

# Disclosing and Accurately Representing Compensation to Clients

The “Focus on Ethics” article series takes a close look at topics important to understanding CFP Board's new *Code of Ethics and Standards of Conduct*.

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A CFP® professional providing financial advice to a Client is obligated to provide the Client with accurate information regarding how the CFP® professional is compensated, and how the Client will pay for the products and services provided by the CFP® professional. Under the [\*Code of Ethics and Standards of Conduct\*](#) (“*Code and Standards*”) which will take effect on October 1, 2019, a CFP® professional owes two important duties to Clients with respect to compensation disclosures. First, a CFP® professional has the duty to provide information to a Client about how the CFP® professional, the CFP® Professional’s Firm, and any Related Party is compensated for providing products and services to the Client, and how the Client pays for the products and services. Second, a CFP® professional has the duty to avoid making false or misleading representations about the CFP® professional and the CFP® professional’s firm’s method of compensation. The *Code and Standards* sets a detailed standard for when a CFP® professional may use the terms “fee-only” and “fee-based.”

**Compensation Information Provided to the Client:** Standard 10 in the new *Code and Standards* requires a CFP® professional to provide various types of information to a Client. It specifically requires disclosure of the following two types of compensation-related information:

- ii. How the Client pays for the products and services, and a description of the additional types of costs that the Client may incur, including product management fees, surrender charges, and sales loads; and*
- iii. How the CFP® professional, the CFP® Professional’s Firm, and any Related Party are compensated for providing the products and services.*

**Form and Timing of Disclosure:** A CFP® professional may provide this information orally or in writing when the CFP® professional is providing Financial Advice that does not require Financial Planning. When the CFP® professional is provides or is required to provide Financial Planning in accordance with the Practice Standards, the CFP® professional must provide this information to the Client in one or more written documents. In both circumstances, the CFP® professional must provide the information to the Client prior to or at the time of the Engagement. In the event there is a Material change to any of the information provided, the CFP® professional must inform the Client of the change.

**Duty When Representing Compensation Method:** CFP® professionals utilize a variety of compensation methods, and CFP Board continues to be compensation neutral. Standard 12 in the

*Code and Standards* describes the duty that a CFP® professional must adhere to when representing compensation method:

*A CFP® professional may not make false or misleading representations regarding the CFP® professional's or the CFP® Professional's Firm's method(s) of compensation.*

The *Code and Standards* does not require disclosure of specific dollar amounts or percentages of compensation to a Client unless the Client specifically asks for this information. If the Client asks a CFP® professional the amount he/she will earn from a specific transaction or service, the CFP® professional must provide this information, to the extent it can be determined. If the cost to the Client is not known until a series of decisions or actions occur, a CFP® professional must make that information available to the Client as it is determined.

**Specific Compensation Representations:** Many members of the public are interested in working with a fee-only financial planner, which has created an incentive for some CFP® professionals (and others) to describe their compensation method as fee-only even when that term is not appropriate. For more than two decades, CFP Board has had standards dictating when a CFP® professional may represent the CFP® professional's or the CFP® Professional's Firm's compensation method as "fee-only." The *Code and Standards* addresses when it is appropriate to use two specific compensation representations: "fee-only" and a term that was not specifically addressed in the *Standards*, "fee-based."

Standard 12.a.i, describes the circumstances under which the term "fee-only" can be appropriately used to characterize compensation method:

***Fee-Only.*** *A CFP® professional may describe his or her or the CFP® Professional's Firm's compensation method as fee-only only where:*a) *The CFP® professional and the CFP® professional's Firm receives no Sales-Related Compensation; and*

*b) Related Parties receive no Sales-Related Compensation in connection with any Professional Services the CFP® professional or the CFP® Professional's Firm provides to Clients.*

While the term "fee-based" is frequently used in the profession, it does not have a universally-accepted meaning. Standard 12.a.ii describes the circumstances under which the term "fee-based" can be appropriately use, and it clarifies that "fee-based" is equivalent to "fee and commission":

***Fee-Based.*** *CFP Board uses the term "fee and commission" to describe the compensation method of those who receive both fees and Sales-Related Compensation. A CFP® professional who represents that his or her or the CFP® Professional's Firm's compensation method is "fee-based" or any other term that is not fee-only:*a) *May not use the term in a manner that suggests the CFP® professional or the CFP® Professional's Firm is fee-only; and*

*b) Must clearly state that either the CFP® professional or the CFP® Professional's Firm earns fees and commissions, or that the CFP® professional or the CFP® Professional's Firm are not fee-only.*

Standard 12 continues with provides detailed explanations of three key phrases used in the Standard for Specific Representations – “*Sales-Related Compensation*,” “*Related Party*,” and “*In Connection with any Professional Services*.”

**Sales-Related Compensation:** Sales-Related Compensation is compensation that provides incentives for the purchase or sale of Financial Assets, thereby presenting a Conflict of Interest. While sales incentives often take the form of commissions, other compensation incentives (such as 12b-1 fees) present the same type of conflict. The term Sales-Related Compensation captures all such compensation incentives. To account for compensation that is based on a Client's decision to hold an asset, such as an incentive to advise a client to annuitize a pension rather than take a lump sum, the Sales-Related Compensation definition also includes compensation received from “holding” Financial Assets for purposes other than to provide Financial Advice. The latter clause excludes fees for managing assets from the definition. Sales-Related Compensation also includes compensation for the referral of a Client to any person or entity other than the CFP® Professional's Firm, as the referral constitutes a Professional Service provided to a Client.

Standard 12.b sets forth common examples of Sales-Related Compensation, but explicitly excludes the following five types of compensation from its definition:

**Related Party:** The *Code and Standards* considers the compensation that a Related Party receives in determining whether a CFP® professional may refer to his or her compensation method as fee-only. Related Party compensation is relevant because of the potential influence on a CFP® professional's recommendations.

Standard 12.c defines a Related Party as a “person or business entity (including a trust) whose receipt of Sales-Related Compensation a reasonable CFP® professional would view as benefiting the CFP® professional or the CFP® Professional's Firm, including, for example, as a result of the CFP® professional's ownership stake in the business entity.” Family members and controlled business entities are presumed to be Related Parties, but a CFP® professional may present facts showing that a reasonable CFP® professional would not consider a particular family member or business entity's receipt of compensation to benefit the CFP® professional or the CFP® Professional's Firm.

**In Connection with any Professional Services:** The *Code and Standards* introduces a new limitation on the relevance of a Related-Party's Sales-Related Compensation to a CFP® professional's representation of compensation method. CFP Board will only consider compensation received by a Related Party to be Sales-Related Compensation when its receipt is “in connection with any Professional Services the CFP® professional or CFP® Professional's Firm provides to Clients.” This connection exists when the compensation results, directly or indirectly, from Client transactions referred (or facilitated) by the CFP® professional or the CFP® Professional's Firm. Standard 12.e includes a safe harbor for CFP® professionals (and their

firms) who adopt and implement policies and procedures designed to prevent recommendations that a Client purchase Financial Assets from or through, or refer any Clients to, a Related Party.

**Compensation Representations by a CFP® Professional's Firm:** Standard 12.f provides a standard for when the CFP® Professional's Firm makes compensation representations that are inconsistent with CFP Board's *Code and Standards*. If the CFP® professional Controls the firm, the CFP® professional must not allow the firm to make a false or misleading misrepresentation of compensation method. For example, when a CFP® professional is the sole owner of a firm that refers to its compensation method as fee-only, but the CFP® professional personally sells insurance and securities in exchange for Sales-Related Compensation. The *Code and Standards* would not permit the CFP® professional to allow the CFP® Professional's Firm, which the CFP® professional Controls, to use fee-only because the CFP® professional earns Sales-Related Compensation.

If the CFP® professional does not Control the firm, the CFP® professional does not have an obligation to prevent the firm from making a false or misleading misrepresentation of compensation method. Instead, the CFP® professional must correct any misrepresentation of compensation method by accurately representing the CFP® professional's compensation method to the CFP® professional's Clients. For example, assume a CFP® professional is an employee at a corporation that refers to its compensation method as fee-only even though the CFP® professional and others in the corporation refer commission-earning insurance business to a Related Party. In this instance, the CFP® professional could not use the term fee-only. Therefore, the CFP® professional must inform Clients that his compensation method is fee and commission.

The *Code and Standards* reflects the commitment that all CFP® professionals make to high standards of competency and ethics. The *Code and Standards* requires CFP® professionals to make accurate disclosure to Clients about how they are compensated and how the Client will pay for the products and services. The *Code and Standards* also prohibits false or misleading representations regarding compensation method.