ruin a week of your life.

If an insurance agent does not do a professional job planning for your insurance needs, she may ruin you financially.

Insurance is at the very foundation of a sound financial plan. Inadequate or inappropriate insurance products can have significant impact on an individual, a family, or a business.

### **Insurance is Purchased Based on Trust**

Although modern insurance contracts are easy-to-read, it does not follow that they are easy-to-understand. Few insureds read their policies; those who do, seldom understand what they are reading. Most people buy their coverage based on trust.

They trust the agent to recommend and procure appropriate coverage. They trust the insurance company to follow through and pay a claim. Trust is an important factor in the purchase of insurance.

These are three of the primary reasons it is imperative that individuals, working in the insurance industry, maintain a high ethical standard.

## **Ethics in the Insurance Industry**

Much is made of the poor image of the insurance industry. Consumers normally do not think of insurance in a positive light. In his analysis of the insurance industry, Lawrence G. Brandon, CPCU, identified five weaknesses of the industry that lead to such a poor reputation.

- Lack of leadership allows insurance organizations to be driven by stockholder expectations rather than long-term goals.
- Poor communication about how the industry and its products are designed to work leads to misunderstandings.
- Lack of customer focus often leads to an adversarial position at a time the customer needs the product the most.
- Burdensome bureaucracies create a negative image.
- Unhealthy competition destroys the pricing integrity of the insurance product.

## **Ethics in Agency Ranks**

The same polls that show the insurance industry is not to be trusted, usually show something quite different about the insurance agency. Most people, when questioned, will tell you their particular agent is doing a good job in looking out for their best interests. The consuming public trusts their local agent much more than they trust the industry as a whole.

Dr. Solomon S. Huebner, pioneer educator who founded the American College of Insurance, seldom spoke of education without also speaking of ethics. The ethics brochure used by the College today, comments on Dr. Huebner's beliefs: "To him, a professional relationship between an agent and client had to be based on sound ethical principles."

"In applying this expert knowledge the practitioner should abandon the strictly selfish commercial view and ever keep in mind the advantage of the client. Conscientious and disinterested service — proper advice and guidance — is the very essence of professional conduct, and in the long run the best policy."

—Dr. Solomon S. Huebner, 1915

Dr. Huebner believed the success of the industry depended on individuals who were both knowledgeable and ethical. How would you feel about doing business with someone whose integrity is unquestioned, but his understanding of the business is less than adequate? How would you feel about doing business with someone extremely bright and knowledgeable, but of questionable morals?

High ethical standards are important in the agency of today, and, fortunately, most insurance agencies meet the challenge. Although it is becoming increasingly difficult, insurance agencies have been successful at attracting and retaining significant numbers of quality, educated individuals who are committed to making the insurance product work for their clients.

While agencies attract individuals with comparatively high ethical standards, the ethics of those individuals is challenged, on a daily basis, by both the insurance industry and the individual clients the agency serves.

### **From a Practical Standpoint**

In the October, 1996 issue of an insurance E&O newsletter, the Vice President of Errors and Omissions with Utica National, Curtis M. Pearsall, identified four trends in E&O. One of trends that was mentioned is of particular interest to our discussion.

"In trials in which juries perceive the insurance agent has done something unethical, damages are now being awarded to the greatest extent possible. The amounts may not be labeled 'punitive,' but the effect is the same. The plaintiff can be awarded the entire amount being sought – even if the amounts would normally be questionable."

Every agent, today, faces significant ethical challenges. The way they respond to those challenges has never been more important.

### **Good Ethics is Good Business**

Maybe it's because our industry is regulated and we are required to satisfy a continuing education requirement. Or maybe it's because our trade association makes it a point to promote ethical behavior. Maybe it is because many of us realize that ethical practices make good business sense. Whatever the reason, agents can be proud of the fact that the Insurance and Financial Services industry produced impressive results in the 2001 Walker Information National Employee Benchmark Study on Integrity in the Workplace, a follow-up to their groundbreaking study first conducted in 1997 and again in 1999.

The goal of this study was to collect and present information on integrity, ethics, and employee loyalty. A total of 3,592 questionnaires were mailed throughout the United States to employees in business, non-profit, and government organizations. Results were tabulated from a total of 2,795 questionnaires returned in the summer of 2001. Listed from best to worst, the industry ranking – as perceived by their employees – based on workplace ethics are:

1. Insurance
2. Financial Services
3. Business Services
4. Wholesale Trade
5. Technology
6. Health Services
7. Communication
8. Manufacturing
9. Retail Trade
10. Transportation

When asked why he thinks the Insurance and Financial services industries scored well in this survey, Marc Drizin, Vice President and Employee Loyalty Specialist from Walker Information, said, “I believe there are two factors. First, both of these industries are regulated and have compliance requirements. The second factor is that success in these industries is dependent upon a company’s ability to build a ‘good’ reputation in the market place. If the consuming public learns that an Insurance or Financial services company is guilty of lying, cheating, or stealing, it will die a very quick death.”

## **The Bad News**

Although these results cast a bright light on our industry, agents need to keep this in mind: If the statistics show that one out of every five employees in our industry is aware of at least one ethical violation over the past two years, there is still a long way to go.

So what kind of ethical violations are agents seeing? When Insurance and Financial Services employees were asked: “Please describe the behavior you suspect is or was in violation,”

- Half reported witnessing unfair treatment of employees;
- 4 in 10 reported improper/personal use of company resources;
- 25% reported lying or intentionally misleading customers;
- Half reported lying on reports or falsifying records;
- 1 in 2 reported lying to supervisors; and
- 4 in 10 reported conflicts of interest.

## **How to Raise the Ethical Bar**

Walker Information Vice President Jeff Marr suggests, “Integrity is clearly a top down value. If senior leaders don’t exhibit the behaviors and decisions of high integrity, the company’s employees aren’t going to go the extra mile to do the right thing.” Leadership is critical if you want to build an ethical organization, but not just with C.E.O.’s and Board members. Ethical leadership can come from anyone. In theory, it is very simple.

For the insurance industry to make significant strides ethically, each agent, individually, has to commit to doing what is right. Agents must do so, not because they have to in order to meet a compliance regulation, but because it is good business. More important, it is the right thing to do.

## **PART I - ETHIC FUNDAMENTALS**

### **INTEGRITY**

Integrity should be a part of all facets of your practice, laying the foundation for an honest and trustworthy relationship with your clients. Applying integrity should not be seen as a burden, but instead as an integral part of your business.

Common areas where your integrity may be tested include: advertising, product sales, processing errors, and disclosure.

### **Advertising**

Obviously, clients are the life-blood of the business. As such, advertising for new clients is a necessity. The ethical problem arises in the form of the advertising used.

You should not use false or misleading advertising. While an advertisement may meet the letter of the rules, it may still be unethical if it violates the spirit of the rules.

As a financial planner, you should not make false or misleading statements about the size, scope or areas of competence of your practice. You should not distribute materially false or misleading materials to the public.

You should not use misleading advertising that creates unjustified expectations for the recipient.

## **Product Sales**

Regardless of your method of compensation (fees and/or commission), investment or insurance products may be recommended to your clients. The ethic issue arises from the incentives and compensation provided by the product sponsors.

In recommending a product, your client places trust in you to be honest and independent. Therefore, you should not allow sales incentives, promotions, or commission levels to influence your decision.

## **Processing Errors**

Mistakes do happen, whether a computer error, clerical error, or otherwise. The ethical issues arise in how you handle the error. Errors require your prompt attention, to correct and to disclose to your client.

## **Disclosure**

Honesty is a key element in your integrity. Honesty requires you not only to answer client inquiries truthfully. It also requires you to disclose truthful information material to a client's decision-making process.

## **Integrity – Case Study**

John Client comes to your office for an appointment, having attended one of your firm's free seminars on retirement planning. The seminar focused on common issues faced by retirees including planning for future changes in economic and health needs. The seminar offered general comments to arouse concern and interest among the attendees. At the end of the seminar, each attendee was offered a free initial consultation at your office.

At the initial meeting John brings detailed personal information. However, he has chosen not to bring his spouse, because "it is my retirement and she will agree with whatever I decide." John has not yet retired, but he wants to retire as soon as possible, providing his assets will support this decision. He is discussing with you his options and his current situation.

John tells you he will need at least \$3,000 net per month to live the way he is accustomed to living. As for income, John's wife does not work outside of the home. His sole source of income for now will be from his retirement assets.

John has not prepared a budget and states that he has no intention of doing so. He will not be eligible for Social Security income for another six years (current age 56). His primary asset is his retirement account from his current employer. The lump sum current value is \$275,000, however, if he postpones retirement for to age 59, the value will increase to \$315,000.

John informs you that he will be eligible only for 18 months of COBRA health insurance, at which time he will need to purchase health insurance for himself and his wife. His health is average, although he does take some expensive prescriptions for his hypertension and borderline diabetes. He does tell you that if he waits to retire at age 59, his employer will provide medical coverage for him and his wife until age 65, or Medicare eligible whichever comes first.

In deciding how to best advise John, you realize that you are currently lagging behind in your investment sales quota. John's investment of \$275,000 would help put you back on track for the end of the year production bonus, as well as meet your quota. In addition, one of the wholesalers is currently offering you an extra 1% concession for all new business. You decide to recommend to John that he retire now.

Would your actions violate your ethical obligations to John?

Yes. Even if you were able to defend the high rate of withdrawal required by John in order to meet his current needs, the future problems for John would seem to weigh against recommending him to retire now. Further, the apparent conflict from the product sales quota and your personal income incentives would appear to compromise your independence and honesty.

While your actions may be defensible, based on the facts given, the appearance of a biased self-interest would be significant.

## **OBJECTIVITY**

In providing objective advice and recommendations to clients, you must be intellectually honest and impartial. Objectivity is defined as someone who is uninfluenced by emotion or by personal bias.

When working with a client, you should exercise reasonable and prudent professional judgment. Providing professional services implies to the client that you are in fact acting in their best interest. As such, you must maintain impartiality in making recommendations or in providing advice to your client.

In exercising reasonable and prudent judgment, you may rely on your experience, knowledge, and education to determine an appropriate course of action. Again, prudent judgment does not imply perfect judgment.

Your judgment does not have to be flawless, it must simply be reasonable in light of the facts and the circumstances.

Prudent is viewed from the eyes of the industry as a whole, given the facts and the circumstances. If a person with similar knowledge, experience, and education would have acted in a similar fashion, you will have acted in a prudent fashion.

To better assist yourself in determining whether a particular course of action is prudent or reasonable, ask yourself whether you would make the same recommendation to yourself. While this is by no means a definitive test, it will help you to refocus on the interests of your client.

## **Conflicts of Interest**

Conflicts of interest will arise in the course of your practice. However, you must learn to recognize where conflicts exist which may affect your objectivity. Conflicts can and do arise at inopportune times.

Learning how to deal with conflicts, as well as to anticipate potential conflicts will serve you and your practice well.

Common examples where conflicts may arise include - divorce, death, product sales, and personal holdings.

### **Divorce**

It goes without saying that divorce is a common occurrence and that it can wreak havoc on a financial plan and finances. However, there is also the issue of a conflict of interest for you.

If both the husband and the wife are clients, you face the difficult choice of being placed between the two in the divorce proceedings. While it may be possible to stay at arm's length, at some point you will be asked to provide financial advice to one, or both, of the spouses. This presents a conflict that is not easily resolved.

### **Death**

With proper planning, a client's finances may be reallocated to the surviving spouse, children, and/or family. However, as is often the case, there may be disgruntled family members who feel they have been treated unfairly by the terms of the will, or by the executor.

Your duty is to the client and his representative - executor. As a result, you may have a conflict of interest with any of the beneficiaries (or non-beneficiaries) of the estate. You may be asked to reveal asset values or other confidential information.

Absent consent from the executor, you may not reveal this information, regardless of your good intentions.

### **Product Sales**

Anytime a product sale is involved with a client, there is the risk of a conflict of interest. Your interest may be in the commissions from the sale. In this instance, simply apply the prudent man standard in evaluating your recommendation.

## Personal Holdings

Aside from the various security regulations, you may have a conflict of interest when you make recommendations concerning companies in which you have a financial stake. Be sure to document the disclosure of your holdings, prior to making any recommendation.

## Objectivity– Case Study

Janet Fleece has come to you for assistance. She wants your assistance and advice in determining how best to invest for her daughter's future college needs. Currently, the daughter is only three years old. The amount of money Janet has to invest at this time is \$1,200, but she plans to add at least \$50 per month.

After discussing with Janet her available investment options, it becomes clear that Janet is not a sophisticated investor. She has never invested in stocks, bond, or mutual funds. While she articulates in a 401(k) at work, she has directed all of her investments to the fixed income account. In addition, Janet has completed an investor profile that indicates she prefers conservative investments.

Based on Janet's information and interview, you begin to research the projected future costs of college. At the same time, you begin to evaluate various conservative investment options that would be appropriate, given Janet's risk tolerance.

Upon completing the research of projected future college expenses, you determine that Janet must save significantly more (to meet the total cost) to meet her goals. If Janet is unable to save more, she will have to reduce either her goals or she will have to accept more risk for her investment. Fortunately, you have recently gone through an identical situation yourself.

Your nephew is the same age as Janet's daughter. His parents (your sister and her husband) wanted to begin a college savings account as well. But, instead of using conservative investments, they elected to use a more complex aggressive growth strategy that you had created.

You are very proud of this investment strategy, having labored over 200 hours creating and fine-tuning it. You created charts, graphs, and a slick spreadsheet program to determine trades. You even took the time to back test the results over various time periods. As a result of all of your effort, you are convinced this strategy is the ideal program for anyone considering a college fund.

When you again meet with Janet, you decide that even though she is risk averse, your strategy is what she needs to do. So, in spite of her previous statements to you regarding her feelings about risk, you recommend your aggressive growth strategy.

Would your actions violate your ethical obligations to Janet?

Yes. Aside from the regulatory problems such actions implicate, you also would have violated your duty to remain objective in dealing with a client. In this instance, you allowed your emotional attachment to an unsuitable investment to obscure your objectivity. In addition, because of the personal nature of your work in creating this strategy, a bias may be inferred in your recommendation.

In either case, Janet's interests were subjectively determined by your personal feelings and agenda.

## **COMPETENCE**

### **Skills & Knowledge**

To effectively provide competent advice and financial planning, you must have attained and maintained an adequate level of knowledge and skill.

Aside from obtaining the requisite licensing, you must strive to acquire the knowledge necessary to provide competent advice. This premise applies whether you are a general practitioner, or a specialist. In both instances, your client has the right to expect a certain minimum level of competency.

Competent does not mean expert. It also does not create a specific or rigid methodology for providing advice or service to clients. Instead, competence refers to a minimum level of ability to provide effective advice and service. You are expected to know the basics and to be able to provide service commensurate with that knowledge.

Of course, if you hold yourself out to be a specialist, you are held to a higher standard of knowledge and competence. For example, if you claim to be an estate planner (as opposed to a general financial planner), your client would be entitled to expect a higher level of competence and knowledge.

There are various associations and organizations that can assist you in becoming better educated. The American College provides the charter life underwriter (CLU) program to assist insurance professionals. The College for Financial Planning provides the certified financial planner (CFP) program to assist individuals who want to improve their knowledge and skills as a financial planner. The Life Underwriter's Training Council also provides a program (LUTCF) to help insurance professionals further develop their skills.

None of the organizations names are required for you to be a competent financial planner. They simply provide a means of demonstrating to the public your commitment to improving your knowledge and skills, via a structured program of instruction. Of course, independent study can accomplish the same goals.

The issue you must address is to what extent you are striving to provide competent advice and service to your clients.

### **Experience**

It has often been said that the best teacher is time itself. In other words, regardless of the knowledge you have obtained (from books, classes, lectures, or seminars) nothing can substitute for actual experience.

Of course, no one likes to hear that experience is necessary, especially if you are trying to enter a new line of business or a new career. However, the premise is true. With experience comes the wisdom of how best to apply the knowledge you have acquired.

In dealing with your clients, you should not only be well versed in the subject matter (e.g. retirement planning), but also you should have some experience with the subject.

Again, this does not mean that you can never work with a client in a new area. Otherwise, you end up with a paradox similar to the chicken or the egg. (How can you get experience unless you practice, but how can you practice without the experience?)

Competence is not a high standard per se. It is a standard that is fashioned by the degree of difficulty. An estate plan will have a higher degree of difficulty than a college education plan. As such, in each case, competency is viewed based on your experience and your knowledge.

Without the knowledge, you would have no idea how to go about providing a solution. However, a lack of experience may only slow the process, or not be as smooth in transition. So long as the client understands, or the client has not been led to expect a higher level of skill, there will not be a breach of your ethical obligation.

### **Duty to Remain Informed**

The duty to remain informed covers several areas - client information, relevant market information, tax information, and professional development.

As the trusted competent adviser, you are expected (unless your relationship is clearly to the contrary) to provide ongoing service and support to your client. This includes keeping current about your client's financial affairs, as well as keeping your client current on issues that may affect their financial plans.

### **Client Information**

A financial plan is only as good as the information and assumptions upon which it is based. Over time, your client's status will change, as may their expectations and goals.

Therefore, you should strive to remain informed as to your client's financial status and changes.

This does not imply you have to be in constant contact with your client. However, you may want to contact your clients on a quarterly basis, or at the very least annually.

### **Relevant Market Information**

If your client invests in securities or purchases insurance products, it will be necessary to keep yourself, and the client, current as to changes.

The objective is for you to recognize whether the client has a potential problem, or if a client's goal has been obtained.

### **Tax Information**

Tax planning is critical in most financial plans, whether for an estate plan, retirement plan, or general financial plan. While you are not expected to provide tax advice (unless you are qualified), you are expected to remain current on tax issues that may affect the client's plans.

## Professional Development

Professional development covers two areas – increasing your knowledge and improving public perception. Obviously, increasing your personal knowledge will increase your competency and lay the foundation for you to grow your business.

By continuing your professional development, you are able to improve the public's perception of you, your practice, and the industry as a whole. While the public perception may not provide immediate benefits to you, over the long term your practice will see the benefits of a public that appreciates the high level of service and advice you can provide.

## Competence– Case Study

Bill Toopay has come to you for help. It seems that Bill was the unfortunate victim in an automobile accident. While traveling with his family on vacation, Bill's minivan was struck broadside by a tractor-trailer. Bill was hospitalized with multiple injuries, and required to have surgery. Bill was able to return home, but due to his disabling injuries he was no longer able to work. As a result, Bill sued the insurance company of the tractor-trailer.

An actuary has determined that Bill's loss of future earnings equals \$875,000. In addition, Bill has incurred over \$225,000 in medical bills and rehabilitation. It is estimated by the actuary that Bill will incur an additional \$185,000 in future medical expenses. Finally, Bill claims that for pain and suffering he should receive an additional \$350,000.

The insurance company has acknowledged that Bill is entitled to compensation for his lost earnings, pain and suffering, and medical expenses. However, instead of offering to pay Bill the amount he requested, the insurance company has proposed a structured settlement. Bill has come to you for financial advice on the structured settlement.

At this time, your practice is geared towards employee benefits. You have become well versed in all aspects of employee benefits, including cafeteria plans, voluntary insurance products, and group insurance. Your involvement with the employee benefits has provided an additional line of business for employees' personal insurance needs. Bill happens to have come to you because of this relationship.

While being very experienced in employee benefit programs, you have no experience with the property and casualty business. You have never dealt with the issues raised in Bill's case. In fact, when it comes to your business and personal liability insurance, you have always dealt with another agency for your needs.

Upon meeting with Bill, you realize he needs very specialized advice. Unfortunately, you do not know what IRS rules apply to structured settlements, what insurance carriers are actively involved in funding these programs, or what issues will need to be addressed in evaluating the settlement offer's financial aspects. However, you do recognize that someone will have to procure the funding instrument (probably an annuity), and will receive the subsequent commission. Because of this insight, you decide to tell Bill you can help him with all of his needs.

Would your actions violate your ethical obligations to Bill?

Yes. While you are not expected to know every answer to every question, you are expected to be competent in all dealings. As such, whereas you are an expert in employee benefits, you are not competent in structured settlements. This does not mean that you cannot become competent with this area, but you must not do so at the expense of a client. The client is entitled to rely upon you to provide competent service and advice, and to inform the client when an issue is not within your area of competence.

## **FAIRNESS**

### **Disclosure & Conflicts**

Fairness is a fundamental issue involving any dealings you will have with a client.

Fairness is often used in general terms to describe the relative value of a particular deal. However, when applied to financial planning it encumbers you with requirements that are more specific. Fairness requires impartiality, intellectual honesty, and disclosure of conflicts of interests. In essence, fairness implies a standard of dealing where you would “do unto others” and you would “have them do unto you.”

A primary principle of fairness is disclosure. As a professional, you are expected to disclose all material information that is relevant to the client’s situation. Examples of material information that should be disclosed include (but is not limited to) conflicts of interest, compensation and/or fees, experience and education, and changes in your business affiliation.

It is expected that you will make such disclosures in a timely fashion. Doing so will permit your client the opportunity to evaluate the information and to make an informed decision. Failure to provide the information in timely fashion would place the client at a disadvantage - unfair position.

It is recommended that, prior to providing any services or advice; you should disclose any potential conflicts that might possibly affect your judgment. If the client agrees to continue the relationship subsequent to the disclosure, they cannot later claim they were unfairly prejudiced.

If a conflict should arise after the relationship has begun, you should immediately disclose the apparent conflict. The problem you face in this situation is that your actions may have created this conflict, thereby placing the client at a disadvantage. The client is entitled to expect that (subject to the original agreement) you will not compromise the relationship due to a conflict created by your actions. As such, if the conflict arises from your actions and the conflict was reasonable foreseeable, you will have violated your duty of fairness.

In disclosing your compensation, some argue it may not be necessary (unless subject to law) for commissioned sales people to disclose the exact compensation paid. The duty to disclose compensation structure focuses more on the mechanics, due to the third party payer. This may seem to go against the affirmative duty to disclose. However, while you are not normally required to disclose the actual amount of commission, if a client asks you should answer truthfully.

## **Impartiality & Honesty**

In addition to maintaining an open relationship with clients where disclosure is customary, fairness dictates that you act with honesty and impartiality.

Fairness encompasses your entire relationship with your client. It affects how you treat the client as compared to other clients (or perspective clients). It affects the time and effort you put forth in advising and serving the client. It affects the manner in which you communicate with your client.

Regardless of any sophisticated models used, each client is unique. Each client has specific problems, concerns, and needs. Although some issues may be common to your other clients, this commonality does not necessarily justify a “cookie cutter” approach. As such, each client is entitled to the same level of respect and responsiveness as any other client. This does not mean that you may not have preferred clients. What it means is that you should not treat a client less favorably in quality of service, than you would treat any other client.

Systems within a business may allow you to operate more efficiently and profitably. However, when a client’s needs do not fit within this system, your duty is to the client. The client is entitled to expect your services will be provided in a non-discriminatory fashion. Remember, if you accept a client, you accept the responsibility of providing service to that client, even if it means less revenue. Simply because the client is not as profitable as you had hoped, does not justify your neglecting your duty of fair dealing.

Communication is the key to any relationship. As you already know, you have a duty to remain in contact with your clients (competence). Communication covers several areas from appointments to newsletters to annual letters. In each instance, you have an ongoing duty to provide information that is informative, but that is not deceptive or misleading.

With a client, you have already established trust. The client relies on you for sincere and honest advice. Because of this relationship, the client is more apt to follow your recommendation. This situation creates the potential for a client to be unduly influenced by a financial professional such as yourself.

Where a new client would likely question in detail your recommendations, a current client is more likely to accept your advice blindly. As a result, you have a heightened duty of honesty and fairness. The client must be made aware of all material information without any misleading statements or deceptive tactics. In other words, you have to be completely honest and forthcoming in all dealings with your clients.

## **Fairness – Case Study**

Eliza Jacobs has come to you for help. Eliza is a recent widow, with two young children. Fortunately, her husband had purchased life insurance. As a result, Eliza will receive \$250,000 in life insurance proceeds. In addition, Eliza is the beneficiary of her husband’s 401(k), and will receive an additional \$50,000.

Eliza currently works part-time, while her children are at school. However, she recognizes she may have to go to work full-time to provide the income and insurance benefits her family will need. Eliza wants you to advise her on how best to invest the life insurance proceeds and the 401(k) to generate income for herself and her children.

After consulting with Eliza, you determine she will need \$2,800 net per month to support her and the children. Currently, she only makes \$1,000 net per month, with no benefits. However, she can continue COBRA for up to thirty-six months on her husband's plan.

Eliza recognizes she will need to take some risk with her assets. Based on the investment profile you gave her, she would be classified as a moderate investor. Therefore, after discussion, she is satisfied to use a portfolio of mutual funds to accomplish her goals.

At this time, you are a licensed investment representative. Your income is based on the sale of investment and insurance products. The mutual funds you sell Eliza will pay a commission to you and your broker-dealer.

While Eliza wants to invest in the mutual funds, she is concerned about the cost. She has read about the sales charges in mutual funds and wants to know the best way to minimize the charges. You briefly explain to her the differences between A, B, and C shares. In addition, you inform Eliza that B shares would be best for her.

In preparing a portfolio for Eliza, you decide to use multiple mutual fund families for allocating Eliza's \$300,000 investment. You decide to use six mutual fund classes among six different fund families. Each fund family would receive no more than \$50,000. You offer Eliza the opportunity to use either A or B shares. Eliza elects the B shares to avoid the sales charge.

Would your actions violate your ethical obligations to Eliza?

Yes. Compliance issues aside, you would have violated your duty of fairness in dealing with Eliza. While you may be able to defend using all of the mutual fund families, you did not adequately disclose material information – the disadvantages. Eliza is entitled to an impartial recommendation.

On its fact, this strategy appears to be nothing more than a method to maximize commissions. While B shares may be suitable for Eliza, you did not take the necessary steps to ensure the dealings were fair. Honesty requires you to tell not only the truth, but also to disclose the truth about issues that you know the client is uninformed.

## **CONFIDENTIALITY**

### **Privacy Rules**

Confidential information, discussions, and actions are part of every financial plan. As a result, clients have a right to expect a high level of privacy.

Because of the media attention regarding the abuses of client information and the lack of protection, legislation has been enacted to protect client's information. Previously there were only limited guidelines regarding privacy. Insurance companies were allowed to share information about a client with affiliates and non-affiliates alike.

The Kentucky Department of Insurance has recently implemented a new federal law, called Gramm-Leach-Bliley for the names of the key sponsors. This law recognizes that insurance companies, banks, credit card companies and other financial institutions are merging into larger global companies and are increasingly sharing information.

Under the new federal law and the Kentucky Department of Insurance regulations, these insurance companies, agents or other licensed representatives must disclose their privacy policy and how they share information about a client.

You may not disclose any nonpublic personal information about a client to a nonaffiliated third party.

While there is a notice procedure that would permit you to release the information, it places the burden on your client to opt-out. In addition, it presumes a client permits you or your firm to release confidential information. Surprisingly, most clients when asked do not wish to share their information.

But, your duty does not stop with adhering to the new laws. The laws focus more on the sale of information to third-party marketers. However, you also have a duty not to disclose client information, even when it is not done for monetary gain.

When a client comes to you, and discloses confidential information, the client is entitled to expect privacy. The client does not expect that right to be waived automatically if the client fails to tell you otherwise. This is an improper shift of responsibility.

Most often, breaches of confidentiality occur where you represent several clients with common ties, such as a previous employer or association. The clients all know you represent the others, and as such have no qualms about asking you details about the other common clients. Unfortunately, regardless of the relationship, you have a duty not to disclose any private information.

If a client consents to the release of information, it is recommended that the consent be in writing. Further, the consent should be limited in scope as to what information may be revealed, and to what parties it may be revealed.

A typical example of client consent may be in the form of a client testimonial (if permitted by regulation), where a client allows you to use their name, comments, and results.

### **Confidentiality – Case Study**

Recently, you have begun to work with a large number of employees who retired from the same company. On this particular day, you have an initial appointment with Richard Knoze. Richard is preparing to retire at the end of the month and wants you to assist him with planning his retirement.

Also, on the same day, you have a review meeting with Tom Brown. Tom had retired 18 months ago from the same company. As both appointments were scheduled subsequent to one another, Richard happened to see Tom leaving his appointment.

Richard's initial appointment went as expected. He had completed the necessary pre-appointment information and he had brought with him the other information needed to begin his retirement plan.

As is normally done with initial appointments, you explain in detail what your services are and how you are compensated. You also talk with Richard about his expectations of you and your firm. Once Richard is comfortable with the process, you begin to discuss his risk tolerance.

Approximately halfway through the interview, Richard abruptly asks if Tom Brown is a client. You answer that Tom is a client. Richard then asks what Tom's risk tolerance is and what investments you recommended for Tom. In addition, as there has been some dissatisfaction among retirees over the early retirement packages offered (in the past some were more lucrative), Richard also asks how much money Tom received in a lump sum when he retired.

Without giving much thought, and because Tom has always been so open and willing to discuss his situation with anyone who would listen, you voluntarily answer Richard's questions. At this point, Richard begins to ask questions regarding other retirees he knows are also your clients. Again, you volunteer the information.

Would your actions violate your ethical obligations to Richard?

No. Although you will have disclosed confidential information to Richard, you did not disclose confidential information about Richard. However, you did disclose confidential information about other clients. It is those clients who you have violated your ethical duty of confidentiality.

Even though a client may be very open with you, or anyone else who asks, it is not your place or right to assume that client's place in revealing confidential information. If someone asks for specific information about a client, you have a duty to protect that information and not to voluntarily disclose it.

A final comment deals with Richard's perception of you as a financial planner. Richard has to wonder that if you would so freely disclose other clients' information, then what will you voluntarily disclose about Richard's personal affairs. In other words, you have undermined your credibility with Richard.

## **PROFESSIONALISM**

### **Courtesy & Dignity**

While courtesy and dignity may not get the same degree of attention as the other ethical duties, they remain a critical part of your practice. In the daily dealings with clients and other professionals, it is easy to overlook some of the basic tenets of civility. Courtesy may be sacrificed in the hurry to complete time specific tasks. Planners may allow their dignity to be diminished in order to make a sale or to sign a sought-after client.

Courtesy is defined as polite behavior, gracious manners, or a polite gesture. These are the basic ingredients of civility. Every person knows how to behave towards others. In working with clients, you are expected to act with the same consideration for your clients.

As opposed to the expressive nature of courtesy, dignity bespeaks personal character traits such as honor. Only you can control the level of dignity that you present to others. To ensure you maintain your dignity in dealing with clients, it is critical that you not sacrifice your integrity, honesty, and diligence.

Because of the nature of your business, you may be in the public eye on a daily basis. The professionalism you present will often dictate the degree of success you enjoy. As such, you should consider the various people you will come into contact with on a daily basis and make a concerted effort to present yourself in as professional a light as possible.

### **Cooperation with other Professionals**

Professionalism does not stop with courtesy and dignity. It also implies an obligation to work with, support, and advocate for your profession. To work with fellow professionals may seem contrary to the principles of competition, but it does not have to be a negative.

Regardless of whether you agree with your fellow professional on various industry issues, you are still a part of that same industry. Because of this common interest, it only makes sense to work together to further the goals and objectives of your industry.

There are several areas where you should strive to work with, support or assist other professionals. You should cooperate with professionals regarding current clients or previous clients. You should work to promote the ideals of your profession. You should not hesitate to report ethical or illegal conduct of other professionals.

### **Client Cooperation**

There will be instances where another professional will contact you regarding a current client or previous client. Once you satisfactorily establish the client has authorized the communication, you have a duty to disclose the information requested.

The disclosure includes any reports or other materials created for the client, for which you have received compensation. The duty to release information does not require you to release proprietary information regarding your business practices.

### **Promotion of Profession**

Even if you are not actively involved with an industry association (e.g. life underwriters), you are still able to advance the ideals of your profession. Advancing your profession does not necessarily require you to volunteer time or funds. There are other means by which you can advance your profession. The easiest and most effective is to adhere to a strict set of ethical principles. By behaving ethically at all times, you provide an example from which your clients base their expectations.

### **Reporting Unethical or Illegal Conduct**

The resources of most local, state, and federal agencies are limited. As a professional, you have a duty to report instances of unethical or illegal conduct (where you have substantial knowledge).

Admittedly, reporting a fellow professional is not a pleasant task. However, for the good of the industry and for the good of the professional's clients, you should report activities that are fraudulent or illegal. Therefore, if you have knowledge, that is not confidential, of questionable activities, you should inform the appropriate authorities.

To encourage reporting, most reporting systems are anonymous and will not require you to disclose your identity.

### **Professionalism – Case Study**

You have been practicing for over ten years. Your practice has steadily grown each year. As a result, to maximize the value of your time, you have become more selective in the new clients you take.

Today a prospective client comes to your office for an initial appointment. The client has completed the pre-appointment information and has brought the additional information you requested. This information is copied and placed in the client's file.

During the course of the interview, it becomes clear the client is not being completely truthful regarding his previous experience with financial planners. When you press for details, the client becomes more agitated. Finally, when you ask the client if he has ever filed a complaint against or sued a financial planner, the client becomes belligerent. The client tells you it is none of your business. The client asks whether you want his business or not.

At this point, you determine this client does not meet the criteria for you to accept him as a new client. However, when you tell the client that you will not be able to assist him further; the client loses his temper and begins to shout profanities.

Approximately two weeks later, you receive a phone call from another financial planner in town. The planner informs you that the same person you refused to accept as a client was now at his office. The planner tells you the client did not want to fill out more financial information forms and that you had a file already on him. The planner asks you to please fax or mail the file to him.

Because of the client's behavior in your office and the disruption and embarrassment it caused you and your staff in front of other clients, you refuse. You tell the planner that the client has already wasted enough of your time and that you will not provide any further assistance to the client. The planner is disappointed, but ends the conversation.

Later that same day, the client arrives at your office demanding his file. You meet the client at the receptionist's desk and inform him that no further assistance will be provided. The client storms out of your office.

Would your actions violate your ethical obligations to the client or the planner?

Maybe. With the client, nothing requires you to provide assistance beyond the scope of your relationship. Because he never became a client, you owe no obligation to him other than to act with professionalism and courtesy. However, the planner is entitled to your cooperation as well.

You should have provided the client's file as requested. Of course, you could have charged the planner for the time and expense of providing the file copies. In addition, you would not be expected to reveal any of your firm's methods or procedures.

## **DILIGENCE**

### **Defining Diligence**

In financial planning, diligence involves providing your services with great effort and care. You should work to provide timely service that is both accurate and thorough. A diligent practice will make reasonable efforts to respond to client concerns, inquiries, and problems. Not taking action on an issue may significantly harm your client's interests. However, a client need not be harmed by inattention in order for you to have beached you duty of diligence.

A diligent practice will have procedures in place to ensure the respective work is done timely and completely. You do not have to use a complicated system, but you should have in place some method for monitoring the progress or status of current work. Common areas of your business that you should systemize include at least the following - client data, client service requests, new business, and client files.

### **Client Data**

In order to readily contact a client or to ensure consistent contact with your clients, a diligent practice will utilize a system for tracking client data. Client data includes the client's full name, mailing address, telephone numbers, and other applicable demographic information. This system should be reasonably maintained to ensure the data is current.

### **Client Service Requests**

Clients are entitled to expect prompt attention to service requests. As a result, your practice should have a system for tracking a client's request for service to completion. Further, the system should ensure the client's request is completed in a timely fashion.

### **New Business**

Aside from the financial incentive for expediting new business, you should utilize a system for tracking new business. It does not matter if you are commission or fee based. The client's investments and/or insurance require your attention to ensure they are completed accurately and timely. A tracking system for new business provides a method for ensuring the client's interests receive prompt attention.

### **Client Files**

A client file is an obvious necessity. However, too often client files resemble a folder with various papers tossed in haphazardly. Your client expects and is entitled to more. A proper client file will allow you to quickly locate necessary information. In addition, a client file will enable you to readily review your client's situation and make appropriate recommendations. The files will save you and your clients' time. Finally, a properly maintained client file will demonstrate your professionalism.

### **Planning & Supervision**

In addition to providing timely, accurate and thorough service to your clients, diligence also entails your ongoing planning and supervision of client accounts. Supervision also extends to monitoring your staff, associates, and other parties working with a client under your direction.

Your clients rely upon you for advice and direction concerning their financial affairs. This reliance is built upon trust and expectation. Over time, your client's situation will change, ostensibly for the better but sometimes for the worse. As a result, you must be prepared to address these changes, and in some cases anticipate the changes.

Planning for a client involves a number of quantitative as well as qualitative issues. In certain situations, after reviewing the client's needs and objectives, you will realize the client will not benefit from your services. The client may have the assets (quantitative) necessary to justify your services, but the client's objectives and needs do not. When this situation occurs, you should recognize your ethical obligation and decline the client.

After accepting a client, you will be providing planning advice. The advice should reflect the client's goals in their entirety. Any omissions should be addressed with the client. Finally, any recommendations should be suitable given the client's needs and objectives.

When making product recommendations to a client, you should make a reasonable investigation as to the merits of the product. Diligence implies you have undertaken a thorough and current review of the recommended products. Due diligence is critical for the client's protection and for your protection.

You may reasonably rely on the diligence of other recognized parties (e.g. broker-dealer), providing you do not possess actual relevant knowledge.

As your practice grows, there may be times when you do not have direct contact with a client or the client's case. Instead, the activity may be handled by a staff person or associate. The client's expectations and right to diligent assistance is not diminished by the use of staff or associates. Therefore, your duties include monitoring the staff person or the associate in their respective dealings with clients.

The actions of your staff or your associates reflect on you, as well as the profession. You have both an ethical duty and a legal duty to supervise their actions. In monitoring staff and associates, you should have a system of accountability. The system should allow you to determine the current status of client service requests, client planning, and client accounts.

Your staff is also subject to the client privacy (confidentiality) obligations. In supervising your staff, you must ensure your staff is trained as to the confidentiality requirements.

Again, monitoring systems should be used to ensure client privacy is maintained.

### **Diligence – Case Study**

Recently, while reading a trade magazine, you ran across an advertisement for a new investment. The investment proposed to guarantee a fixed return over a relatively short duration. The promised returns ranged from 12% for one-year to 48% for three years.

During the same period, the market was in a doldrums. The stock market was at a five-year low, having declined another twelve percent this year. In addition, interest rates were at a three-year low. The average rate on a five-year certificate of deposit was only 4.8%. Other fixed investments were not fairing much better – with bonds and annuities not paying much more.

Your clients have been calling and asking for direction and advice. They are concerned with the decline in their portfolios and in their interest income. At this point, you recall the advertisement and decide to find out a bit more.

Upon talking with the sales representative who answered the phone, you learn the investment does not require a license. It is neither registered as a security and is not regulated by your state's insurance department. However, you are informed this is to your advantage. Not only will you not have to share the commission with your broker-dealer, but also you will not have to wait to be appointed before you sell it.

You are told the product is simple. The company buys and resells life insurance policies. The company buys insurance policies at a discount from terminally ill patients. The company obtains the money to buy the insurance policies from individual investors such as your clients. The company pays you a commission, deducts its expenses, profit percentage, and uses the remainder to purchase the insurance policy.

Thinking this is a potential win-win situation, you sign a contract to sell the investment. You then begin contacting your clients to recommend this "hot, new" investment. You explain how simple it is, and how the return is virtually guaranteed. Your clients are excited about the prospects of the guaranteed returns and willingly invest their retirement money in the scheme.

Approximately, eighteen months later, things begin to unravel. Your commission payments begin to run late and your clients begin to request more details on their investments. When you contact the company, you learn it never actually purchased the insurance policies. In addition, the money for purchasing the insurance policies has either been squandered on expenses, or simply vanished along with the principals. Your clients have lost their entire investment. You are now being sued.

Would your actions violate your ethical obligations to your clients?

Yes. Due diligence is fundamental to any investment or insurance recommendation you make to your clients. By failing to learn the details of the investment scheme, you have violated this duty with your clients.

Even if the investment had proven successful and made your clients money, you would still be faced with a due diligence violation. Due diligence is more than simply getting an overview. It involves a detailed analysis of the merits, the stability, and the viability of the company. When you deal with an unregulated entity, you risk the results contained in this example.

## **PROFESSIONAL CODE OF ETHICS**

Professional associations as a whole have issued codes of ethics for the members. Some codes are fairly short and succinct. Other codes go into great detail as to the meaning behind the codes. To illustrate the detail and enforcement mechanisms for a professional code of ethics, the CFP Code of Ethics should be reviewed.

**CERTIFIED FINANCIAL PLANNER BOARD OF STANDARDS INC.  
CODE OF ETHICS AND PROFESSIONAL RESPONSIBILITY**

**OVERVIEW**

**Preamble and Applicability**

The Code of Ethics and Professional Responsibility (Code of Ethics) has been adopted by Certified Financial Planner Board of Standards Inc. (CFP Board) to provide principles and rules to all persons whom it has recognized and certified to use the CFP®, CERTIFIED FINANCIAL PLANNER™ and certification marks (collectively “the marks”).

CFP Board determines who is certified and thus authorized to use the marks. Implicit in the acceptance of this authorization is an obligation not only to comply with the mandates and requirements of all applicable laws and regulations but also to take responsibility to act in an ethical and professionally responsible manner in all professional services and activities.

For purposes of this Code of Ethics, a person recognized and certified by CFP Board to use the marks is called a CFP Board designee. This Code of Ethics applies to CFP Board designees actively involved in the practice of personal financial planning, in other areas of financial services, in industry, in related professions, in government, in education or in any other professional activity in which the marks are used in the performance of professional responsibilities.

This Code of Ethics also applies to candidates for the CFP® certification who are registered as such with CFP Board. For purposes of this Code of Ethics, the term CFP Board designee shall be deemed to include current certificates, candidates and individuals who have been certified in the past and retain the right to reinstate their CFP certification without passing the current CFP® Certification Examination.

**Composition and Scope**

The Code of Ethics consists of two parts: Part I – Principles and Part II – Rules. The Principles are statements expressing in general terms the ethical and professional ideals that CFP Board designees are expected to display in their professional activities. As such, the Principles are aspirational in character but are intended to provide a source of guidance for CFP Board designees.

The comments following each Principle further explain the meaning of the Principle. The Rules in Part II provide practical guidelines derived from the tenets embodied in the Principles. As such, the Rules describe the standards of ethical and professionally responsible conduct expected of CFP Board designees in particular situations. This Code Of Ethics does not undertake to define standards of professional conduct of CFP Board designees for purposes of civil liability.

Due to the nature of a CFP Board designee’s particular field of endeavor, certain Rules may not be applicable to that CFP Board designee’s activities. For example, a CFP Board designee who is engaged solely in the sale of securities as a registered representative is not subject to the written disclosure requirements of Rule 402 (applicable to CFP Board designees engaged in personal financial planning) although he or she may have disclosure responsibilities under Rule 401.

A CFP Board designee is obligated to determine what responsibilities he or she has in each professional relationship including, for example, duties that arise in particular circumstances from a position of trust or confidence that a CFP Board designee may have. The CFP Board designee is obligated to meet those responsibilities.

The Code of Ethics is structured so that the presentation of the Rules parallels the presentation of the Principles. For example, the Rules, which relate to Principle 1 – Integrity are numbered in the 100 to 199 series, while those Rules relating to Principle 2 – Objectivity are numbered in the 200 to 299 series.

## **Compliance**

CFP Board requires adherence to this Code Of Ethics by all CFP Board designees. Compliance with the Code Of Ethics, individually and by the profession as a whole, depends on each CFP Board designee's knowledge of and voluntary compliance with the Principles and applicable Rules, on the influence of fellow professionals and public opinion, and on disciplinary proceedings, when necessary, involving CFP Board designees who fail to comply with the applicable provisions of the Code Of Ethics.

## **PRINCIPLES**

These Code of Ethics' Principles express the profession's recognition of its responsibilities to the public, to clients, to colleagues and to employers. They apply to all CFP Board designees and provide guidance to them in the performance of their professional services.

### **Principle 1 – Integrity**

A CFP Board designee shall offer and provide professional services with integrity. As discussed in "Composition and Scope," CFP Board designees may be placed by clients in positions of trust and confidence. The ultimate source of such public trust is the CFP Board designee's personal integrity.

In deciding what is right and just, a CFP Board designee should rely on his or her integrity as the appropriate touchstone. Integrity demands honesty and candor which must not be subordinated to personal gain and advantage. Within the characteristic of integrity, allowance can be made for innocent error and legitimate difference of opinion; but integrity cannot co-exist with deceit or subordination of one's principles.

Integrity requires a CFP Board designee to observe not only the letter but also the spirit of this Code of Ethics.

### **Principle 2 – Objectivity**

A CFP Board designee shall be objective in providing professional services to clients. Objectivity requires intellectual honesty and impartiality. It is an essential quality for any professional.

Regardless of the particular service rendered or the capacity in which a CFP Board designee functions, a CFP Board designee should protect the integrity of his or her work, maintain objectivity, and avoid subordination of his or her judgment that would be in violation of this Code Of Ethics.

### **Principle 3 – Competence**

A CFP Board designee shall provide services to clients competently and maintain the necessary knowledge and skill to continue to do so in those areas in which the CFP Board designee is engaged.

One is competent only when he or she has attained and maintained an adequate level of knowledge and skill, and applies that knowledge effectively in providing services to clients.

Competence also includes the wisdom to recognize the limitations of that knowledge and when consultation or client referral is appropriate.

A CFP Board designee, by virtue of having earned the CFP® certification, is deemed to be qualified to practice financial planning. However, in addition to assimilating the common body of knowledge required and acquiring the necessary experience for certification, a CFP Board designee shall make a continuing commitment to learning and professional improvement.

### **Principle 4 – Fairness**

A CFP Board designee shall perform professional services in a manner that is fair and reasonable to clients, principals, partners and employers, and shall disclose conflict(s) of interest in providing such services.

Fairness requires impartiality, intellectual honesty and disclosure of conflict(s) of interest. It involves a subordination of one's own feelings, prejudices and desires to achieve a proper balance of conflicting interests.

Fairness is treating others in the same fashion that you would want to be treated, and is an essential trait of any professional.

### **Principle 5 – Confidentiality**

A CFP Board designee shall not disclose any confidential client information without the specific consent of the client unless in response to proper legal process, to defend against charges of wrongdoing by the CFP Board designee or in connection with a civil dispute between the CFP Board designee and client.

A client, by seeking the services of a CFP Board designee, may be interested in creating a relationship of personal trust and confidence with the CFP Board designee. This type of relationship can only be built upon the understanding that information supplied to the CFP Board designee will be confidential. In order to provide the contemplated services effectively and to protect the client's privacy, the CFP Board designee shall safeguard the confidentiality of such information.

### **Principle 6 – Professionalism**

A CFP Board designee's conduct in all matters shall reflect credit upon the profession. Because of the importance of the professional services rendered by CFP Board designees, there are attendant responsibilities to behave with dignity and courtesy to all those who use those services, fellow professionals, and those in related professions.

A CFP Board designee also has an obligation to cooperate with fellow CFP Board designees to enhance and maintain the profession's public image and to work jointly with other CFP Board designees to improve the quality of services. It is only through the combined efforts of all CFP Board designees, in cooperation with other professionals, that this vision can be realized.

## **Principle 7 – Diligence**

A CFP Board designee shall act diligently in providing professional services. Diligence is the provision of services in a reasonably prompt and thorough manner.

Diligence also includes proper planning for, and supervision of, the rendering of professional services.

## **RULES**

As stated in Part I – Principles, the Principles apply to all CFP Board designees. However, due to the nature of a CFP Board designee's particular field of endeavor, certain Rules may not be applicable to that CFP Board designee's activities.

The universe of activities engaged in by a CFP Board designee is indeed diverse and a particular CFP Board designee may be performing all, some or none of the typical services provided by financial planning professionals. As a result, in considering the following Rules, a CFP Board designee must first recognize what specific services he or she is rendering and then determine whether a specific Rule is applicable to those services.

To assist the CFP Board designee in making these determinations, this Standards of Professional Conduct includes a series of definitions of terminology used throughout the Code of Ethics. Based upon these definitions, a CFP Board designee should be able to determine which services he or she provides and, therefore, which Rules are applicable to those services.

## **Rules that Relate to the Principle of Integrity**

### **Rule 101**

A CFP Board designee shall not solicit clients through false or misleading communications or advertisements:

#### **A. Misleading Advertising:**

A CFP Board designee shall not make a false or misleading communication about the size, scope or areas of competence of the CFP Board designee's practice or of any organization with which the CFP Board designee is associated; and

#### **B. Promotional Activities:**

In promotional activities, a CFP Board designee shall not make materially false or misleading communications to the public or create unjustified expectations regarding matters relating to financial planning or the professional activities and competence of the CFP Board designee. The term "promotional activities" includes, but is not limited to, speeches, interviews, books and/or printed publications, seminars, radio and television shows, and video cassettes.

### **C. Representation of Authority:**

A CFP Board designee shall not give the impression that a CFP Board designee is representing the views of CFP Board or any other group unless the CFP Board designee has been authorized to do so. Personal opinions shall be clearly identified as such.

#### **Rule 102**

In the course of professional activities, a CFP Board designee shall not engage in conduct involving dishonesty, fraud, deceit or misrepresentation, or knowingly make a false or misleading statement to a client, employer, employee, professional colleague, governmental or other regulatory body or official, or any other person or entity.

#### **Rule 103**

A CFP Board designee has the following responsibilities regarding funds and/or other property of clients:

- A. In exercising custody of, or discretionary authority over, client funds or other property, a CFP Board designee shall act only in accordance with the authority set forth in the governing legal instrument (e.g., special power of attorney, trust, letters testamentary, etc.)
- B. A CFP Board designee shall identify and keep complete records of all funds or other property of a client in the custody, or under the discretionary authority, of the CFP Board designee.
- C. Upon receiving funds or other property of a client, a CFP Board designee shall promptly or as otherwise permitted by law or provided by agreement with the client, deliver to the client or third party any funds or other property which the client or third party is entitled to receive and, upon request by the client, render a full accounting regarding such funds or other property.
- D. A CFP Board designee shall not commingle client funds or other property with a CFP Board designee's personal funds and/or other property or the funds and/or other property of a CFP Board designee's firm.
- E. Commingling one or more clients' funds or other property together is permitted, subject to compliance with applicable legal requirements and provided accurate records are maintained for each client's funds or other property.
- F. A CFP Board designee, who takes custody of all or any part of a client's assets for investment purposes, shall do so with the care required of a fiduciary.

### **Rules that Relate to the Principle of Objectivity**

#### **Rule 201**

A CFP Board designee shall exercise reasonable and prudent professional judgment in providing professional services.

## **Rule 202**

A financial planning practitioner shall act in the interest of the client.

## **Rules that Relate to the Principle of Competence**

### **Rule 301**

A CFP Board designee shall keep informed of developments in the field of financial planning and participate in continuing education throughout the CFP Board designee's professional career in order to improve professional competence in all areas in which the CFP Board designee is engaged.

As a distinct part of this requirement, a CFP Board designee shall satisfy all minimum continuing education requirements established for CFP Board designees by CFP Board.

### **Rule 302**

A CFP Board designee shall offer advice only in those areas in which the CFP Board designee has competence. In areas where the CFP Board designee is not professionally competent, the CFP Board designee shall seek the counsel of qualified individuals and/or refer clients to such parties.

## **Rules that Relate to the Principle of Fairness**

### **Rule 401**

In rendering professional services, a CFP Board designee shall disclose to the client:

- A. Material information relevant to the professional relationship, including, conflict(s) of interest, the CFP Board designee's business affiliation, address, telephone number, credentials, qualifications, licenses, compensation structure and any agency relationships, and the scope of the CFP Board designee's authority in that capacity.
- B. The information required by all laws applicable to the relationship in a manner complying with such laws.

### **Rule 402**

A CFP Board designee in a financial planning engagement shall make timely written disclosure of all material information relative to the professional relationship. In all circumstances and prior to the engagement, a CFP Board designee shall, in writing:

- A. Disclose conflict(s) of interest and sources of compensation; and
- B. Inform the client or prospective client of his/her right to ask at any time for information about the compensation of the CFP Board designee.

- C. As a guideline, a CFP Board designee who provides a client or prospective client with the following written disclosures, using Form ADV, a CFP Board Disclosure Form or an equivalent document, will be considered to be in compliance with this Rule:
- The basic philosophy of the CFP Board designee (or firm) in working with clients. This includes the philosophy, theory and/or principles of financial planning which the CFP Board designee will utilize.
  - Résumés of principals and employees of a firm who are expected to provide financial planning services to the client and a description of those services. Such disclosures shall include educational background, professional/employment history, professional designations and licenses held.
  - A statement that in reasonable detail discloses (as applicable) conflict(s) of interest and source(s) of, and any contingencies or other aspects material to, the CFP Board designee's compensation.
  - A statement describing material agency or employment relationships a CFP Board designee (or firm) has with third parties and the nature of compensation resulting from such relationships.
  - A statement informing the client or prospective client of his/her right to ask at any time for information about the compensation of the CFP Board designee.

### **Rule 403**

Upon request by a client or prospective client, the CFP Board designee in a financial planning engagement shall communicate in reasonable detail the requested compensation information related to the financial planning engagement, including compensation derived from implementation.

The disclosure may express compensation as an approximate dollar amount or percentage or as a range of dollar amounts or percentages. The disclosure shall be made at a time and to the extent that the requested compensation information can be reasonably ascertained. Any estimates, shall be clearly identified as such and based on reasonable assumptions.

If a CFP Board designee becomes aware that a compensation disclosure provided pursuant to this rule has become significantly inaccurate, he/she shall provide the client with corrected information in a timely manner.

### **Rule 404**

The disclosures required of a CFP Board designee in a financial planning engagement described under Rule 402 shall be offered at least annually for current clients, and provided if requested.

### **Rule 405**

A CFP Board designee's compensation shall be fair and reasonable.

### **Rule 406**

A CFP Board designee who is an employee shall perform professional services with dedication to the lawful objectives of the employer and in accordance with this Code of Ethics.

### **Rule 407**

A CFP Board designee shall:

- A. Advise his/her employer of outside affiliations which reasonably may compromise service to an employer.
- B. Provide timely notice to his/her employer and clients about change of CFP® certification status.
- C. Provide timely notice to clients, unless precluded by contractual obligations, about change of employment.

### **Rule 408**

A CFP Board designee shall inform his/her employer, partners or co-owners of compensation or other benefit arrangements in connection with his or her services to clients, which are in addition to compensation from the employer, partners or co-owners for such services.

### **Rule 409**

If a CFP Board designee enters into a personal business transaction with a client, separate from regular professional services provided to that client, the transaction shall be on terms which are fair and reasonable to the client and the CFP Board designee shall disclose, in writing, the risks of the transaction, conflict(s) of interest of the CFP Board designee, and other relevant information, if any, necessary to make the transaction fair to the client.

### **Rule 501**

A CFP Board designee shall not reveal — or use for his or her own benefit — without the client's consent, any personally identifiable information relating to the client relationship or the affairs of the client, except and to the extent disclosure or use is reasonably necessary:

- A. To establish an advisory or brokerage account, to effect a transaction for the client, or as otherwise impliedly authorized in order to carry out the client engagement.
- B. To comply with legal requirements or legal process
- C. To defend the CFP Board designee against charges of wrongdoing
- D. In connection with a civil dispute between the CFP Board designee and the client

For purposes of this rule, the proscribed use of client information is improper whether or not it actually causes harm to the client.

## **Rule 502**

A CFP Board designee shall maintain the same standards of confidentiality to employers as to clients.

## **Rule 503**

A CFP Board designee doing business as a partner or principal of a financial services firm owes the CFP Board designee's partners or co-owners a responsibility to act in good faith. This includes, but is not limited to, adherence to reasonable expectations of confidentiality both while in business together and thereafter.

## **Rules that Relate to the Principle of Professionalism**

### **Rule 601**

A CFP Board designee shall use the marks in compliance with the rules and regulations of CFP Board, as established and amended from time to time.

### **Rule 602**

A CFP Board designee shall show respect for other financial planning professionals, and related occupational groups, by engaging in fair and honorable competitive practices. Collegiality among CFP Board designees shall not, however, impede enforcement of this Code Of Ethics.

### **Rule 603**

A CFP Board designee who has knowledge, which is not required to be kept confidential under this Code Of Ethics, that another CFP Board designee has committed a violation of this Code Of Ethics which raises substantial questions as to the designee's honesty, trustworthiness or fitness as a CFP Board designee in other respects, shall promptly inform CFP Board.

This rule does not require disclosure of information or reporting based on knowledge gained as a consultant or expert witness in anticipation of, or related to, litigation or other dispute resolution mechanisms. For purposes of this rule, knowledge means no substantial doubt.

### **Rule 604**

A CFP Board designee who has knowledge, which is not required under this Code Of Ethics to be kept confidential, and which raises a substantial question of unprofessional, fraudulent or illegal conduct by a CFP Board designee or other financial professional, shall promptly inform the appropriate regulatory and/or professional disciplinary body.

This rule does not require disclosure or reporting of information gained as a consultant or expert witness in anticipation of, or related to, litigation or other dispute resolution mechanisms. For purposes of this Rule, knowledge means no substantial doubt.

## **Rule 605**

A CFP Board designee who has reason to suspect illegal conduct within the CFP Board designee's organization shall make timely disclosure of the available evidence to the CFP Board designee's immediate supervisor and/or partners or co-owners.

If the CFP Board designee is convinced that illegal conduct exists within the CFP Board designee's organization, and that appropriate measures are not taken to remedy the situation, the CFP Board designee shall, where appropriate, alert the appropriate regulatory authorities, including CFP Board, in a timely manner.

## **Rule 606**

In all professional activities, a CFP Board designee shall perform services in accordance with:

- A. Applicable laws, rules and regulations of governmental agencies and other applicable authorities
- B. Applicable rules, regulations and other established policies of CFP Board.

## **Rule 607**

A CFP Board designee shall not engage in any conduct which reflects adversely on his or her integrity or fitness as a CFP Board designee, upon the marks, or upon the profession.

## **Rule 608**

The Investment Advisers Act of 1940 requires registration of investment advisers with the U.S. Securities and Exchange Commission and similar state statutes may require registration with state securities agencies.

CFP Board designees shall disclose to clients their firms' status as registered investment advisers. Under present standards of acceptable business conduct, it is proper to use registered investment adviser if the CFP Board designee is registered individually.

If the CFP Board designee is registered through his or her firm, then the CFP Board designee is not a registered investment adviser but a person associated with an investment adviser. The firm is the registered investment adviser.

Moreover, RIA or R.I.A. following a CFP Board designee's name in advertising, letterhead stationery, and business cards may be misleading and is not permitted either by this Code Of Ethics or by SEC regulations.

## **Rule 609**

A CFP Board designee shall not practice any other profession or offer to provide such services unless the CFP Board designee is qualified to practice in those fields and is licensed as required by state law.

## **Rule 610**

A CFP Board designee shall return the client's original records in a timely manner after a client has requested their return.

## **Rule 611**

A CFP Board designee shall not bring or threaten to bring a disciplinary proceeding under this Code Of Ethics, or report or threaten to report information to CFP Board pursuant to Rules 603 and/or 604, or make or threaten to make use of this Code Of Ethics for no substantial purpose other than to harass, maliciously injure, embarrass and/or unfairly burden another CFP Board designee.

## **Rule 612**

A CFP Board designee shall comply with all applicable renewal requirements established by CFP Board including, but not limited to, payment of the biennial CFP Board designee fee as well as signing and returning the Terms and Conditions of Certification in connection with the certification renewal process.

## **Rules that Relate to the Principle of Diligence**

### **Rule 701**

A CFP Board designee shall provide services diligently.

### **Rule 702**

A financial planning practitioner shall enter into an engagement only after securing sufficient information to satisfy the CFP Board designee that:

- A. The relationship is warranted by the individual's needs and objectives; and
- B. The CFP Board designee has the ability to either provide requisite competent services or to involve other professionals who can provide such services.

### **Rule 703**

A financial planning practitioner shall make and/or implement only recommendations which are suitable for the client.

### **Rule 704**

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

## **Rule 705**

A CFP Board designee shall properly supervise subordinates with regard to their delivery of financial planning services, and shall not accept or condone conduct in violation of this Code Of Ethics.

### **ADVISORY OPINION 2001-1**

#### **General Rule**

Loans between CFP Board designees and their clients should be avoided in the client-planner relationship.

#### **Background**

The Board of Professional Review (the "BOPR") has generally viewed loans between CFP Board designees and their clients unfavorably and, in the majority of cases, to be a violation of the Code Of Ethics and Professional Responsibility (Code Of Ethics).

Since the Code Of Ethics does not have a rule that specifically prohibits such transactions, however, the BOPR has addressed the issue under various rules, depending upon the facts and circumstances of the case being examined.

Due to an increase in the number of disciplinary cases that involve the issue of loans between a CFP Board designee and his or her client, the BOPR is issuing this advisory opinion to clarify its position and to serve as a guide to both CFP Board designees and their clients.

#### **Issue**

Whether a loan between a CFP Board designee and his or her client(s) violates the Code Of Ethics.

#### **Analysis**

Cases involving a loan between a CFP Board designee and a client involve an investigation of whether that CFP Board designee has violated the Code Of Ethics.

The BOPR has evaluated these cases under a number of rules, including, but not limited to, Rules 201, 202, 401, 402, 606, 607 and 703. To determine which, if any, rules have been violated, the BOPR considers:

- Whether the designee is a financial planning practitioner (as defined by the Code Of Ethics).
- Whether the client is a family member or a financial institution. The degree to which the CFP Board designee is related to the client is relevant. (The rationale for considering the type of relationship is discussed later in this opinion.)
- Whether the terms and conditions of the loan are fair and reasonable to the client

While any and/or all of the rules mentioned above, and others, may apply in a particular case, this advisory opinion focuses on two rules which are implicated in the majority of “loan” cases and are, therefore, most frequently cited by the BOPR: Rules 202 and 607.

## **Rule 202**

Rule 202 of the Code Of Ethics requires financial planning practitioners to act in the best interest of their clients.

Accordingly, this rule applies to CFP Board designees who are acting as financial planning practitioners, defined in the Code of Ethics as:

“[A] person who is capable and qualified to offer objective, integrated and comprehensive financial advice to or for the benefit of clients to help them achieve their financial objectives and who engages in financial planning using the financial planning process in working with clients.”

## **Borrowing from a Client**

In cases involving a loan between a financial planning practitioner and a client, where the client is the lender and the practitioner is the borrower, the BOPR presumes that the practitioner is not acting in the best interest of the client.

## **BOPR Recognizes Exceptions**

There are two exceptions to this presumption:

1. When the client is a family member
2. When the client is a financial institution acting in its normal course of business activity

The BOPR recognizes that borrowing and/or lending of funds between family members is a common, generally accepted, practice. Likewise, financial institutions are in the business of borrowing and lending funds and, as such, often provide loans to individuals, regardless of whether they are CFP Board designees. In both instances, loans between these groups can fall outside the scope of the planner-client relationship.

In either of the two situations described above, while the BOPR does not presume that the planner’s borrowing of funds is a violation of Rule 202, it may still find that the transaction was not in the client’s best interests if the financial planning practitioner is unable to establish that:

- The terms and conditions of the loan were clearly and objectively disclosed to the client, taking into consideration the client’s level of sophistication
- The terms and conditions of the transaction were fair and reasonable under the circumstances
- The client fully understood (a) the terms and conditions of the transaction and (b) the impact of the transaction on his/her financial situation

## **Lending to a Client**

In the more rare case where a financial planning practitioner lends funds to a client, the BOPR will presume that the practitioner is not acting in the best interest of the client. As a client who borrows funds from his or her planner is likely to be inhibited from ending the planner-client relationship, regardless of whether the client's financial planning needs are being met.

Even if the financial planning practitioner can demonstrate that a particular loan to a client did not inhibit the client from ending the relationship, the transaction will still be presumed to be a violation of Rule 202. If (a) the loan was used as an enticement for the client to make a financial decision, including, but not limited to, purchasing a financial product, or (b) the loan had a below market interest rate and could be considered a form of rebate.

The exception to this presumption is when the client is a family member. Even if the client is a family member, however, the BOPR may still find that the transaction was not in the client's best interest if the financial planning practitioner is unable to establish that

- A. The terms and conditions of the loan were clearly and objectively disclosed to the client, taking into consideration the client's level of sophistication
- B. The terms and conditions of the transaction were fair and reasonable under the circumstances
- C. The client fully understood the terms and conditions of the transaction and the impact the transaction may have on his/her financial situation.

## **Rule 607**

Rule 607 prohibits a CFP Board designee from engaging "in any conduct which reflects adversely on his or her integrity or fitness as a CFP Board designee, upon the marks, or upon the profession."

As defined in the Code Of Ethics, CFP Board designees include individuals who are currently certified, candidates for certification, and individuals who have any entitlement, either direct or indirect, to use the CFP certification marks.

Accordingly, this rule has been interpreted to apply to all CFP Board designees regardless of whether they are practitioners, including candidates for certification, and individuals who have the right to renew their CFP® certification without re-taking CFP Board's CFP® Certification Examination.

## **Whether the Client is the Borrower or Lender**

The BOPR interprets Rule 607 broadly, finding conduct which gives the "appearance of impropriety" to be a violation of the rule.

Accordingly, the BOPR has taken the position that most loans between a CFP Board designee and a client give the appearance of impropriety and, therefore, reflect negatively on the integrity of the designee, the CFP marks and the financial planning profession.

## **BOPR Recognizes Exceptions**

The same two exceptions discussed under Rule 202 (i.e., loans between a planner and a family member or loans between a planner and a financial institution) apply under Rule 607 when the planner is the borrower. In cases where the client is the borrower, only the family member exception applies.

Even if one of the exceptions applies, the BOPR may still find that the transaction violates Rule 607 if the CFP Board designee fails to establish that:

- The terms and conditions of the loan were clearly and objectively disclosed to the client
- The terms and conditions of the transaction were fair and reasonable under the Circumstances
- The client fully understood (a) the terms and conditions of the transaction and (b) the impact of the transaction on his/her financial situation

## **Summary**

The BOPR urges all CFP Board designees to avoid the practice of borrowing from or lending to clients. This advisory opinion focuses on the two most frequently cited rules (Rules 202 and 607) in cases involving loans between CFP Board designees and their clients.

CFP Board designees should remember, however, that the BOPR may find such transactions to be in violation of other rules in the Code Of Ethics, as well.

## **ADVISORY OPINION 2003-1**

### **General Rule**

CFP Board designees must avoid possible misrepresentation when using the term “fee-only.”

### **Background**

The Board of Professional Review (“BOPR”) views misrepresentation of compensation arrangements to be a violation of the Code of Ethics and Professional Responsibility (Code of Ethics).

The Code of Ethics defines the term “fee-only” as denoting “a method of compensation in which compensation is received solely from a client with neither the personal financial planning practitioner nor any related party receiving compensation which is contingent upon the purchase or sale of any financial product.”

BOPR Advisory Opinions 97-1 and 97-2 allowed for a designee to use the term “fee-only” to describe the compensation received from a specific client, even if other methods of compensation were used with other clients, and could offer “fee-only” services to a client, even if the designee also received commissions from the same client or other clients for other services.

In light of recent regulatory trends regarding the misrepresentation of methods of compensation, media focus on the issue, and the perceptions of the general public, the BOPR has redefined the appropriate use of the term “fee-only.”

The purpose of this Advisory Opinion is to reduce confusion on the part of CFP Board designees, their clients, and the public, and to maintain consistency with other organizations’ use of the term “fee-only.” Thus, the Board of Governors withdrew Advisory Opinions 97-1 and 97-2 in January 2002 and the Code of Ethics definition can no longer be considered an accurate reflection of the BOPR’s position on this issue.

## **Issue**

When may a CFP Board designee use the term “fee-only” to describe the designee as an individual, the designee’s practice or the designee’s services?

## **Analysis**

A fee arrangement exists when the CFP Board designee is compensated solely by the client, or another party operating exclusively on behalf of the client, for professional services provided.

The BOPR has defined types of compensation arrangements. The following qualify as fees:

- Hourly, fixed or flat fees
- Percentage fees, which are based on some aspect of the client’s financial profile, such as assets under management or earned income
- Performance-based fees, which are tied to the profitability of the client’s invested assets

## **Use of the Term "Fee-Only"**

In order for a CFP Board designee to describe his or her compensation as “fee-only”, all compensation from all clients must be derived solely from fees. Minimal exceptions may be allowed provided the compensation is inconsequential and independent of the purchase of any product or service.

Likewise, when using terms including, but not limited to, “fee-only services” and “fee-only firm,” the same requirements apply.

## **Potential Rule Violations**

Cases involving misrepresentation of compensation arrangements or failure to disclose compensation arrangements warrant investigation of whether that CFP Board designee has violated the Code of Ethics. The rules implicated in this analysis include, but are not limited to, Rules 101(a) and (b), 102, 201, 202, 401, 402, 606, 607 and 702.

The BOPR must consider whether the CFP Board designee is a financial planning practitioner (as defined by the Code of Ethics) in determining which, if any, rules have been violated. While any and/or all of the rules mentioned above may apply in a particular case, this advisory opinion focuses

on three rules that would most often be implicated in a case involving misrepresentation of and/or failure to disclose compensation arrangements: Rules 101(a) and (b), 401 and 402.

### **Rule 401**

Rule 401 of the Code of Ethics requires CFP Board designees to disclose to the client material information relative to the professional relationship, including compensation structure. The BOPR urges that disclosures under Rule 401 be clear, straightforward and unambiguous so as to be easily understood by all parties.

In cases involving CFP Board designees who represent themselves as “fee-only” to a client but accept compensation not defined as fees by the BOPR from that relationship or other client relationships, the BOPR presumes that the CFP Board designee has failed to disclose material information relative to the professional relationship.

### **Rule 402**

Rule 402 requires CFP Board designees in a financial planning engagement to make timely written disclosure of all material information relative to the professional relationship, in all circumstances and prior to the relationship, including sources of compensation. Adherence to the provisions of Rule 402 by CFP Board designees in financial planning engagements allows the public to make informed decisions about whether to use the professional services of the CFP Board designee.

Rule 402(a) is violated when the CFP Board designee in a financial planning engagement, in the disclosure provided to the client, represents himself or herself as “fee-only” when, in fact, that designee accepts compensation not defined as fees by the BOPR in that relationship or other client relationships.

### **Rule 101(a) and (b)**

Rule 101(a) and (b) prohibit CFP Board designees from soliciting clients through false or misleading advertisements and/or promotional activities. The use of the term “fee-only” must be used carefully and only when the CFP Board designee derives all compensation from all clients solely from fees.

The BOPR presumes advertisements and/or promotional activities to be false or misleading when they contain the term “fee-only” and the CFP Board designee advertising or promoting his or her services accepts compensation not defined as fees from that client relationship or any other client relationships.

### **Summary**

The public regards compensation structure as important information when choosing a financial planning professional. The Code of Ethics requires CFP Board designees to act with integrity and fairness toward the public in all activities. The appropriate use of the term “fee-only” in all public discourse provides a key opportunity for CFP Board designees to demonstrate professionalism by avoiding casual use of the term.

The BOPR advises CFP Board designees to avoid using the term “fee-only” except when all compensation from all clients is derived solely from fees. CFP Board designees should also avoid the

use of other terms designed to induce the public into a distorted belief that the designee receives “fee-only” compensation when in fact the designee receives commissions, referral compensation, or any other form of compensation not defined as fees by the BOPR.