

B. FINANCIAL PLANNING AND APPLICATION OF THE PRACTICE STANDARDS FOR THE FINANCIAL PLANNING PROCESS, 4. INTEGRATION FACTORS:

1: DETERMINING WHETHER FINANCIAL PLANNING IS REQUIRED WHEN AN ENGAGEMENT EXPANDS OVER TIME

Pedro, a CFP® professional, has a new client, Napoleon, who is 28 years old. Napoleon is engaged to be married and has a two-year old child from a previous marriage. At their first meeting, Napoleon informs Pedro that he recently received a \$20 million inheritance. Napoleon asks Pedro for advice on how to invest his inheritance. Napoleon and Pedro's firm enter into an Engagement to provide investment management for the inheritance funds. Pedro's firm sends Napoleon a document stating that "the only time an Advisor is providing Financial Planning is if the engagement explicitly provides for Financial Planning."

Over time, Pedro and Napoleon's professional relationship expands, with Pedro providing "modular" Financial Advice over successive meetings:

- Prior to his wedding, Napoleon tells Pedro that he wants to purchase a home for his family. He also wants to know if he has enough money to quit his job and live off his inheritance for the rest of his life. Pedro determines, based on Napoleon's net worth, cash flow, retirement projections, and risk tolerance, that a moderate growth portfolio likely will provide Napoleon with a comfortable lifestyle and a new home. Pedro tells Napoleon that he can quit his job and advises Napoleon to continue his employer-sponsored health insurance coverage. Pedro also helps Napoleon determine how much he should spend on his new home.
- Two months after he is married, Napoleon and Pedro discuss Napoleon's need for new health insurance coverage. Pedro compares several private health insurance policies with those from the insurance marketplace, and recommends Napoleon purchase a private policy. Pedro incorporates this new expense into the cash flow analysis.
- Four months later, Napoleon tells Pedro that he would like to begin saving for his son's college. Pedro presents an education funding analysis for Napoleon's son and recommends that Napoleon front-load a 529 savings plan with a \$75,000 one-time contribution. Pedro factors this expense into Napoleon's cash flow analysis.
- Sometime later, Napoleon tells Pedro he is concerned that his ex-wife and other family members may try to make a claim on his inheritance. Pedro prepares an estate planning analysis and recommends that Napoleon create Wills, Trusts, Powers of Attorney, and Health Care Directives. Pedro provides the names of three experienced, qualified, and reputable attorneys who are available to help Pedro implement the recommendation.
- At their most recent meeting, Napoleon discusses his desire to provide for his child and second wife. Pedro recommends the gifting of certain assets to an Irrevocable Trust, changing beneficiary designations, and annual gifting strategies that would benefit Napoleon's mother and his two-year old son. Pedro includes the annual gifting expense in the cash flow analysis.

QUESTION:

Is Pedro providing Financial Advice that Requires Financial Planning?

RESPONSE OPTIONS:

- A. Yes, because Pedro's Financial Advice requires integration of relevant elements of Napoleon's personal and/or financial circumstances.
- B. No, because Pedro did not create a comprehensive financial plan, but instead delivered modular Financial Advice over the course of several meetings.
- C. No, because Pedro did not specifically state that he was performing Financial Planning.
- D. No, because Pedro's firm's disclosure document states that "the only time an Advisor is providing Financial Planning is if the Advisor and client explicitly agree to the engagement."

Best Response: A is the best response. Pedro is providing Financial Advice that requires Financial Planning. This case study involves the Application of the Practice Standards for the Seven-Step Financial Planning Process (Standard B.3.) ("Practice Standards"), the Integration Factors (Standard B.4.), and the Duty to Provide Information to a Client (Standard A.10.).

A CFP® professional must comply with the Practice Standards, and therefore, provide Financial Planning, when:

- a. The CFP® professional agrees to provide or provides:
 - i. Financial Planning; or

- ii. Financial Advice that requires integration of relevant elements of the Client's personal and/or financial circumstances in order to act in the Client's best interests ("Financial Advice that Requires Financial Planning");
or

b. The Client has a reasonable basis to believe the CFP® professional will provide or has provided Financial Planning.

Pedro's firm does not have an explicit agreement for Pedro to provide Financial Planning to Napoleon. Pedro also has not discussed Financial Planning with Napoleon, and Napoleon has no reasonable basis to believe that Pedro will be providing Financial Planning. Therefore, the issue is whether Pedro's Financial Advice requires integration of relevant elements of Napoleon's personal and/or financial circumstances in order to act in Napoleon's best interests, such that Pedro is required to provide Financial Planning to Napoleon. CFP Board has established the following Integration Factors that CFP Board will weigh in making that determination:

- a. The number of relevant elements of the Client's personal and financial circumstances that the Financial Advice may affect;
- b. The portion and amount of the Client's Financial Assets that the Financial Advice may affect;
- c. The length of time the Client's personal and financial circumstances may be affected by the Financial Advice;
- d. The effect on the Client's overall exposure to risk if the Client implements the Financial Advice; and
- e. The barriers to modifying the actions taken to implement the Financial Advice.

CFP Board would weigh the Integration Factors in this case as follows:

- Pedro is addressing Napoleon's need for or desire to develop goals, manage assets and liabilities, manage cash flow, identify and manage the financial effect of health considerations, provide for educational needs, preserve or increase wealth, prepare for retirement, and address estate and legacy matters. Therefore, Pedro's Financial Advice may affect several relevant elements of Napoleon's personal and financial circumstances, which weighs in favor of a finding that Financial Planning is required.
- Pedro will be managing Napoleon's \$20 million inheritance, which is a significant portion of Napoleon's Financial Assets and a significant amount of Financial Assets. Therefore, this factor weighs in favor of a finding that Financial Planning is required.
- Napoleon has asked Pedro to focus on his long-term financial outlook, and to prepare long-term planning scenarios. Therefore, Pedro's Financial Advice likely will affect Napoleon's personal and financial circumstances for a long time, which weighs in favor of a finding that Financial Planning is required.
- It is not clear how Pedro's analysis, including the assumptions he uses and the recommendations he makes, will impact Napoleon's overall risk exposure. Therefore, this factor does not weigh for or against a finding that Financial Planning is required.
- Pedro is recommending a large deposit in a 529 savings plan (\$75,000). If Napoleon needs to access the money in the 529 savings plan for something other than qualified education expenses, he may have to pay taxes and a penalty. In addition, Pedro is recommending that Napoleon gift assets to an Irrevocable Trust, as well as to Napoleon's mother and son. These facts weigh in favor of a finding that Financial Planning is required because, if implemented, these recommendations would be difficult to modify.

Based upon a weighing of the Integration Factors, Pedro will be providing Napoleon with Financial Advice that Requires Financial Planning. Most significantly, Pedro's Financial Advice (a) will affect most of Napoleon's Financial Assets; (b) may affect several relevant elements of Napoleon's personal and financial circumstances; (c) will affect Napoleon's personal and financial circumstances for a long time; and (d) may be difficult to modify, if implemented.

Where, as here, a CFP® professional provides or agrees to provide Financial Advice that requires integration of relevant elements of the Client's personal and/or financial circumstances to act in the Client's best interests, then the CFP® professional has additional duties to the Client, unless the Client does not want to engage the CFP® professional to provide Financial Planning.

If the Client does not agree to engage the CFP® professional to provide Financial Planning, then the CFP® professional must either:

- a. Not enter into the Engagement;
- b. Limit the Scope of Engagement to services that do not require application of the Practice Standards, and describe to the Client the services the Client requests that the CFP® professional will not be performing;

- c. Provide the requested services after informing the Client how Financial Planning would benefit the Client and how the decision not to engage the CFP® professional to provide Financial Planning may limit the CFP® professional's Financial Advice, in which case the CFP® professional is not required to comply with the Practice Standards; or
- d. Terminate the Engagement.

In this case, Pedro's and Napoleon's professional relationship has expanded over time and is not limited to the provision of investment advice. There is no indication that Napoleon does not want to engage Pedro to provide Financial Planning. Therefore, Pedro is required to provide Financial Planning to Napoleon.

When Pedro's Financial Advice expands to the point that the Financial Advice requires Financial Planning, Pedro has additional duties to Napoleon. Pedro is required to provide Financial Planning and to comply with the Practice Standards. In addition, under the Duty to Provide Information to a Client, most of the information that Pedro may have provided to Napoleon orally (or in writing) when providing Financial Advice now must be delivered to Napoleon in writing, in one or more written documents. This includes the following information, which must be provided prior to or at the time of Engagement:

- A description of the services and products to be provided;
- How the Client pays for the products and services, and a description of the additional types of costs that the Client may incur;
- How the CFP® professional, the CFP® Professional's Firm's, and any Related Party are compensated for providing the products and services;
- The existence of any public discipline and bankruptcy, and the locations of the webpages of certain public websites that sets forth the CFP® professionals' public disciplinary history or any personal or business bankruptcy when the CFP® professional was a Control Person;
- Full disclosure of all Material Conflicts of Interest with the CFP® professional's Client that could affect the professional relationship, including sufficiently specific facts so that a reasonable Client would be able to understand the CFP professional's Material Conflicts of Interest and the business practices that give rise to the conflicts, and give informed consent to such conflicts or reject them;
- A written notice at the time of the Engagement identifying policies regarding the protection, handling, and sharing of a client's non-public personal information that were adopted and implemented by the CFP® professional's Firm, and thereafter not less than annually except under certain enumerated circumstances.
- Any arrangement by which someone who is not the Client will compensate or provide some other material economic benefit to the CFP® professional, the CFP® Professional's Firm, or a Related Party for engaging or recommending the selection or retention of additional persons to provide financial or Professional Services for a Client; and
- Any other information about the CFP® professional or the CFP® Professionals' Firm that is Material to a Client's decision to engage or continue to engage the CFP® professional or the CFP® Professional's Firm.

Pedro also must provide to Napoleon the terms of the Engagement, including the Scope of Engagement and any limitations, the periods during which the services will be provided, and Napoleon's responsibilities. Pedro is responsible for implementing, monitoring, and updating the Financial Planning recommendation(s) unless specifically excluded from the Scope of Engagement.

Response B is not the best response because Pedro is not required to provide one document called a "financial plan" to be required to provide Financial Planning. Pedro provides Financial Advice to Napoleon in modules, with the breadth of the Financial Advice expanding over time. The scope of the Financial Advice is such that Pedro is required to integrate relevant elements of Napoleon's personal and/or financial circumstances in order to act in Napoleon's best interests. Therefore, Pedro is providing Financial Advice that requires Financial Planning.

Responses C and D are not the best responses because they offer reasons that do not determine whether Pedro must provide Financial Planning. Instead, that determination depends on whether Pedro's Financial Advice requires integration of relevant elements of Napoleon's personal and/or financial circumstances. A CFP® professional who does not explicitly state that he or she is providing Financial Planning still may be required to provide Financial Planning and comply with the duties that apply when Financial Planning is required.

Relevant Standards and Definitions: Application of Practice Standards (Standard B.3.); Integration Factors (Standard B.4.); Duty to Provide Information to a Client (Standard A.10.).