

ETHICS OF DISCLOSURE IN FINANCIAL PLANNING: SHOULD THE FINANCIAL PLANNING INDUSTRY BE INTENTIONAL IN DISCLOSING PRACTICE VIOLATIONS?

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Introduction and Hypothesis

A Wall Street Journal article in the Summer of 2019 found that one of the largest financial planning organizations, the Certified Financial Planner™ (CFP®) Board, did not accurately disclose practice violations of CFP® professionals (Zweig, & Fuller, 2019). The article found that more than 6,300 CFP® professionals had practice-related violations and regulatory skirmishes from the Financial Industry Regulatory Authority (FINRA)¹ that were not mentioned on the CFP® Board's website: LetsMakeAPlan.org. LetsMakeAPlan.org is a website sponsored by the CFP® Board that, "allows you to find individuals who are currently authorized by CFP Board to use the CFP® certification marks, who have indicated they currently provide financial planning services to clients, and who accept new clients" (CFP® Board, 2019a). A tool that helps individuals locate financial planners that also does not accurately disclose the financial planners' practice violations, questions the level of organizational responsibility and transparency in the financial planning industry.

Consumers have check systems available to help them discover whether or not their financial planners have practice violations, such as FINRA's BrokerCheck, the Investment Adviser Public Disclosure (IAPD) database, the Electronic Data-Gathering, Analysis, and Retrieval (EDGAR) database, and others. These check systems serve as an alert system for consumers, letting consumers know whether or not their financial planner has a practice violation. The question begged is if it is up to the consumer to research this information or if it is up to the financial planning industry to be intentional in alerting consumers of their financial planner's practice violations.

The hypothesis of this study is that consumers are unaware of the existence of the financial planning disclosure check systems that are available to them. The lack of knowledge of these systems prevents consumers from having complete information when deciding to work

¹ It should be noted that the author of this study holds the CFP® designation and does not have any practice violations as defined by the FINRA BrokerCheck system.

with a financial planner. The findings of this study suggest that consumers lack awareness of the available resources that provide essential information when selecting to work with a financial planner. The conclusions drawn suggest that there is a need to promote transparency and disclosure in the financial planning industry.

Background

Clients of financial planners generally find their financial planner to be ethical and, generally, having the necessary technical competencies to fulfill their responsibilities as a financial planner (Cull & Bowyer, 2017). However, there are currently no legal or government-mandated requirements for an individual to hold themselves out as a financial planner and to practice financial planning; this is not to be confused with the security licensing requirements mandated for individuals who sell financial products. The lack of a formal licensing requirement is one area where the financial planning industry is vastly different from other professions, such as the legal or medical professions. Licensing requirements are formal regulatory ways to set minimum quality and ethical standards (Leland, 1979). In the absence of a minimum knowledge and ethical threshold, consumers considering working with a financial planner may look for other signals of market quality and ethical standards when selecting a financial planner, such as credentialing or the presence of a designation (Spence, 1973).

Consumers are more receptive to advice if it comes from people who they perceive as experts (Harvey, 1997), and the CFP® designation provides confidence to financial planning consumers (Gallouj, 1997; James, 2013). When individuals are asked to identify one professional from whom they would seek advice, Certified Financial Planners™ are the preferred resource (Murphy & Yetmar, 2010). 92% of individuals prefer their financial planner to have the CFP® designation, and individuals even prefer that their financial planner to have the CFP® designation over a master's degree (Bae & Sandager, 1997). The CFP® curriculum can be found in numerous undergraduate, graduate, and certificate programs in over 200 colleges and universities.

The most recognized designation or credential in financial planning is the CFP® designation (Alfest, 2004). With respect to the rigor of the technical competency required for the CFP® designation, the pass rate for financial planners testing to obtain the CFP® credential is 68% and 46% for first time takers and repeat test takers, respectively²

² Pass rates are from the posted CFP® Certification Examination Statistics from the July, 2019 exam. Historical Statistics are available on the CFP® Board's website in the CFP® examination

(CFP® Board, 2019b). With respect to the ethical competency to become a holder of the CFP® certification, 7% of the test to obtain the CFP® designation covers professional conduct, which includes testing on the CFP® Board's code of ethics³ (CFP® Board, 2019d). To maintain the CFP® designation, CFP® professionals are required to complete ethics training as a part of their continuing education requirements (CFP® Board, 2019e).

The primary motivations for financial planners to obtain a designation or credential are to broaden knowledge in financial advice and to establish professional credibility (Terry and Vibhakar, 2006). A financial planner obtaining a designation or credential, or multiple designations and credentials, may be a way to not only improve a financial planner's knowledge, but also may be a way to market to and attract consumers. Evidence shows that consumers who value designations pay financial planners more than those who did not have a designation (Raskie et al., 2017). A 2010 Wall Street Journal article notes that, "Increasingly, say regulators, financial advisers are using these dubious designations as marketing tools to win the trust of older, wealthier clients, in hopes of selling high-fee investments that are not appropriate for them" (Zweig & Pilon, 2010).

Financial planning is a credence service, and there is a high level of subjectivity in evaluating quality (Dulleck & Kerschbamer, 2006), and this asymmetric information presents opportunities for CFP® professionals to potentially take advantage of their consumers. When there is situational asymmetric information in financial planning, clients look to their CFP® professionals to be trustworthy, transparent, and provide full disclosure in delivering their service. Disclosure and transparency are a form of trust (McKnigh & Chervany, 1996), and trust builds commitment (Warrington, et al., 2000) and binds relationships (Ring, 1996). Without trust the objectives and desired outcomes from a given relationship are in chronic jeopardy (Johnson & Cullen, 2017). Trust and ethical behavior lead to higher levels of customer satisfaction (Román, 2003).

With so much trust placed in the hands of financial planners by their clients, the financial planning industry's responsibility should be to provide full transparency and disclosure. A code of ethics and

statistics.

³ The CFP® examination itself is one of several requirements to hold the CFP® designation. Other requirements include the attainment of a bachelor's degree from an accredited university or college, completing a CFP® Board registered education program, 3 years of financial planning experience or two years of apprenticeship, and completing the CFP® Board's candidate fitness standards (CFP® Board, 2019c).

mandated ethical training on its own may not be sufficient in achieving ethical behavior. Ethical behavior needs to be promoted, implemented and enforced (Brien, 1998). The public's trust in the financial services industry is still recovering from the 08-09 financial crisis and will likely persist (Collett, 2009). Clients of financial planners rated the ethical values of financial planners as more important than technical competence (Cull & Bowyer, 2017). Consumers should have complete information and be aware of any past violations of financial planning professionals before deciding to enter a financial planning relationship and deciding to continue ongoing advice from a financial planner.

Data and Methods

The 2015 wave of the investor survey of the National Financial Capability Study (NFCS) is utilized to examine consumers' level of knowledge of the available check systems in the financial planning industry. The NFCS is a project of the FINRA Investor Education Foundation. The goal of the NFCS is to understand how individuals can best manage and make decisions about their financial resources (FINRA 2015). The investor survey of the NFCS is self-administered by respondents on a website. The original survey data uses no additional weighting to account for non-response bias (FINRA 2015).

Data that are collected from the NFCS are utilized because of the relevancy of the questions that the survey asks its participants. The NFCS asks, "Have you heard of any of the following consumer information tools?"

- BrokerCheck
- IAPD (Investment Adviser Public Disclosure) database
- EDGAR (Electronic Data-Gathering, Analysis, and Retrieval) database

For each of the consumer information tools, the survey participants can select either: Yes, No, Don't know, or Prefer not to say. Don't know, Prefer not to say, and incomplete responses are dropped from the 2,000 original respondents in the sample. The sample size of this study is 1,894.

Below is information about each of the consumer information tools and resources:

BrokerCheck

The FINRA sponsored BrokerCheck resource is a, “trusted tool that shows you employment history, certifications, licenses, and any violations for brokers and investment advisors” (BrokerCheck, 2019). The check system tool allows users to find brokers barred by FINRA, find out whether or not a particular financial planner is registered to sell securities, find any pending Securities and Exchange Commission (SEC) litigations the financial planner may have, and the tool provides insight into the financial planner’s employment history, regulatory actions, and investment-related licensing information, arbitrations, and complaints.

IAPD

The IAPD, “provides instant access to registration documents filed by more than 25,000 SEC- or state-registered investment advisers” (IAPD, 2019a). The IAPD is a tool that provides users access to Form ADV filings and registration information filed with states of financial planners. Form ADV and the registration information provides financial planning consumers with information “about the investment adviser’s business, ownership, clients, employees, business practices, affiliations, and any disciplinary events of the adviser or its employees” and “the types of advisory services offered, the adviser’s fee schedule, disciplinary information, conflicts of interest, and the educational and business background of management and key advisory personnel of the adviser” (IAPD, 2019b).

EDGAR

“All companies, foreign and domestic, are required to file registration statements, periodic reports, and other forms electronically through EDGAR” (EDGAR, 2019). This system allows users to see information for companies and others who are required by law to file forms with the U.S. Securities and Exchange Commission. The companies that the EDGAR check system tracks include financial planning and advising companies such as J.P. Morgan, TD AmeriTrade, Charles Schwab, and others.

Table 1 provides insight into the number of individuals that have heard of BrokerCheck, IAPD, and EAGER. Roughly, 14.47% have heard of BrokerCheck, 12.94% have heard of IAPD, and 21.44% have heard of EAGER. Table 1 also provides insight into the sample’s distribution across various demographic variables. The sample includes respondents with an average non-retirement investment account value between \$50k and \$250k, income of around \$100k, and is weighted toward older individuals. 38.49% of the sample have college degrees, 55.91% identify as male, and 79.78% identify as white.

To examine whether or not the demographic variables of the sample affect whether or not the sample has heard of these consumer information tools, a probit analysis is performed on each of the consumer information tools. Each of the consumer information tools serves as dependent variables, coded as a “1” if the survey participant responded with a “yes” response and a “0” for “no” responses. The demographic variables from Table 1 serve as the explanatory variables for the probit analysis. The non-retirement account value, income, and age variables enter the models categorically, where non-retirement account values below \$2,000, income less than \$50,000, and ages 18 to 35 serve as the respective reference categories. College degree, gender, and race enter the model dichotomously, where no college degree, female, and non-white serve as reference categories.

Discussion

Table 2 presents the average marginal effects from the probit regression models. Generally, higher levels of non-retirement investment account values are associated positively with having knowledge of the availability of the consumer information tools

tested. Non-retirement account balances may serve as a proxy for net worth, and individuals with higher levels of net worth may receive greater utility from knowing whether or not their financial planner has any practice violations. Interestingly, income is not a significant predictor of whether or not consumers have heard of any of the check systems. An individual that has a college degree is associated positively with having heard of BrokerCheck. Males, compared to females, are more likely to have heard of BrokerCheck and EAGER. An individual that is white is associated negatively with having heard of all three consumer information tools.

Although the results of the probit regressions provide demographic insight, Table 1 reveals the reason that this study was conducted. The low percentages of individuals who are aware of the existence of financial planning violation check systems is alarming. All three check systems have no cost to the consumers and are simple to navigate. The financial planning industry can take steps to inform consumers that these resources are available. Promoting awareness of the check systems can close the asymmetrical information gap that exists between consumers and financial planners.

Another potential, and perhaps more pragmatic step forward, is for the financial planning industry to require financial planners to inform their consumers of any practice violations as a part of their client onboarding process. Increasing public policy efforts that require additional disclosures in the financial planning industry also can provide consumers with greater transparency.

Conclusion

The results of this study support the hypothesis, showing that financial planning consumers are unaware of the check systems they have available. Roughly, 14.47% of individuals have heard of BrokerCheck, 12.94% of individuals have heard of IAPD, and 21.44% of individuals have heard of EAGER. Consumers are unaware of these tools. Providing full disclosure minimizes information asymmetry for consumers when they select their financial planners. The financial planning industry should take reasonable action to promote transparency between consumers and financial advisors.

Tables

Table 1 - Descriptive Statistics

	Mean	Std. Dev.	Min	Max
BrokerCheck ¹	0.1447	0.3519	0	1
IAPD ¹	0.1294	0.3357	0	1
EAGER ¹	0.2144	0.4105	0	1
Non-Retirement				
Accounts ²	6.3289	2.4095	1	10
Income ³	2.1399	0.7319	1	3
Age ⁴	2.3495	0.7471	1	3
College Degree (no degree as base)	0.3849	0.4867	0	1
Gender (female as base)	0.5591	0.4966	0	1
Race (non-white as base)	0.7978	0.4018	0	1

Data collected from the 2015 wave of the investor survey of the National Financial Capability Study (NFCS).

N = 1,894

¹Indicates the fraction of “yes” responses when survey participants are asked if they have ever heard of this resource.

²What is the approximate total value of all of your investments in non-retirement accounts?

- 1 Less than \$2,000
- 2 \$2,000 to less than \$5,000
- 3 \$5,000 to less than \$10,000
- 4 \$10,000 to less than \$25,000
- 5 \$25,000 to less than \$50,000
- 6 \$50,000 to less than \$100,000
- 7 \$100,000 to less than \$250,000
- 8 \$250,000 to less than \$500,000
- 9 \$500,000 to less than \$1,000,000
- 10 \$1,000,000 or more
- 98 Don't know
- 99 Prefer not to say

³Household income

- 1 <\$50K
- 2 \$50-\$100K
- 3 \$100K+

⁴Age

- 1 18-34
- 2 35-54
- 3 55 +

Table 2 – Marginal Effects from Probit Regressions:

	BrokerCheck		IAPD		EAGER	
	Marginal Effect	Standard Error	Marginal Effect	Standard Error	Marginal Effect	Standard Error
Non-Retirement Accounts						
(less than \$2,000 as base)						
\$2,000 to less than \$5,000	0.0417	0.0270	0.0331	0.0288	0.0263	0.0474
\$5,000 to less than \$10,000	0.0737***	0.0278	0.0346	0.0261	0.0114	0.0426
\$10,000 to less than 25,000	0.0853***	0.0263	0.0729***	0.0276	0.0681	0.0431
\$25,000 to less than 50,000	0.1027***	0.0276	0.0486*	0.0258	0.0278	0.0410
\$50,000 to less than \$100,000	0.1195***	0.0234	0.0779***	0.0239	0.0779*	0.0384
\$100,000 to less than \$250,000	0.1506***	0.0233	0.1207***	0.0245	0.1218***	0.0379
\$250,000 to less than \$500,000	0.1916***	0.0274	0.1582***	0.0284	0.1464***	0.0406
\$500,000 to less than \$1,000,000	0.1820***	0.0333	0.1574***	0.0344	0.1650***	0.0459
\$1,000,000 or more	0.1064***	0.0341	0.1238***	0.0375	0.1836***	0.0507
Income						
(<\$50K as base)						
\$50-100k	0.0002	0.0227	-0.0129	0.0224	-0.0223	0.0263
\$100k+	-0.0214	0.0247	-0.0313	0.0242	0.0259	0.0299
Age						
(18-34 as base)						
35-54	-0.1359***	0.0320	-0.1549***	0.0311	-0.0353	0.0326
55+	-0.2558***	0.0296	-0.2373***	0.0294	-0.1742***	0.0302
College Degree						
(No Degree as base)						
	0.0280*	0.0166	0.0179	0.0160	-0.0208	0.302
Gender						
(female as base)						
	0.0303*	0.0158	0.0038	0.0151	0.0679***	0.0187
Race						
(non-white as base)						
	-0.0473**	0.0183	-0.0584***	0.0174	-0.0412*	0.0224

Data collected from the 2015 wave of the investor survey of the National Financial Capability Study (NFCS).

N = 1,894

*** Significant at the one-percent level ** Significant at the five-percent level * Significant at the ten-percent level.

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