

CERTIFIED FINANCIAL PLANNER
BOARD OF STANDARDS, INC.

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July 23, 2003

Jonathan G. Katz
Secretary
Securities and Exchange Commission
450 Fifth Street, NW
Washington, DC 20549-0609

Re: File No. SR-NASD-2003-92 – Rule 2370 To Govern Certain Lending Arrangements Between Registered Persons and Customers

Dear Mr. Katz:

I am writing to provide CFP Board's¹ comments on the National Association of Securities Dealers' (NASD) proposed changes to rules regarding loans between registered persons and customers. CFP Board appreciates this opportunity to provide comments it hopes are helpful.

CFP Board supports the NASD rule to more closely regulate loans between registered persons and customers. The Commission may find of interest that CFP Board itself has grappled with this issue. In 2001, it released an advisory opinion that gave direction to CFP® certificants as to when these types of transactions may occur under its *Code of Ethics and Professional Responsibility*. In general, CFP certificants strongly discourages, but does not entirely prohibit the practice. I have attached that advisory opinion to this letter for your further review.

CFP Board is pleased NASD is proposing to further regulate a practice that is fraught with potential conflicts of interest for registered persons. If you have any questions regarding CFP Board, its marks or the individuals it certifies, please contact me at 703-414-5814 or mherndon@CFP-Board.org.

Sincerely,

Michael C. Herndon
Director, Public and Government Affairs

¹ Founded in 1985, Certified Financial Planner Board of Standards Inc. (CFP Board) is a nonprofit professional regulatory organization that fosters professional standards in personal financial planning so that the public values, has access to and benefits from competent financial planning. CFP Board currently authorizes more than 42,000 individuals to use its marks in the United States and 16 international affiliates certify additional thousands of qualified persons in other countries. CFP Board also serves as an educational resource to federal and state lawmakers and regulators on personal financial planning issues.

Advisory Opinion 2001-1

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; or

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; and
- 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, and (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; and
- 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.