

KITCES IAR ETHICS CE DAY

Professional Ethics Obligations Of Financial Planners



WELCOME

- The content of this program is based on CFP Board's Code of Ethics and Standards of Conduct (Code and Standards), which became effective on October 1, 2019.
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LEARNING OBJECTIVES

By the conclusion of this training, participants will have improved their ability to:



Recognize what constitutes Financial Advice.



Apply the Fiduciary Duty.



Describe when Financial Advice requires Financial Planning (and the additional obligations that apply to CFP professionals)



LEARNING OBJECTIVES (CONTINUED)

By the conclusion of this training, participants will have improved their ability to:



Identify duties when using or referring other service providers or technologies.



Describe the process the CFP Board follows to uphold the Code and Standards.



Determine what information must be provided to the Client and when to document the exchange of information.



CODE & STANDARDS

Why is it important to have a Code of Ethics and Standards of Conduct?

What happens if CFP® professionals fail to comply with the Code and Standards?



LEARNING OBJECTIVE 1

Recognize what constitutes Financial Advice.



SCENARIO: FINANCIAL ADVICE

Adina is expecting her first child. She reached out to Tomas, a CFP® professional, to learn more about 529 savings plans.

During a 30-minute meeting, Tomas provides an overview of how 529 plans work. He addresses some of Adina's general questions about 529 plans.



SCENARIO: FINANCIAL ADVICE

Is Tomas
providing
Financial
Advice?



Tomas provides a document titled "529 Plans and Other College Savings Options."

Adina thanks Tomas for his time and says she will follow up with him in the next few weeks.



HOW DO WE KNOW IF SOMETHING IS STEERING AWAY FROM BEING INFORMATIONAL OR EDUCATIONAL?



FINANCIAL ADVICE

Definition

- A communication that, based on its content, context, and presentation, would reasonably be viewed as a recommendation that the Client take or refrain from taking a particular course of action with respect to:
 - The development or implementation of a Financial Plan;
 - The value of or the advisability of investing in, purchasing, holding, gifting, or selling Financial Assets;
 - Investment policies or strategies, portfolio composition, the management of Financial Assets, or other financial matters; or
 - The selection and retention of other persons to provide financial or Professional Services to the Client;
- Or, the exercise of **discretionary authority** over the Financial Assets of a Client.



FINANCIAL ADVICE

Definition

- Financial Advice is NOT:
 - A communication that, based on its **content, context, and presentation**, would not reasonably be viewed as a recommendation;
 - Responses to directed orders; and
 - The following, if a reasonable CFP® professional would not view it as Financial Advice:
 - Marketing Materials;
 - General Financial Education; and
 - General Financial Communications.



CODE & STANDARDS

Why does it matter
if I know when I'm
providing financial
advice?



KNOWLEDGE CHECK – FINANCIAL ADVICE

True or False?

- 1 Fulfilling a directed order from a Client to buy a stock is Financial Advice.
- 2 In order for there to be Financial Advice, there must be compensation.
- 3 Providing marketing and general financial education materials is generally not providing Financial Advice.



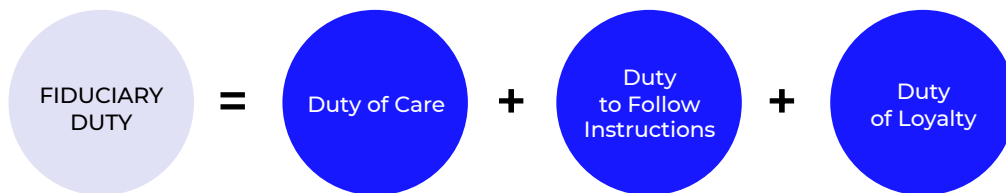
LEARNING OBJECTIVE 2

Apply the Fiduciary Duty



FINANCIAL DUTY IN FINANCIAL PLANNING

- Acting in the best interest of the client
- **Securities and Exchange Commission (SEC):** For Registered Investment Advisers (RIAs), the SEC imposes a fiduciary duty that includes providing advice that is in the best interests of the client, full disclosure of all material facts, and avoiding misleading statements.
- **Department of Labor:** The DOL's fiduciary rule, primarily focused on retirement accounts, mandates that financial advisors act in the best interests of their clients when providing advice on retirement accounts and ensures that the advice is free from conflicts of interest.



Applies at all times when providing Financial Advice to a Client.

Must act in the best interests of the Client.



COMMONALITIES IN FIDUCIARY DUTY



Acting in the best interest of the client



Duty of Care



Avoiding Conflicts of Interest



Ensuring proper disclosures



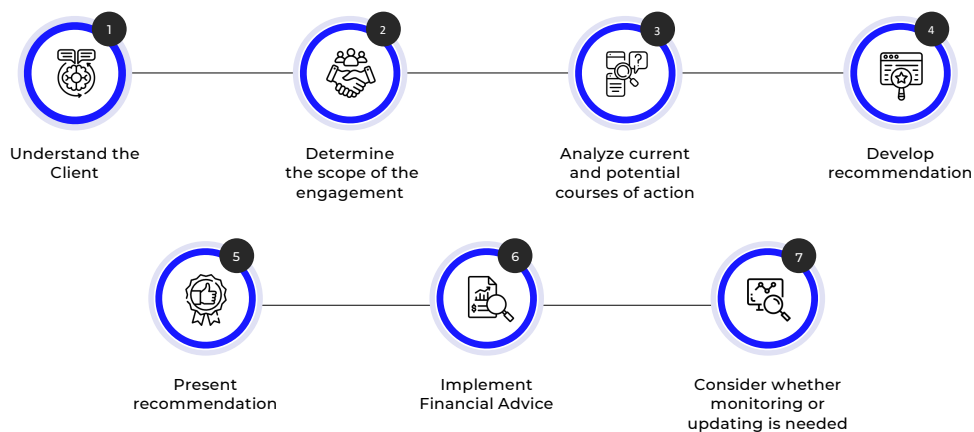
DUTY OF CARE

Definition

- Duty of Care is a component of the Fiduciary Duty.
- You must act with the care, skill, prudence, and diligence that a prudent professional would exercise in light of the Client's:
 - Goals
 - Risk Tolerance
 - Objectives
 - Financial and personal circumstances



PROCESS FOR COMPLYING WITH THE DUTY OF CARE



SCENARIO: DUTY OF CARE

Meet Jade

Jade is a CFP® professional with over 25 years of industry experience.



SCENARIO: DUTY OF CARE

Meet Ivy

Ivy has a 401(k) through her company and wants to set up a new Roth IRA account to supplement her retirement savings.



JADE'S RECOMMENDATION

During their meeting, Jade recommends three mutual funds to Ivy for investment. Jade always recommends these funds to investors because she has done due diligence on them, they have had positive results, and investors seem to like them.



RECOMMENDATIONS: DUTY OF CARE

- A** No, because a prudent CFP® professional would not recommend a new investor invest in mutual funds.
- B** Yes, because Ivy has done her due diligence into the mutual funds.
- C** Yes, because Ivy's experience with past clients shows that these mutual funds return positive results for investors.
- D** No, because Jade did not consider Ivy's individual circumstances before providing the investment recommendations.



SCENARIO: FULFILLING THE DUTY OF CARE

Let's think through how Jade could have fulfilled her Duty of Care to Ivy.



SCENARIO: CLIENT INSTRUCTIONS

Imagine you have a retired Client who instructs you to withdraw retirement funds to help their child start a business.

You do not believe this is in their best interests given their goals in retirement.

How would you proceed?



SCENARIO POLL: CLIENT INSTRUCTIONS

Imagine you have a retired Client who instructs you to withdraw retirement funds to help their child start a business. You do not believe this is in their best interests given their goals in retirement.

How would you proceed?

- ☐ Withdraw the funds without discussion.
- ☐ Refuse to withdraw funds.
- ☐ Discuss why you think this is not in their best interest and withdraw the funds if they still want to proceed.
- ☐ Discuss why you think this is not in their best interest and terminate the engagement.



POLL: CLIENT INSTRUCTIONS

How often do clients give you instructions that you believe are not in their best interests?

- ☐ NEVER
- ☐ RARELY
- ☐ SOMETIMES
- ☐ OFTEN

When in doubt,
DOCUMENT!



KNOWLEDGE CHECK – CLIENT INSTRUCTIONS

True or False?

- 1 You must resign the Engagement if you disagree with Client instructions.
- 2 You must follow Client instructions as long as they are reasonable and lawful or limit the engagement.
- 3 You must explain why you think the instructions are not in the Client's best interests and the potential consequences.



DUTY OF LOYALTY

Definition

- Place Client's interests first.
- Avoid Conflicts, or:
 - Fully Disclose.
 - Gain Client's Informed Consent.
 - Manage Conflict in the Client's best interest.



CONFLICT OF INTEREST

Definition

- Your interests (including the interests of your firm) are adverse to duties to a Client.
- You have duties to one Client that are adverse to another Client.

Having a Conflict ≠ Acting on a Conflict



SCENARIO: DUTY OF CARE

Meet Mei

Prospective client with 18 months worth of her expenses in a bank account.

- Wants to invest and is looking for someone to help manage the investments.
- Wants help developing a strategy for paying down her mortgage.



SCENARIO: DUTY OF LOYALTY

Meet Darren

CFP® professional
compensated through a
percentage of assets under
management.



SCENARIO: DUTY OF LOYALTY

Darren's Firm

Darren's firm has an
agreement with its clearing
broker to receive payments
when clients are invested in
certain mutual funds.



SCENARIO: CONFLICTS OF INTEREST LANGUAGE

Identify the
problems with
Darren's
statement.

?

In explaining his services,
Darren says that paying a fee
for investment advice is
“conflict-free.”

CFP®

SCENARIO: IDENTIFY CONFLICTS OF INTEREST

?

What conflicts are present?



Interest in maximizing
assets under management.



Interest in giving advice
to invest assets rather than
to pay debt.



Incentive to invest in funds
that will result in firm
compensation – even though
Darren is not directly
compensated.

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SCENARIO: MANAGING CONFLICTS OF INTEREST

Duty of Loyalty requires Darren to avoid the Conflicts of Interest, or:

- 1 Fully disclose Material Conflicts of Interest.
- 2 Obtain the Client's informed consent to the conflict.
- 3 Manage the conflict in Client's best interests.



SCENARIO: IDENTIFY CONFLICTS OF INTEREST

? Are these conflicts Material?

Information is Material when a reasonable Client or prospective Client would consider the information important in making a decision.



FULL DISCLOSURE & INFORMED CONSENT

What is “full” disclosure?

How do I know if I have informed consent?



SUFFICIENTLY SPECIFIC FACTS

Definition

Enough so a reasonable Client can:

- Understand the Conflict
- Give informed consent to the Conflict, or
- Reject the Conflict

Must be provided before the Financial Advice.



FULL DISCLOSURE

Types of Sufficiently Specific Facts:



The nature and extent of the conflict.



How the conflict affects or could affect the advice.



The sources and scale of compensation for the firm and/or financial professional.



INFORMED CONSENT

When can informed consent be implied?

Informed consent can be implied with full disclosure.

When is consent less likely to be inferred?

Magnitude of potential harm to the Client if Conflict acted upon

Extent of deviation from business practices

Ambiguity will be interpreted in favor of the Client.



SCENARIO: FULL DISCLOSURE

How-to

Darren's disclosures need help. Re-write his language so that he fully discloses his Material Conflicts of Interest.

A

"I receive an AUM fee"

A better disclosure

The amount I earn from working with you depends on the amount of assets I manage for you. We have a financial incentive to recommend that you make financial decisions to increase the assets I manage.

B

"My firm may have revenue sharing arrangements with mutual fund companies".

A better disclosure

My firm receives payments to make mutual funds and exchange-traded funds available to you. I have a financial incentive to recommend the services and products that make us more money.



WRITTEN DISCLOSURE

Written disclosure of conflicts is not required – but it is advised.

Still must be documented.

Discuss reasons why written disclosure is always good idea.



MANAGING CONFLICTS OF INTEREST

Why?

To ensure the Client's interests come first.

What is required?

Reasonably designed business practices to prevent acting on the conflict.



SCENARIO: MANAGING CONFLICTS OF INTEREST

How-to

Darren wants to make sure he has a system in place to comply with the Duty of Loyalty.

Is there a process Darren can follow to provide advice in Mei's best interests?



MANAGING CONFLICTS



Identify Material Conflicts of Interest

Develop (and periodically review and update) a comprehensive list of the Material Conflicts of Interest that may arise in a financial planning practice.



Review & Evaluate Existing Practices for Management of Conflicts

Review Firm conflict management or mitigation practices and any additional conflict management practices that the financial planner follows.



Implement Any Additional Conflict Management Practices

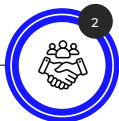
Consider any additional steps the financial planner needs to take to properly manage conflicts under the codes and standards that apply to them and implement any such practices.



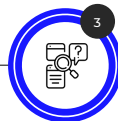
PRUDENT PROCESS CONSISTENT WITH THE DUTY OF CARE



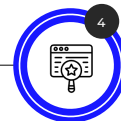
Understand the Client



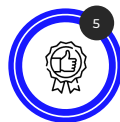
Determine the scope of the engagement



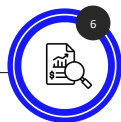
Analyze current and potential courses of action



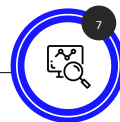
Develop recommendation



Present recommendation



Implement Financial Advice



Consider whether monitoring or updating is needed





LEARNING OBJECTIVE 3

Describe when Financial Advice requires Financial Planning
(and the additional obligations that apply to CFP
professionals).

