A. DUTIES OWED TO CLIENTS, 1. FIDUCIARY DUTY:

15. APPLYING THE FIDUCIARY DUTY TO CLIENTS SEEKING LIFE INSURANCE

Viktor is a CFP® professional and an insurance agent for Old Jersey Life, an insurance firm. Viktor receives a call from prospective clients, Anya and Kristof, who received his name from a neighbor. The neighbor and his husband had worked with Viktor to purchase a whole life insurance policy.

Anya just gave birth to the couple's first child, Ivan. Kristof paused his career to focus on their newborn. Anya's salary is currently the family's only source of income.

Anya and Kristof have completed an estate plan with a local attorney that includes provisions for a trust for Ivan and any future children if they both were to die prematurely. However, Anya and Kristof are concerned that Anya's employer-provided life insurance is insufficient to provide for the family's needs if Anya passes away. They liked the idea of saving for the future by accumulating cash in a whole life insurance policy.

Anya, Kristof and Viktor enter an engagement for Financial Advice concerning life insurance. Viktor learns the following information:

- **Ages**:
    - Anya & Kristof: 31 years old
    - Ivan: 4 months

Assets		Liabilities	
Condo	$270,000	Condo home mortgage	$200,000
Company 401(k) plan account	$30,000		
Checking and Savings accoun	$35,000		

Incomes		Annual expenses	
Anya	$100,000	Fixed expenses (per year inc. taxes}	$75,000
Kristof is the primary caregiver but intends to return to work when Ivan and any other children start school.		Discretionary expenses	$15,000

- **Annual Savings:**
    - 401(k) plan account contribution: $2000 (2% of salary; company will match up to 5%).
    - Savings Account: $8,000.
- **Existing Insurance:**
    - Employer-provided policy on Anya's life at 1x base salary = $100,000
    - No additional life insurance coverage on Kristof's life
    - Employer-provided health insurance policy for the family and short- and long-term disability insurance policies for Anya

Viktor discusses Anya and Kristof's priorities with them. Their first priority is to have sufficient life insurance to address the risk of Anya's or Kristof's premature death. Anya and Kristof also would like to increase their savings for retirement.

Viktor evaluates what additional funds a surviving spouse would need if the other spouse were to unexpectedly pass away, taking into account applicable Social Security survivorship benefits, additional child care costs and the period of need. Based on this evaluation, Viktor determines the insurance needs of each spouse.

Viktor examines Anya's employer-provided policy to assess the range of additional life insurance amounts, policy types and premiums. He also examines alternative life insurance policies, including term life insurance and whole life insurance. Anya and Kristof's approximate insurance needs and the annual premiums for term and whole life insurance are shown below.

	Insurance Need	Term Insurance premium (annual)	Whole life insurance* premium (annual)
Kristof	$500,000	$700	$11,000
Anya (in addition to the employer-provided policy)	$1,500,000	$1,000	$18,000

*Whole life insurance is a type of "cash value" life insurance that generally does not expire and that accumulates value over time. Term insurance provides a death benefit only for a defined period; however, premiums for whole life insurance are substantially higher than premiums for the same amount of term insurance.

Viktor has developed factors relevant to when a client might benefit from whole and term insurance and a business process that he uses to evaluate those factors. He applies those factors here and determines that both Anya and Kristof would benefit from additional life insurance to guard against the risk of premature death. He determined, however, that term insurance, rather than whole life insurance, was the better option for Anya and Kristof in light of their financial capacity and needs, as explained further below.

Viktor provides this information to Anya and Kristof. Viktor explains how he will be paid on the policies and the conflicts of interest that the payments present. Specifically, he explains that:

- He has an interest in recommending that both Anya and Kristof purchase insurance because he will earn a commission for each policy. He will not earn a commission if they do not purchase an insurance policy from him.
- He receives employee benefits if he sells products from his firm, Old Jersey, and this creates an incentive for him to recommend an Old Jersey product even if other products in the marketplace are less expensive.
- Because the size of the commission is based on the expense of the premium, he would earn more on the whole life insurance than the term life insurance.

Viktor explains to Anya and Kristof that he believes purchasing term insurance is in their best interests, even though they were interested in whole life insurance. In particular, Viktor explains that:

- Term insurance would cover the financial hazard of premature death, which is their top priority.
- The premium commitment for whole life insurance is substantially higher than for term insurance and higher than their current savings rate.
- Even if Anya and Kristof could have afforded the whole life premiums, there were alternatives that were better suited to saving for retirement than the cash value accumulation of whole life insurance. In particular, Viktor pointed out that Anya was not taking full advantage of her company's 401(k) match.
- While the term insurance will expire in 20 years, the policy he recommends has a favorable conversion feature if they determine they need a lifelong form of insurance in the future.

Viktor further explains that he has evaluated the marketplace for term policies, as well as Anya's option for increasing her insurance through her employer and found that his company's term insurance premiums were the most competitive, Based upon this presentation, Anya and Kristof purchase the term life insurance that Viktor recommends.

QUESTION:

Did Viktor satisfy his Fiduciary Duty in providing Financial Advice to Anya and Kristof?

RESPONSE OPTIONS:

A. Yes, because Viktor evaluated their goals, risk tolerance, objectives, and financial and personal circumstances and clearly disclosed and managed his conflicts of interest.

B. No, because Viktor should have acted on his clients' preference to purchase whole life insurance.

C. Viktor did not have a Fiduciary Duty because he was not providing Financial Advice— he recommended an insurance policy with no investment component.

Response A is the best response. This case involves the Fiduciary Duty (Standard A.1.) and the definitions of Financial Advice and Financial Assets (Glossary).

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. Financial Advice includes communications that, based on their content, context and presentation, would reasonably be viewed as a recommendation to take or refrain from taking a particular course of action with respect to the advisability of investing in, purchasing, holding, gifting or selling Financial Assets. "Financial Assets" include securities, insurance products, real estate, bank instruments, commodities contracts, derivative contracts, collectibles or other financial products.

The Fiduciary Duty includes a Duty of Loyalty, a Duty of Care and a Duty to Follow Client Instructions. The Duty of Loyalty requires a CFP® professional to (a) place the interests of the Client above the interests of the CFP® professional and the CFP® Professional's Firm; (b) avoid Conflicts of Interest, or fully disclose Material Conflicts of Interest to the Client, obtain the Client's informed consent, and properly manage the conflict; and (c) act without regard to the financial or other interests of the CFP® professional, the CFP® Professional's Firm, or any individual or entity other than the Client, which means that a CFP® professional acting under a Conflict of Interest continues to have a duty to act in the best interests of the Client and place the Client's interests above the CFP® professional's. 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. The Duty to Follow Client Instructions requires a CFP® professional to comply with all objectives, policies, restrictions, and other terms of the Engagement and all reasonable and lawful directions of the Client.

Viktor fulfilled the Duty of Loyalty:

Viktor has Material Conflicts of Interest. First, Viktor has a conflict of interest because he receives commission compensation for selling the insurance policy that he would not receive if he did not sell the insurance policy. This conflict exists even though he will earn a smaller commission on the sale of term insurance than he would receive on the sale of whole life insurance. Additionally, Viktor has a financial incentive to recommend the Old Jersey product through the benefits he receives from Old Jersey. This conflict exists even if he determines that the Old Jersey product is better for his Clients than other products. Viktor cannot avoid these conflicts, so he must fully disclose the conflicts, obtain the Client's informed consent and properly manage the conflicts.

Full Disclosure and Informed Consent. Viktor fully disclosed these conflicts with sufficiently specific facts to infer informed consent. Specifically, he explained how the compensation he receives and how his relationship with Old Jersey creates incentives to recommend that Anya and Kristof purchase this insurance product from Old Jersey.

Conflict Management. Viktor followed business practices reasonably designed to prevent the Material Conflicts of Interest from compromising his ability to act in Anya and Kristof's best interests. Specifically, Viktor adopted and followed a prudent process, consistent with the Duty of Care, for evaluating alternative insurance recommendations. That process is discussed further below.

Viktor fulfilled the Duty of Care

Viktor assessed Anya and Kristof's goals, risk tolerance, objectives, and financial and personal circumstances, including their objective to address risk, their financial capacity and their alternative opportunities for savings, such as Anya's 401(k) plan employer match.

When determining which policies to recommend, Viktor followed a prudent process. He used as part of his regular business a set of factors to help determine whether to recommend any life insurance and, specifically, whether to recommend whole life versus term insurance. While Kristof and Anya stated an initial preference for whole life insurance, Viktor explained to them why that course would not be in their best interests at this time.

Finally, Viktor conducted due diligence by comparing the Old Jersey term insurance to alternatives — specifically, other term insurance products in the marketplace and increasing Anya's employer-provided insurance. He determined that the Old Jersey term insurance product was the most competitive.

Response B is not the best response. In this case, Anya and Kristof merely indicated an interest in whole life insurance, which was not an instruction. Viktor reviewed with his Clients his conclusion that whole life insurance was not in their best interests, and Anya and Kristof followed his recommendation. Had Anya and Kristof directed Viktor to sell them whole life insurance, even though Viktor concluded that whole life insurance was not in their best interests, then Viktor would need to follow this reasonable and lawful direction or decline to enter into the Engagement.

Response C is not the best response because insurance products are "Financial Assets" regardless of whether the insurance product has an investment component. A recommendation concerning the value of or the advisability of holding a Financial Asset is Financial Advice that is subject to CFP Board's Fiduciary Duty.