INSTITUTE FOR
THE FIDUCIARY STANDARD

August 21, 2017

TO: CFP Board of Standards
RE: Proposed Code of Ethics and Standards of Conduct

Introduction.

The CFP Board considers its standards revisions at an historic time not unlike 1940. Dodd Frank was enacted seven years ago on the heels of the financial crisis. Rutgers law professor Arthur Laby writes that while the Securities Act of 1933 and Exchange Act of 1934 responded to the crises of the stock market collapse and ensuing depression, seven years later, the Advisers Act of 1940, "Grew out of study and reflection." [1] Similarly, seven years after Dodd Frank, CFP Board faces a daunting challenge in promulgating standards while the continued distrust of Wall Street lingers. One conservative think tank goes so far to conclude that most investors believe the Street, "Operates by a foreign code of conduct." [2]

In this environment, a question should be asked, 'What do investors want from advisors, consistent with professional standards?' A 2016 CFA Institute survey offers important insights. [3] The survey suggests transparency and clarity on fees and conflicts stand out above most other concerns. Even beating the benchmarks or beating other firms. One reading: in an important sense meeting client needs has become easier – not tougher – in recent times.

The proposed standards are a good first step.

The proposed standards move financial planners towards professionalism on a number of fronts. Two stand out. One, in a sharp departure from the current standards, all CFPs who render financial advice are held to fiduciary conduct. Two, in the proposed standards conflicts begin to be addressed. Still, to fully meet fiduciary requirements, more steps need be taken in three areas especially.

Conflicts.

Conflicts of interest have mattered to policy makers, jurists and world leaders throughout history, from Hammurabi and Aristotle to the crafters of the Advisers Act 77 years ago and the Supreme Court in 1963. In 2012, Carlo V. di Florio, then Director of the SEC Office of Compliance and Inspections, said, in a thoughtful speech, "Conflicts of Interest can be thought of as viruses that threaten an organization's well-being … a mortal threat to the body." [4]. The country has since had a refresher course in 2017 from the Bully Pulpit as to *why* conflicts matter.

CFP Board proposed standards call for disclosure and management of conflicts in its proposed standards. Neither is sufficiently well defined. This means many broker-dealers will likely follow SIFMA's lead. SIFMA also calls for disclosure and management of conflicts.

ACTION STEPS: CFP Board standards guidance should acknowledge both the importance of conflicts and the present absence of education, guidance and understanding of their inherently harmful nature. As a threatening virus, conflicts should be defined as presumed harmful and deserving of being avoided or eliminated. However, if a conflict is accepted by a broker or adviser and is not avoided, then what?

The cornerstone of addressing conflicts must be mitigation that neutralizes the virus. Concrete and specific mitigation measures and remedies proportional to the risks and harms are needed. CFP Board should provide explicit guidance on these remedies and measures because the BD industry and the vast majority of CFPs and their firms have no record, no tradition and no culture of mitigating conflicts.

What's it cost?

The standards call for describing "how" clients pay and "how" CFPs and firms are paid – not "what" is paid. This requirement falls short and serves to maintain an unacceptable standard. CFPs should be mindful of how low is this standard. Consider how there may be no other product sale or equivalent service rendered that operates under in so much darkness, is so fervently defended, and so routinely associated with poor outcomes.

ACTION STEP: Complete disclosure of "what" the client pays in all-in costs and fees in $ or % AUM should be required in writing. At minimum, a good faith written estimate is provided.

Enforcement.

Enforcement is crucial, especially in an age of skepticism. Michael Kitces asks how the standards can be enforced with resource constraints and the ambiguity in the standards. And what about the added factor of BDs' own policies? One CFP writes her BD, UBS, notified customers that CFP standards do not "change the obligation of UBS or financial advisors."

ACTION STEP: Credible enforcement is key for the standards to be effective and credible. Without credible enforcement investors are left to relying on the honor system. Numerous provisions can be adopted to provide reasonable measures that enhance compliance and that do not require the resources of conventional regulatory enforcement. One such provision to be considered: have CFPs affirm their adherence to CFP Board standards on their ADV.

Recommendations to strengthen standards.

As seen in the CFA Institute research, investors are pretty clear about what they want from advisors. And beating the benchmark *is not tops*. Speak candidly and plainly. Show me CFPs are 100% in and don't skirt the tough stuff. Earn my trust by what you do. Among other requirements, you will:

1. Mitigate, neutralize conflicts; (CFP Board provides explicit guidance.)
2. Provide written disclosure of all costs.
3. Put a statement of adherence to CFP Board standards on ADV.

Not practical?

Some will view these measures – treating conflicts as serious harms, disclosing complete costs and adopting credible enforcement measures – as too ambitious and more than what CFPs can do. Some will say they're impractical "in the real world." CFPs should ask an investor if they're "impractical."

Efforts to weaken standards or 'skirt the hard stuff' are nothing new. They are old as standards themselves. This is why when objections to fiduciary duties as impractical in "the real world" are heard, the words of former SEC Commissioner Luis Aguilar (2008-2015) should be recalled. Aguilar spoke in 2010 on why weakening fiduciary duties was not an option. The commissioner spoke on "Preserving the Fiduciary Standard" and that there is no such thing as a "partial" fiduciary.[5] :

"The fiduciary standard has served advisory clients well for many years, and I believe that it should be the governing standard whenever investment advice is provided. If you are giving advice to an investor, regardless of the title on the business card, you should always be bound to do so in the best interests of the client. While the scope of service may vary between clients, the standards of loyalty and care in providing that service should not. You simply cannot be three-quarters of a fiduciary."

Commissioner Aguilar raises a point not much heard in public discussions. Professionals don't get to choose which parts of their standards to meet. There are no partial credits. It's all or nothing, pass or fail. As Commissioner Aguilar states, one cannot be a "three-quarters of a fiduciary." 2017 can well be another 1940 for *advice*, when industry leaders chose to push back the excesses of a prior decade and to clearly differentiate advice from sales. CFP Board is at the helm today and much is at stake. Let's hope history repeats itself.

Respectfully submitted,

Knut A. Rostad
President

1. Arthur B. Laby, "Selling Advice and Creating Expectations: Why Brokers Should be Fiduciaries," November 2012, http://www.thefiduciaryinstitute.org/wp content/uploads/2013/02/LabySellingAdviceCreatingExpectations.pdf
2. The right leaning American Enterprise Institute assembled and analyzed polling data on how the public views finance and Wall Street and Dodd Frank, five years after the crash. The report can be found here: http://www.aei.org/publication/five-years-after-the-crash-aei-political-report-september-2013/
3. www.cfainstitute.org/learning/future/Pages/investor_trust_study.aspx
4. https://www.sec.gov/news/speech/2012-spch103112cvdhtm
5. https://www.sec.gov/news/speech/2010/spch032610laa.htm