

The Emerging Role of the Financial Planner

FINC 3405 – Financial Planning
Dr. Basciano – Spring 2004

Adapted From: Practicing Financial Planning For Professionals by Mitra, Kirkman and Seifert. RH Publishing, 2002.

Demands of the Financial Future

- o Financial Fears of the 21st Century:
 - Fear of living too long
 - Agony of suffering from a catastrophic illness
 - Major depression leading to the collapse of the global economy
 - Widespread poverty after retirement
 - Bankruptcy of Social Security and Medicare System
 - Dethroning of the US as the dominant economic power
- o Not all is bad:
 - Better quality of life than previous generations
 - Longer life spans
 - Better health
 - More Leisure time
- o To take full advantage of these "positives", people "need financial security and thus must surmount complicated financial hurdles".

Percent of Persons 65 Years and Over Below the Poverty Level 1999

Data Classes

Percent
5.8 - 8.0
8.1 - 10.6
11.1 - 14.2
15.5 - 18.8
44.0 - 44.0

Features

- Major Road
- Street
- Stream/Waterbody

Items in gray text are not visible at this zoom level



Percent of Persons Age 21 to 64 With Disabilities - 1999

Data Classes

Percent
14.0 - 16.2
16.7 - 18.5
19.2 - 20.0
20.9 - 22.7
23.2 - 28.2

Features

- Major Road
- Street
- Stream/Waterbody

Items in gray text are not visible at this zoom level



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Financial Condition of Social Security

- The long-term financial position of social security is discussed in the following quote from "Highlights of Financial Position" source: <http://www.ssa.gov/finance/>
- For more information concerning the financial position of social security see:
 - <http://www.ssa.gov/finance/>

Long Term Financing

Social Security's financing is not projected to be sustainable over the long term with the tax rates and benefit levels scheduled in current law. By 2018, benefit payments will exceed tax revenues, and, by 2042, the Trust Fund will be exhausted according to the projections by Social Security's Chief Actuary. The primary reason for the projected long-term inadequacy of financing under current law is the changing demographics of the United States: baby boomers approaching retirement, retirees living longer, and birth below population replacement rates. In present value terms, the 75 year shortfall is \$3.5 trillion, which is a \$200 billion increase from the 2002 estimate. Possible reform alternatives being discussed -- singularly or in combination with each other -- are (1) increasing payroll taxes, (2) decreasing benefits, (3) using general revenues or (4) increasing returns through either personal savings accounts or direct investments of the trust funds.

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Financial Condition of Medicare

- The long-term financial position of Medicare is discussed in the following quote from "Trust fund faces earlier insolvency" source: <http://www.thehill.com/news/031704/fund.aspx>
 - "Last year, the trustees estimated the Medicare trust fund would go bankrupt in 2026. This year, the insolvency date will be moved up by a couple of years. The estimate has little to do with the new drug benefit, which is not financed out of the trust fund."

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The Emerging Trends Changing Family Patterns

- Changing demographics of the US family unit:
 - 2002 Census indicates that less than 25% of US households consisted of married couples with children
 - In 1950, this composition comprised 70% of households
 - Single person households now comprise 25% of US households
 - In 1950, this composition comprised 11%
 - When the traditional family unit remains, they are now less likely to provide the financial support network provided by previous generations (parent and child care).
 - The 21st century is marked by a shift to an individual's responsibility for meeting their own financial goals.

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The Emerging Trends The Reality of the American Dream

- Increasing cost of home ownership:
 - In 1949, a typical 30 year old used 14% of their salary to service their mortgage
 - Today, approximately 45% of a typical 30-year old's salary goes to a mortgage
- Increasing cost of raising children:
 - In 1980 it cost approximately \$80,000 to raise a child to the age of 18 (does not include college educational expenses)
 - In 2002, the cost is estimated to be \$400,000 (again without considering college educational expenses)
- Increasing costs of college:
 - The average rate of inflation for higher education is 7% (far above the 4% rate experienced in the overall economy)
 - Projected four year college costs for the year 2020:
 - Private College- \$253,604
 - Public College- \$118,576

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Cost of Home Ownership

Monthly housing costs as a percentage of income, 1995

Source: U.S. Census Bureau, 1998, Statistical Abstract of the United States: 1998, Table No. 1216

Homeownership can be very costly:

Housing costs are often one of the largest components of a family's budget. In 1995 (the most recent year data are available), median monthly housing costs, on average, were 19 percent of before-tax family income for homeowners. For 19.0 percent of homeowners, monthly housing costs were less than 10 percent of family income; for 13.4 percent of homeowners, monthly housing costs were 40 percent or more of family income.

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Cost of Raising Children

- The source of the information on the following two slides is:
 - <http://moneycentral.msn.com/articles/family/kids/tlkidscost.asp>
 - "The Cost of Raising Children The table below shows the estimated annual costs of raising a child, based on a survey by the U.S. Department of Agriculture. The table shows costs based on a family with two children on a per-child basis. The data comes from the Consumer Expenditure Survey by the U.S. Department of Labor, conducted from 1990-92. The figures have been updated to 2001 dollars using the Consumer Price Index."
 - "The USDA ends its cost survey when a child legally becomes an adult at age 18. It does not include any estimates for sending your children to college nor does it offer any cost estimates if your child remains in your home as a dependent after the age of 18. The College Board reports that in the 1998-99 school year, a resident student at a four-year private college will spend about \$23,578 a year; a student at a public college will pay \$9,008 a year."

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Cost of Raising Children

Dual-Parent Family

Age of Child	Housing	Food	Transportation	Clothing	Health	Child care/ Education	Miscellaneous	Total
Before-tax income: up to \$39,100								
0 to 2	2,500	910	780	370	460	840	630	6,490
3 to 5	2,470	1,010	750	360	440	820	680	6,630
6 to 8	2,380	1,300	880	400	510	560	680	6,710
9 to 11	2,150	1,560	950	450	560	340	720	6,730
12 to 14	2,400	1,640	1,070	750	560	240	900	7,560
15 to 17	1,940	1,780	1,440	660	600	400	680	7,480
Total	41,520	24,600	17,610	9,970	9,390	9,990	12,720	124,800
Before-tax income: \$39,100 to \$85,800								
0 to 2	3,380	1,090	1,160	430	610	1,380	980	9,030
3 to 5	3,350	1,260	1,130	420	580	1,530	990	9,260
6 to 8	3,260	1,600	1,260	470	660	980	1,030	9,260
9 to 11	3,030	1,890	1,330	520	720	640	1,250	9,190
12 to 14	3,280	1,900	1,450	870	720	470	1,250	9,940
15 to 17	2,820	2,110	1,840	780	770	810	1,010	10,140
Total	57,360	29,550	24,510	10,470	12,180	17,430	18,960	176,460

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The Emerging Trends The Realities of Retirement

- Two major trends are impacting retirement savings needs:
 - Life expectancy is increasing: (longer retirement period)
 - Male: 76 (text)
 - Female: 82 (text)
 - Early Retirement: (shorter work life)
 - 60% of all private sector employees now retiring before the age of 65
- Retirement Needs:
 - The BLS estimates that 70-75% of preretirement income is needed to continue at a comparable lifestyle during retirement.
 - Note that this is not a "magic" number.
- Social Security:
 - Will it be there in the future?
 - Maximum benefit: \$13,500 (regardless of how great the individual's preretirement income)

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Concept of Personal Financial Planning

- Personal financial planning defined:
 - Most comprehensive definition developed by the Certified Financial Planner Board of Standards in its Code of Ethics and Professional Responsibility.
 - This definition is found on page 1-2 of the text.
 - The Code of Ethics and Professional Responsibility is scheduled for coverage in a later class.

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Financial Planning Defined

- "...."denotes the process of determining whether and how an individual can meet life goals through the proper management of financial resources"
 - Focus is on the process and not the product!
 - Financial planning may lead to the recommendation of a specific product; however, "a financial planner should never act as an order taker"!
 - Avoid the "one size fits all" approach:
 - Mutual funds, Life Insurance, etc
 - Financial planning should be approached as a process by either:
 - Developing comprehensive financial plans
 - Segmented approach focused on solving a specific problem

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Financial Planning Defined

- "The management of financial resources can be seen as the technical side of the process"
 - Requires current knowledge about instruments and strategies that are available to solve various financial issues.
- "The other side of the process requires that all the planner's knowledge of financial strategies and instruments be brought to the surface of the client's goals"
 - Help client articulate goals
 - Determining feasibility of goals given available resources, instruments and strategies
 - Redefining goals
 - Implementation
 - Refer to a third party when necessary

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Key Areas of Financial Planning

S	Safety through Risk Management Process
E	Educational Planning
C	Cash Management, Savings, Credit & Debt Management
U	Ultimate Disposition through Estate Planning
R	Retirement Planning
I	Investment Planning
T	Tax Planning
Y	Yearning for Financial Independence Planning

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Key Areas of Financial Planning

- o Figure 1-1 on page 1-5 provides an overview of a comprehensive financial plan based on S-E-C-U-R-I-T-Y.
- o A "true professional" in financial planning must possess the five C's of financial planning.

Client	Client interests must always come first
Communication	Communication is the key to motivating clients to implement plan recommendations
Coordination	Coordination of various professionals provides the highest quality of overall financial planning
Competence	Competence based on education and experience is essential.
Commitment to Ethics	Commitment to Ethics and professionalism is basis for providing quality service

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The Client The Emerging Client

- o Changes in the economic environment between the end of WWII and the 1970's led to the need for financial planners that could offer a more complex array of products and services.
- o Recent economic events leading to increased complexities and greater need for comprehensive planning:
 - Double digit inflation (80's)
 - Stagflation (inflation with no growth)
 - High unemployment
 - Massive budget and trade deficits
 - Numerous changes in tax laws
- Defined contribution versus defined benefit plans
- Trend in number of employers over working life

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The Client

The Emerging Client

- Demographics:
 - Change in family unit
 - Lower emphasis on children
 - Caring for elderly parent's
 - Emergence of prenuptial agreements

- Bottom Line:
 - The typical client of the 70's is non-existent
 - Their really is no "typical" client!

- However, all individuals have certain basic financial planning needs.

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The Client

The Common Denominators

- Three distinct fears shared in common:
 - Fear of lack of financial resources during old age (or retirement)
 - Dying too young
 - Suffering a disability

- Living too long:
 - Potential bankruptcy of Social Security and Medicare
 - Potential bankruptcy of retirement plans
 - Increasing health care costs
 - Increasing housing costs
 - Long term care
 - Nursing homes
 - Inflation and non-indexed retirement income

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The Client

An Overview of the Retirement Planning Process

- General steps in the retirement planning process:
 - Step One: Determine the Retirement Goals
 - Step Two: Determine Current Financial Status
 - Calculate Net Worth = Assets – Liabilities
 - Step Three: Savings Planning
 - Estimate annual expenses during retirement (pro forma cash flow statements)
 - Determine amount needed to fund retirement (savings goal)
 - Determine annual savings necessary to fund retirement (retirement savings gap)
 - Planner should stress:
 - Savings goal and desired lifestyle reflect personal preferences of the client
 - Tradeoff exists between sacrificing current income to increase savings and future income

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The Client

An Overview of the Retirement Planning Process

- Fourth Step: Investment Planning
 - Channeling savings into the appropriate investment products
 - How much should the investment earn?
 - How much risk can be assumed?
 - How long is one willing to wait before the investment is likely to pay off?
 - Can the investment be easily liquidated?
 - What are the tax ramifications of investing in these products?
- Fifth Step: Integration of Investment Plan with Tax Planning
 - Some investment products offer tax advantages (tax exempt or deferred)
 - However, these advantages oftentimes need to be weighed against lower returns
- Sixth Step: Integration with Estate Planning

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The Client

Dying Too Young

- Dying too young refers to the premature death of the primary "breadwinner" of the family.
 - Can be a catastrophic financial event for the surviving members of the family
- An appropriate financial planning strategy in this respect involves risk management and more particularly risk transfer.
 - The purchase of life insurance effectively transfers the risk of premature death to an insurance company.
- Difficult for planners for two reasons:
 - Calculation of insurance needs is difficult and involves some subjectivity.
 - Negative reputation of some insurance agents, companies, and sales tactics.

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The Client

Becoming Disabled

- Disability planning poses a serious challenge for financial planners.
 - People underestimate the likelihood of disability and the resultant financial costs
 - People underestimate the term of the disability and the long term financial implications
 - People perceive disability insurance as an expensive and likely unnecessary coverage
- Although disability insurance is more expensive on the surface than life insurance policies, the appropriate comparison involves comparing the present value of each policy.
 - Disability more likely & cost may be significant
 - Additionally, the products meet different financial needs!

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The Client The Risk of Disability

- Risk of Disability Over Death – National Safety Council
 - Ages 30 – 50 3-4 times more likely
 - Ages 50+ 2 times more likely
 - Working Career 3 times more likely

- Current Statistics – National Safety Council
 - 1 out of 5 Auto Accident
 - 1 out of 21 Disabling Accident
 - 1 out of 96 House Fire
 - 1 out of 114 Death

- If you are interested in knowing the “odds of dying” visit the following link:
 - <http://www.nsc.org/lrs/statinfo/odds.htm>

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Communication The Potential Client

- “I don't care how much you know until I know how much you care”.
- Financial Planner must begin by convincing the client that he or she is (A-B-C)
 - **A**ccountable for all planning related actions
 - **B**oth caring and committed for the long term
 - **C**ompetent both academically and experientially
- How the ABCs are achieved:
 - Recognition of the client's fears
 - Articulates short term and long term objectives
 - Develops a program to meet these objectives
- Emphasis must be on communicating that financial planning is not a science, rather it is a long term process that involves continuous monitoring, evaluation, and modification. In addition, the process must be co-operative in order to succeed.

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Communication The Planning Client

- Six stages in financial planning (**EGPRIM**):

E	Establishing client objectives
G	Gathering data (quantitative and qualitative)
P	Processing and analyzing the planning data
R	Recommending specific actions for clients by producing a written comprehensive financial plan
I	Implementing the plan
M	Monitoring the progress and conducting periodic reviews

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Professional Practice Standards An Overview

Series	Stage
100	Establish Relationship & Goals
200	Gather Data
300	Analyze & Evaluate Data
400	Develop & Present Plan
500	Implement Plan
600	Monitor Plan

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Communication Establishing Client Objectives

- o Difficult for two reasons:
 - Clients oftentimes are unsure about their objectives and even more frequently are unable to effectively articulate their needs
 - Planner needs well developed communication skills- both verbal and nonverbal
- o Process:
 - Normally begins with a survey or Financial Planning Questionnaire covering the eight topics identified earlier (SECURITY)
 - Questionnaire completed by the client with help from the planner
 - Planner interviews client concerning goals & objectives in each of the eight areas
 - Planner summarizes the results at the end of the interview (recap facilitates corrections, clarifications, & reinforcement)
 - Results committed to paper and given to client for future reference

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Are You An Effective Communicator?

Communication Type	Possible Weights	Answers
Words	38%	
Inflection & Tone	55%	
Non-Verbal	7%	

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Communication

Establishing Client Objectives

- Some key distinctions:
 - Goals are open-ended statements
 - Objectives are quantifiable targets that can be measured in accomplishing the client's goals
 - Strategies are detailed programs, carefully crafted, to accomplish the predefined objectives

- Communication After the Meeting:
 - Send minutes of the meeting to the client
 - Confirm all of the items discussed
 - Proposed plan of action
 - Individual responsible for providing information to the planner (accountant, attorney, insurance agents, etc)

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Communication

Gathering Data

- Data gathering is a vital (albeit un-enjoyable) step in the financial planning process.

- Things the planner should do in the information gathering process:
 - Assist client in completing the questionnaire
 - Make sure that the client understands the questions and any assumptions being made (inflation rates, investment returns, etc)
 - Win the client's trust and confidence
 - Utilize technology to systematize the results and effectively interpret the quantitative data

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Communication

Gathering Data- Quantitative Data

- Examples of necessary quantitative data include: (1-10)
 - Value of assets and liabilities
 - Cash flows
 - Insurance (Health, Life, Auto, Disability, Long Term Care, etc)
 - Retirement and Pension Savings & Employee Benefits
 - Tax returns (last three years)
 - Details on investment accounts
 - Businesses
 - Trust Accounts
 - Gifting Programs
 - Estate Distribution Plan
 - Financial and Economic Assumptions

- Discuss the relevance of this information to the planning process.

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Communication

Gathering Data- Qualitative Data

- Examples of necessary qualitative data include: (1-10)
 - Insurability of family members
 - Employment expectations
 - Risk tolerance
 - Attitudes, fears and preferences
 - Anticipated lifestyle changes
 - Life's priorities
 - Interests and hobbies
- Discuss the relevance of this information to the planning process.
- Final point, "the client should recognize that the process of data gathering can be time consuming, and that the planner would be exposed to a great deal of highly confidential and sensitive information pertaining to the client."

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Communication

Processing & Analyzing Financial Data

- Communication at this step is limited to clarification of any of the data items.
- This step focuses on:
 - Assembling the data into a format appropriate to facilitate the relevant analysis (balance sheets, cash flow statements, etc)
 - Many firm's have computer software available that will automate this step of the process.
 - Key would be to check the accuracy and completeness of the data provided for analysis
 - To verify no input errors (GIGO)

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Communication

Recommendations for Actions

- Once data is gathered, processed and analyzed, a comprehensive financial plan is constructed.
- Subsequently, the planner must meet with the client to go over the financial plan and answer any questions.
 - The success of any plan depends on its implementation.
 - Successful implementation hinges on the client's understanding of, and commitment to, the plan.
 - This in turn hinges upon effective communication of the plan to the client by the financial planner.
 - Additionally, the planner must stress the importance of taking timely actions to accomplish the plan.

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Communication Implementation

- The client should be aware that they are under **no** obligation to implement the plan through the planner: however, they should be made aware that the success of the plan is critically dependent on timely implementation.
- If the plan involves the purchase of insurance or investment products and these sales are through the planner, the planner must:
 - Clearly specify that any commissions generated from the sales are in addition to, and not in lieu of, any planning fees already collected
 - Provide written documentation of the advantages, limitations and risks associated with each product
 - Ensure that the client is comfortable with the products
- Fee based planners need to provide a list of referrals to expedite the implementation process.

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Communication Monitoring and Review

- Personal Financial Planning is a never ending process:
 - Economic environment changes
 - Financial needs change
 - Personal situations change
 - Tax laws change
- Typically, annual reviews are conducted with the client:
 - To assess the progress made towards reaching the plans objectives and goals
 - To modify the plan given any changes in the client's needs
 - To maintain a relationship with the client
- Note that there is no universal acceptance of the one year review period: however, at minimum the planner and client should meet anytime that there is a significant change in personal, financial, or economic conditions.

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Results of the Goals and Objectives Interview

- Normally, a computer program is used to generate a comprehensive financial plan for the client.
 - The plan is normally voluminous- could be more than 100 pages in length
 - All of the financial planning areas are covered
 - Includes current status
 - Specified objectives & goals
 - Recommended Strategies
 - Short range and long range objectives and goals are covered
- Normally a plan will contain the following sections:
 - Basic Observations
 - Key Recommendations.
 - Trip Tick
 - Comprehensive Plan

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Results of the Goals and Objectives Interview

- Basic Observations:
 - Summarizes the key elements of the plan that follows
 - Executive summary of sorts
- Key Recommendations:
 - Generic recommendations are made in each area followed by more specific product recommendations
- Trip Tick:
 - Lists items to be completed in their relative order of priority
- Comprehensive Plan:
 - Contains all of the detailed analysis for all of the planning areas

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Results of the Goals and Objectives Interview

- Covering the financial plan is "the biggest test" of the financial planner as a professional communicator.
 - Must cover actions that need to be taken
 - Responsible party for each action
 - Expected date of completion for each step in the plan
 - Key is to win trust, win commitment, and motivate client to implement the plan.
- Plan Cost:
 - Some firms provide a financial plan for free (make fees off plan implementation)
 - Some firms charge for the plan (fee only) and refer the client out for necessary products
 - Some charge for the plan and charge for the products used in implementing the plan
 - Plan costs can range from a few hundred to thousands of dollars

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Coordination

- Given the complexities involved in financial planning, a planner is unlikely to be able to provide all of the necessary services.
 - All things to all people, or Jack of All Trades
- Rather, the planner should act as a:
 - Coach, Quarterback, or Orchestra Leader
- Know your limits, and refer the client out when appropriate:
 - Attorney
 - Accountant
 - Portfolio Manager
 - Insurance Counselor
 - Real Estate Professionals

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Competence Academic Degrees

- Financial planning is an emerging profession:
 - Qualifications are still debated
- Academic Degrees:
 - International Board of Standards and Practices of Certified Financial Planners (IBCFP) formed in June 1986
 - Changed name on Feb. 1, 1994 to the Certified Financial Planner Board of Standards (CFP Board)
 - Currently working on a model curriculum for financial planning degree granting institutions (modification of text)
- More information concerning the CFP Board, requirements, and job analysis survey can be found at:
 - <http://www.cfp.net/become/>

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Competence Credentials

- CFP certification mark was transferred to the CFP Board in 1986. In order to use this mark, an individual must:
 - Complete a minimum of 15 semester hours in approved curriculum at a registered program
 - Pass a single comprehensive exam (one four hour exam on Friday, and two three hour exams on Saturday)
 - Meet an experience requirement of 3-years (degreed) 5-years (non-degreed)
 - Beginning in January of 2007, a bachelors degree in any field of study is required
- More information on the requirements can be found at:
 - <http://www.cfp.net/become/Steps.asp>
- Other designations available include: chartered Financial Consultant (ChFC), Personal Financial Specialist (PFS), Registered Financial Planner (RFP), Chartered Life Underwriter (CLU), CPA, and JD.

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Competence Credentials

- The topics covered on the examination, general examination information and sample questions can be found at the following links:
 - Exam Topic List:
 - <http://www.cfp.net/become/topiclist.asp>
 - Exam Information:
 - <http://www.cfp.net/become/examdetails.asp#qa>
 - Sample Examination Case Questions:
 - <http://www.cfp.net/become/examquestions.asp>

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Competence Experience

- The three or five year work experience requirement can be completed after the candidate's examination. However, the designation and mark are not permitted for use until all requirements have been met.
- Experience is defined as:
 - Full time or equivalent employment in situations in which the candidate actively uses the knowledge, skills, and abilities required for the certification exam.

Competence Continuing Education

- The CFP Board of Standards' Continuing Education Standards can be found at the following link:
 - <http://www.cfp.net/certificants/ce.asp#1>
- Overview of continuing education requirements:
 - 30 hours of CE are required per reporting period (2 years)
 - 28 hours from any of the subject topics
 - Fundamentals of Financial Planning
 - Estate Planning
 - Investments
 - Retirement Planning
 - Employee benefit Planning
 - Tax Planning
 - 2 hours from a CFP Board approved program on CFP Boards' Code of Ethics and Professional Responsibility (Ethics Code) and/or Financial Planning Practice Standards (Practice Standards)
 - Credits in excess of 30 hours may not be carried over.

Commitment to Ethics

- The Code of Ethics and Professional responsibility will be covered later in subsequent lectures.
- Author's guidance on Ethics:

E	Efficient
T	Trustworthy
H	Honest
I	Ingenious
C	Completely loyal to the client
S	Sincere

The Four - E's of CFP Certification

E	Defined
Education	Pre- Examination (15 semester hours) Challenge Continuing Education (30-28-2, 2yrs) Bachelors Degree in 2007
Examination	1 Exam in 3 Parts (4 hrs Friday , 6 hours Saturday)
Experience	3 Years – Bachelors Degree 5 Years – O/W Can be met after examination
Ethics	Pre-Certification Post Certification

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