

A. DUTIES OWED TO CLIENTS, 3. DUTY OF COMPETENCE:

2: APPLYING THE DUTY OF COMPETENCE TO FINANCIAL ADVICE, INCLUDING LIFE INSURANCE PRODUCTS

SCENARIO:

Bridget (age 38) and Elena (age 40) are a married couple with one child, Martin, who is 8. They work full time, have roughly equal incomes totaling \$250,000 annually, and are in good health. Martin has a disability that likely will require him to have home care during adulthood.

Elena used to work in finance, and she and Bridget self-describe as “conservative” savers and investors. Both have been working since their mid 20s and consistently have contributed to their retirement accounts. They have a cash emergency fund that covers six months of their monthly fixed expenses. They each also have employer-provided group term life insurance that would pay three times their annual salary in a lump sum after death. Both also have short- and long-term disability policies that meet their needs.

Bridget and Elena have come to Roscoe, an insurance-licensed CFP® professional, for Financial Planning. They are focused on the likelihood that Martin will outlive their ability to provide financial support. They want to ensure that Martin is provided for if either of them were to die prematurely or have an unexpected life event that materially decreases their income.

Roscoe gathers additional financial information, which shows that they are on track to retire consistent with their goals, have sufficient liquidity to cover their current needs and have unallocated cash flow.

In connection with his evaluation of Bridget and Elena’s insurance needs, Roscoe requests information about Martin’s present care cost and the care he might need in the future. Roscoe prepares a Capital Needs Analysis (CNA) projecting Martin’s likely resource needs over the next 70-80 years, along with the assets that would be available to satisfy those financial needs.

Roscoe holds an insurance license and is competent to provide Financial Advice about some insurance products, but he determines that he does not have the relevant knowledge or skill to provide the specific Financial Advice concerning insurance options that are in the best interests of Elena and Bridget given their personal and financial circumstances. Accordingly, Roscoe reaches out to Lina, a licensed insurance professional whose primary focus is life insurance solutions for Clients, including families with special needs. Lina has helped Roscoe before when he had Clients who faced similar circumstances. In each circumstance, Lina provided services in the client’s best interests. Roscoe periodically reviews online regulatory databases that disclose professional misconduct and is not aware of Lina having ever been sanctioned for misconduct.

Together, Roscoe and Lina discuss and evaluate the following options:

- Rely solely on Bridget and Elena’s existing, employer-provided term life insurance. Lina and Roscoe agree that employer-provided insurance is insufficient to cover Martin’s expenses based on the information provided and that the group term coverage will cease shortly after they stop working for their employers.
- Buy term life insurance. Term insurance could supplement their employer insurance but expires after the 10- to 30-year term period, at which time renewal premiums increase significantly.
- Buy whole life insurance or other cash-value life insurance. Whole life insurance provides level premium coverage that would last their entire lives, with premium payments on Martin’s behalf until his life expectancy of 89. The premiums initially would be substantially higher than term life insurance. However, with regular premium payments, the policy would accumulate cash value over time, and the couple would be able to use the cash value for supplemental income if needed.
- A combination of whole life and term life insurance. Roscoe asks Lina to consider a combination of life insurance products to provide financial resources for Martin’s potential financial needs while moderating the overall outlay for insurance coverage.

Elena and Bridget meet with Lina. Roscoe also attends to help answer questions. Lina explains the pros and cons of the options above. At Roscoe’s suggestion, Lina explains the necessary commitment to annual premiums for whole life insurance, and Roscoe provides his assessment of their ability to fund the annual premiums based on their financial circumstances.

QUESTION:

Which response best describes Roscoe's actions with respect to the Financial Advice to purchase insurance?

RESPONSE OPTIONS:

- A. Roscoe should recommend that Bridget and Elena buy term insurance because it has the lowest premium.
- B. Roscoe is taking the right steps to develop a recommendation in the Clients' best interests, regardless of what product Lina recommends.
- C. Roscoe is not providing Financial Advice; only Lina is.

Option B is the best response. This case involves the Duty of Competence (Standard A.3.), Duties When Recommending, Engaging, and Working With Additional Persons (Standard A.13.), the Fiduciary Duty (Standard A.1.), including the Duty of Care (Standard A.1.b.), and the definition of Financial Advice (Glossary). This case study does not address how the Duty of Loyalty applies to the scenario.

Under the Duty of Competence, a CFP® professional must provide Professional Services with competence, which means having relevant knowledge and skill to apply that knowledge. When the CFP® professional is not sufficiently competent in a particular area to provide the Professional Services required under the Engagement, the CFP® professional must gain competence, obtain the assistance of a competent professional, limit or terminate the Engagement, and/or refer the Client to a competent professional.

When engaging or recommending the selection or retention of additional persons to provide financial or Professional Services for a Client, a CFP® professional must:

- i. Have a reasonable basis for the recommendation or Engagement based on the person's reputation, experience and qualifications;
- ii. Disclose to the Client, at the time of the recommendation or prior to the Engagement, 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 the recommendation or Engagement; and
- iii. When engaging a person to provide services for a Client, exercise reasonable care to protect the Client's interests.

At all times, when providing Financial Advice to a Client, a CFP® professional must act as a fiduciary and, therefore, act in the best interests of the Client. The Fiduciary Duty includes a Duty of Loyalty, a Duty of Care and a Duty to Follow Client Instructions. The Duty of Care requires a CFP® professional to act with the care, skill, prudence and diligence that a prudent professional would exercise in light of the Client's goals, risk tolerance, objectives and financial and personal circumstances.

Financial Advice is:

- 1. 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:
 - a. The development or implementation of a financial plan;
 - b. The value of or the advisability of investing in, purchasing, holding, gifting or selling Financial Assets;
 - c. Investment policies or strategies, portfolio composition, the management of Financial Assets or other financial matters; or
 - d. The selection and retention of other persons to provide financial or Professional Services to the Client; or
- 2. The exercise of discretionary authority over the Financial Assets of a Client.

The determination of whether Financial Advice has been provided is an objective rather than subjective inquiry. The more individually tailored the communication is to the Client, the more likely the communication will be viewed as Financial Advice. The provision of services or the furnishing or making available of marketing materials, general financial education materials or general financial communications that a reasonable CFP® professional would not view as Financial Advice, does not constitute Financial Advice.

In this case, Roscoe is providing Financial Planning. Therefore, Roscoe is providing Professional Services and must satisfy the Duty of Competence. Additionally, Roscoe is providing Financial Advice to a Client and must satisfy the Fiduciary Duty, including the Duty of Care.

Response A is not the best response. Under the Duty of Care, a CFP® professional may not cause the Client to incur excessive costs or be exposed to excessive risk relative to comparable, reasonably available alternatives. However, a CFP® professional is not always required to choose the lowest cost option. Cost is an important factor among several factors that a CFP® professional must analyze. If a CFP® professional considers and analyzes the material advantages and disadvantages of the alternatives and determines that the higher cost option is in the best interests of the Client, then the CFP® professional may recommend the higher cost option.

Response B is the best response. Here, Roscoe recognized that, even though he is insurance-licensed, he is not competent to provide the Financial Advice that Bridget and Elena's situation required. Consistent with the Duty of Competence, Roscoe obtained the assistance of Lina, a competent professional. As required by the Duties When Recommending, Engaging and Working With Additional Persons, Roscoe had a reasonable basis for recommending Lina given her reputation, experience and qualifications. Roscoe had personal experience working with Lina, other Clients previously received services from her that were in their best interests and Roscoe periodically reviews online regulatory databases that disclose professional misconduct and is not aware of sanctions against Lina for misconduct.

Roscoe also exercised reasonable care to act in Bridget and Elena's best interests. Roscoe:

- Gathered relevant information;
- Collaborated with Lina to understand his Clients' options;
- Attended the meeting between his Clients and Lina to provide support and knowledge that facilitated Lina's delivery of Professional Services;
- Asked Lina to provide supplemental information to help Bridget and Elena understand the options; and
- Provided his own Financial Advice to help his Clients make an appropriate decision.

Response C is not the best response. Roscoe is providing Financial Advice in two ways. First, he is recommending Lina, another professional. The definition of Financial Advice includes recommending the selection or retention of other persons to provide financial or Professional Services to the Client. Second, Roscoe is providing Financial Planning, which is Financial Advice that integrates relevant elements of the Client's personal and financial circumstances, including insurance coverage.

Relevant Standards and Definitions: Duty of Care (Standard A.1.b.); Duty of Competence (Standard A.3.); Duties When Recommending, Engaging, and Working With Additional Persons (Standard A.13.); definition of Financial Advice (Glossary).