

## Chapter 2

### PERSONAL FINANCIAL PLANNING PROCESS

#### Multiple Choice Questions

**Question 1.** When a financial planner designs a formal contract, which of the following should *not* be included?

- A. A range of services to be performed
- B. Method of compensation
- C. The client's responsibility in the planning process
- D. The fact that the financial planner is not authorized to provide any legal advice
- E. All must be included

**Answer: E**

**Question 2.** A standard rule-of-thumb with respect to data gathering is that the data should be sufficiently complete to enable the planner to do all *except* which of the following?

- A. Evaluate the client's financial position
- B. Determine the client's personality, dreams, and fears
- C. Articulate short- and long-term goals
- D. Formulate a set of strategies for helping the client achieve his or her stated goals
- E. All are necessary functions

**Answer: E**

**Question 3.** Which of the following are true?

- A. After the data gathering process it is desirable for the financial planner to make the client feel comfortable by explaining why such detailed personal and financial data is needed to develop a plan.
- B. The extent of data collection should depend upon the amount of time available to the client.
- C. Development of a more comprehensive financial plan requires a more sophisticated set of investment data.
- D. A and C.
- E. All of the above.

**Answer: D**

**Question 4.** Quantitative data includes which of the following?

- A. Cash
- B. Risk tolerance level
- C. Stock/bonds and mutual funds
- D. A and C
- E. B and C

**Answer: D**

**Question 5.** Qualitative data includes which of the following?

- A. Feeling toward society
- B. Priorities of various objectives
- C. Attitude toward life insurance

D. A and B

E. B and C

**Answer: E**

**Question 6.** Which of the following is an example of a personal assumption that you will need to obtain from the client (as opposed to an economic assumption)?

A. Inflation rate of higher education

B. Priorities of goals and objectives

C. Reinvestment rate of return on blue chip stocks

D. Projected income tax rate schedule

E. Anticipated social security benefit

**Answer: B**

**Question 7.** In evaluating alternative planning solutions and products the financial planner may be involved in all of the following job tasks *except* for:

A. A. Considering the impact of the strategy on other parts of the plan

B. Consulting with other professionals

C. Assessing how the alternative solutions aligns with the client's goals and attitudes

D. Evaluating different scenarios in order to account for future uncertainties

E. All of the above may be associated with this step in the planning process

**Answer: D**

**Question 8.** Which of the following is (are) typically required of the financial planner during the implementation stage?

- A. Coordination with other financial professionals
- B. Selection of appropriate financial products
- C. Rebalance the investment portfolio
- D. A and B
- E. B and C

**Answer: D**

**Question 9.** All of the following are job tasks that are specifically associated with monitoring the client's portfolio *except* for:

- A. Identifying changes in client circumstances and goals
- B. Monitoring changes in the financial and legislative landscape
- C. Creating a timeline to implement recommendations
- D. Comparing portfolio performance to projections and benchmarks
- E. Preparing client materials (e.g., performance reports, meeting handouts, etc.)

**Answer: C**

**Question 10.** Which of the following can be said with regard to the financial planning process?

- A. Personal financial planning is a never ending process
- B. Over time a person's tax environment, financial conditions, and personal situation can change
- C. A person's goals should be monitored at least annually
- D. All of the above represent planning process

E. A and C only represent planning process

**Answer: D**

## Part A: Long Essay Questions

**Question 1: Define the steps involved in the financial planning process.**

**Answer 1:** Financial planning is a dynamic process. The six steps in the financial planning process are as follows:

1. Establish the relationship and define the engagement
2. Gather client data necessary to fulfill the engagement
3. Analyze the data
4. Develop the plan
5. Implement the plan
6. Monitor the plan

**Question 2: Describe specific activities within the financial planning process.**

**Answer 2:** In each step of the financial planning process, there are several activities that the financial planner will conduct.

1. Conduct the initial interview and sign a formal engagement contract
2. Gather the client's qualitative and quantitative data, and collect missing data
3. Formulate reasonable planning assumptions to be used in analyzing the plan
4. Analyze the current plan's strengths, weaknesses, and gaps
5. Evaluate alternative strategies and products

6. Synthesize final recommendations
7. Communicate final recommendations to the client
8. Refine plan recommendations based on client feedback
9. Implement the revised plan
10. Monitor the progress and make sure that all the planning regulations are being successfully met

**Question 3: How does a financial planner qualify a potential client?**

**Answer 3:** The financial planner should take great care in qualifying a potential client, thereby establishing the basis for a lasting relationship between them. During the initial interview, the planner sizes up a potential client by determining if there is a reasonable basis for establishing a long-term relationship with the individual or the family.

The initial interview is not an end in itself. It is designed to help the financial planner recognize the potential client's *true* desires and determine if the chemistry is right for establishing a long-lasting relationship. Sometimes, the former element will not surface quickly, and the planner may have to probe *behind the scenes* in order to discover these desires.

**Question 4: Give examples of situations where the *real* problems of potential clients are far different from those communicated to the financial planner.**

**Answer 4:** The two cases presented in the text provide these examples. Other cases can be developed with relative ease.

**Question 5: Why is the signing of a formal contract an important element of a financial planning process?**

**Answer 5:** Every financial planner–client relationship has a built-in life span. Unless great care is taken to nurture them, some relationships are destined to die early, while a rare few are likely to ripen to old age. By signing a contract, both the planner and the client agree in principle to establish a long and fruitful relationship. Also, the contract helps the planner *manage* the client’s expectations. This prevents future misunderstandings.

At the time of the signing of the contract, the client receives the planning brochure in compliance with SEC Rule 204-3, commonly known as the brochure rule. Alternatively, the planner may provide the client with a copy of the ADV (Part II) of the Registered Investment Advisor Agreement.

**Question 6: In the financial planning profession it is often said that “a plan, irrespective of its sophistication, is only as good as the data and assumptions on which it is based.” Comment on this statement.**

**Answer 6:** The statement is basically true. Unless the data are accurate and reflective of the client’s goals, aspirations, and fears, no matter how sophisticated, the plan will not have much value for the client. Consequently, a standard rule of thumb is that the data must be sufficiently comprehensive to enable the planner to: (a) analyze the client’s financial condition; (b) determine the client’s personality, dreams, and fears; (c) articulate the client’s short- and long-range goals; and (d) formulate a set of strategies for helping the client achieve his or her stated goals.



**Question 7: Is there a difference in the mechanics that is used for collecting qualitative as opposed to quantitative data?**

**Answer 7:** Most certainly. A practical yet effective means of collecting *qualitative* data is to conduct an extensive goals and objectives interview during which this type of data can be collected. Examples of qualitative data include: (a) priorities of various objectives, (b) risk tolerance level, (c) good and bad experiences with various types of investment products, (d) feelings toward life insurance, (e) difficulty with generating savings, (f) need for achieving financial independence before retirement, (g) desire to find a public or private college education for children, and (h) general feeling toward finances. Generally, open-ended questions are appropriate for obtaining qualitative data.

The technique for collecting *quantitative* data is different. The extent of data collection depends upon the type of plan and the level of sophistication desired by the client. The most *efficient* means of collecting quantitative data is to use a fact-finding questionnaire and an explanation sheet explaining the nuances of more involved questions. The data-gathering questionnaire could be relatively simple, or it could be highly complex, if conditions so warrant.

**Question 8: In analyzing the client's data, the financial planner assesses the strengths and weaknesses of the current plan. The objective is to improve the client's chances of achieving his or her goals. Provide examples of what you might consider to be major gaps in a risk management plan for a young couple with children.**

**Answer 8:** Examples of weaknesses and gaps are presented in the text. Other examples can be developed with relative ease.

**Question 9: Describe the process of developing planning recommendations.**

**Answer 9:** Once the planner has identified areas of the current plan that need improvement, it is important to consider alternative planning strategies and products. This is because planning is an integrative process and no one solution “fits all.” A planner’s mindset might start from “what is possible” and proceed to what constitutes the best integrative solution. Because the future is uncertain, it is also important to consider different scenarios when formulating the recommendation.

**Question 10: Communicating the plan, in both written and oral format, is an important job task. What interpersonal communications skills do you think would improve the client’s willingness to approve the plan and agree to implementation?**

**Answer 10:** Professional skills for communicating plan recommendations include the following:

- Narrate client’s story – The planner should link the recommendations to the specific goals, so the client would relate them to the stated goals and aspirations.
- Personalize the discussion – Help the client visualize the emotional reaction of the family to the planner’s recommendations.
- Clarify concepts – Present the underlying concepts by using simple, rather than technical, language, so the client understands them.
- Connect with stories – Christina Baldwin clarified this concept by stating at the National FPA Convention, “Words are how we think, stories are how we link.”

- Engage the client – Since the success of the plan ultimately rests on a complete buy-in by the client, it is imperative that the client remains engaged during the entire implementation period. In this process, questions such as “How do you feel about that recommendation?” or “How would you wish to cut back on your monthly spending so you could increase your retirement contributions?” could improve the implementation process.
- • Motivate action – The best way to motivate a client is by explaining the consequences of not going ahead with the planner’s recommendations.
- • Observe expressions – The planner needs to be an active listener and an observer. That is because client responses come in the form of verbal response, facial expressions, and gestures.

**Question 11: Explain the importance of plan monitoring and review.**

**Answer 11:** Personal financial planning is a never-ending process. Over time, a client’s personal situation, financial conditions, economic conditions, and tax environment can and often do change. Consequently, the client’s progress vis-à-vis the short- and long-range goals set in the plan should be monitored on a continuing basis and the client should be advised about the factors which could affect the plan’s progress. In addition, a periodic review and revision of the plan’s recommendations are not only desirable but also essential if the financial planner wishes to participate in the financial planning process on a long-term basis. There is, of course, no universal definition of how frequently this periodic review should be conducted. A typical time cycle is comprised of an annual update with provision for a more frequent review whenever personal, financial, or economic conditions change.

## Part B: Short Essay-type Questions

**Question 1:** Impressed with your presentation of the ten-step financial planning process (A to J), John Client signs a contract and writes a check for \$2,500 (half of the planning fee). He then makes the following comment: “I am a very busy person. I don’t care to see a written plan and don’t want to know if you religiously follow the six-step planning process. I will be satisfied if you just tell me what to do.” How should you as John’s financial planner handle this situation?

**Answer 1:** It appears that the planner did a poor job of sizing up a client. It is not a bad idea for the planner to start the exploratory process all over again. For a meaningful, long-term relationship, the client must appreciate the value of a ten-step process and the planner must insist on the client’s understanding of the recommendations before deciding to act on them.

**Question 2:** Your affluent client has filled out your planning questionnaire. During the data-gathering interview, the client complained that he had to do too much work and hoped that he would not have to spend any more time. You have discovered that the information supplied by him is incomplete and the accuracy of the data supplied by him is highly questionable. What is your next step?

**Answer 2:** Without complete, accurate, and detailed data, the value of the plan will be minimal at best, and negative at worst. Furthermore, the client must understand that financial planning is a cooperative process, and the success of a plan ultimately depends upon the client’s willingness to cooperate, learn, critically evaluate the recommendations, and ultimately implement them with definite resolve. The planner

has the obligation to communicate these thoughts to the client and to make sure that he/she understands them and is willing to cooperate with the planner.

**Question 3: After you develop a financial plan for your client, you realize that it looks too sophisticated for your client. You hate to downgrade the plan, but you are afraid that in its current form the plan would be a total turn off. What is your best course of action?**

**Answer 3:** It is not necessary to downgrade a plan just because the client is unsophisticated. Good communication can be established by adding to the plan the following sections: (a) goals and objectives interview; (b) basic observations; (c) key recommendations; and (d) trip tick or action plan.

**Question 4: You have asked John Client to come in for an annual review. John says that he does not have any money to invest and consequently does not want to pay you to conduct the annual review. What do you tell him?**

**Answer 4:** Apparently the client does not understand the nature and importance of annual review. It is your responsibility to educate him on this score, emphasizing the fact that an annual checkup is necessary to maintain the general well-being and financial health. The client should also be informed that investment review is only a part of the service rendered during the annual review.

**Question 5: In the Recommendations section of your plan, you have included the following: (a) universal life insurance for \$400,000; (b) a \$4,000 disability income policy which will cost \$4,500 per year; (c) liquidation of \$600,000 of individual stocks currently owned by the client; and (d) purchase of a \$500,000 single premium deferred annuity. You are a fee and commission-type planner and have**

**offered to implement these recommendations yourself, if the client so desires.**

**The client fails to take any action. How do you handle this situation?**

**Answer 5:** The first question is to assess if the client's reluctance to implement is a result of unacceptable recommendations or lack of understanding regarding the recommendations. At first glance, the recommendations appear as a list with industry jargon. Moreover, recommendations are not linked to goals. For example, the client might not understand the term "universal life insurance policy." How does the \$400,000 policy impact his or her goal? How much will that policy cost, and is it affordable? Financial planning is both an art and a science, and in this situation the communication of recommendations could be improved.