Making it clear:

AN ADVISOR’S GUIDE TO WRITTEN ENGAGEMENT & DISCLOSURE
DEFINING THE RULES OF ENGAGEMENT

by Andrew Rickard

The day is quickly approaching when Canadian financial planners will be required to complete an engagement and disclosure document every time they open a new client file. Are you ready?

In the military, commanding officers use rules of engagement to explain how and when soldiers should act in battle. These rules don’t outline specific targets or list positions to be captured, but they do explain the general conditions under which units should operate.

In much the same way, the Financial Planners Standards Council (FPSC) has issued their own rules of engagement to those of us on the financial planning battlefield - specifically in the form of practice standards.

Establishing consistency

Applicable to all of the 15,000 CFPs in Canada, the FPSC practice standards are meant to both reduce confusion and misunderstanding between clients and planners, and to establish a certain consistency of service. In other words, if Joe Public does business with a CFP, he can expect similar treatment regardless of location or the licensee’s sponsoring firm.

The FPSC is quick to point out that the standards "do not represent new ethical or professional obligations," but rather "expand on and apply the concepts already embodied in the code of ethics" to which CFPs have already subscribed. The standards do, however, lay out one important new administrative duty - namely the use of a written document, signed by both parties, to outline the scope of the financial planning relationship.

The "write" way

This apparently small requirement could require a radical change in thinking on the part of most financial planners. According to Chris Reynolds, president and co-founder of the Investment Planning Counsel of Canada, only 7% of financial planners currently prepare a letter of engagement.

The document itself must not only define each party’s responsibilities and the timeframes of the engagement, but also disclose the advisor’s method of compensation and any conflicts of interest. Even if a CFP is not working as a financial planner, but is instead functioning solely as an "order taker" and processing trades on the client’s behalf, he or she will still be required to complete an (albeit shorter) written disclosure document (see sidebar for details).

A good idea, CFP or no CFP

While they may not be required to do so by a parent organization, those who do not hold the CFP designation should still consider putting some sort of engagement mechanism in place simply because it affords a way to define their responsibilities and manage their professional liability.

Larry Stubbs teaches financial planning at the British Columbia Institute of Technology, and was involved in formulating the draft version of the FPSC’s practice standards. As he pointed out last year when the standards project was first announced, the use of an engagement letter is an excellent way for planners to anticipate and eliminate future headaches.

"Having sat down with the client and clearly outlined what my obligations are as a planner," says Stubbs, "there is much less probability that the relationship will blow up in my face. There are no surprises, and each party knows what’s at stake."

Andrew Rickard is a Toronto-based writer and CFP with G.P. Capital Management.
Excerpt from the FPSC Practice Standards

A written letter of engagement is essential to ensure mutual understanding and agreement between the CFP professional and the client regarding the terms of the engagement. In setting out the terms of the engagement, as a minimum, the CFP professional should include:
- Assurance of protection of client confidentiality;
- A statement that any assumptions used in the engagement will be reasonable for the circumstance;
- The specific parties to the engagement;
- The specific financial planning services to be provided;
- The tenure and timeframes for the engagement, which may include subsequent reviews;
- The CFP professional’s compensation arrangements with respect to the engagement; and
- Existing conflicts of interest and agreement to disclose conflicts of interest if or when they occur.

Additional information that may form part of the engagement letter includes, but is not limited to:
- The potential need to use other professionals during the engagement;
- Provisions for termination of the engagement; and
- Specific limitations on the use of client information.

If requested by a client, or the situation arises where it is appropriate, a CFP professional should disclose avenues available to the client for redress, including mechanisms for lodging complaints.

Over time, the terms of the engagement may change by mutual understanding and agreement. Any material changes to the engagement must be confirmed in writing.

Modular, or Segmented, Financial Planning Engagements
Financial planning may be performed on a modular, or segmented, basis rather than a comprehensive basis at the request of the client. In a modular financial planning engagement, these practice standards still apply, and it is necessary to outline the specific financial planning activities being undertaken in the letter of engagement. This serves to establish realistic expectations for the client and the CFP professional.

Engagements Where Implementation or Review Do Not Apply
There may be certain financial planning engagements where implementation and/or review of the plan may be excluded from the engagement by mutual agreement between the CFP professional and the client. In these circumstances, practice standards 100 through 400 still apply, and the engagement letter must explicitly exclude implementation and/or review from the engagement.

Non-Financial Planning Engagements
Where a CFP professional enters into a non-financial planning engagement or offers non-financial planning services that, in his or her professional judgment may reasonably be construed by the client to be financial planning services, the CFP professional will make written disclosure that he or she is not in that instance undertaking a financial planning engagement.

To read complete FPSC practice standards, go to www.cfp-ca.org/licensees/licensees_practicestandards.asp
ENGAGEMENT AND DISCLOSURE TEMPLATE

Adapted in part from the practice standards issued by the Financial Planners Standards Council, the following is meant to serve as a creative starting point for financial planners who wish to begin writing their own engagement and disclosure documents. Since compliance requirements can vary widely according to firm, industry segment and province, advisors should check with their compliance department and/or retain legal counsel for advice appropriate to their particular situation.

Introduction

The introduction should outline the purpose of the engagement and disclosure document in general terms. Besides explaining why this is an important document, you may also wish to include other information, such as your (or your firm’s) financial planning philosophy or mission statement.

Sample wording:

This document is meant to give you, the client, a better understanding of what you may expect from the financial planning process, and what our respective obligations are within that process. In general terms, the financial planning process consists of the following six steps:

1. Define the terms of our relationship.
2. Discuss your financial goals, and I’ll obtain your essential financial data.
3. Evaluate your situation based on the information you’ve provided.
4. Develop and present a written financial plan for you to consider.
5. Implement some or all of the strategies outlined in the plan.
6. Monitor and revise the plan as necessary.

Much of what follows in this document deals with the first point, but you will find information that relates to the other five steps as well.

Services provided

This section lists the areas for which the planner is, and is not, responsible for providing. For example, a fee-only planner would not be responsible for selecting or processing stock trades because she would not be licensed to do so. If the client is only interested in advice in one specific area, that should be also spelled out here.

Sample wording:

In our initial meeting on [insert date here] you indicated that your only interest was in establishing an education savings plan for your child [insert child’s name here]. I will therefore limit my advice to education savings strategies, and will not address any other financial planning areas.
Compensation

This section should outline how the advisor is to be paid, and by whom. Note that this is not meant to be a replacement for the usual sales disclosure guidelines and regulations that govern securities, insurance, real estate and other financial products and services, but rather an additional clarification for the benefit of the client.

Sample wording:

The advisor is paid a fee plus commission. You will pay the advisor a flat fee of $500 upon receipt of your complete financial plan. Should you decide to purchase a financial product from a third-party product provider, the advisor will be also be compensated by that third party in the form of a commission.

Employment relationships and affiliations

Use this space to explain your relationship with other financial services companies (e.g., your mutual fund dealer, your managing general agent, your partner, etc.)

Sample wording:

Since I offer both mutual funds and insurance products, I work in an agent-principal relationship with different companies. All mutual funds are offered through my mutual fund dealer [insert name and address of dealer here] and I place my insurance business with [insert name or names and addresses of the insurance companies and/or managing general agents with whom you have a contract here].

If, subsequent to our initial engagement, there are any changes to my business affiliations or agency relationships that may have an affect on our relationship, I will inform you.

Conflicts of interest

If there are circumstances in which the advisor’s own interests may prevent him or her from offering disinterested advice to the client, that fact must be declared.

Sample wording:

I am required to declare any interest that may prevent me from offering disinterested advice. I am unaware of any current conflicts of interest and, should any conflicts appear in the future, you may rest assured that I will bring them to your attention immediately.

Confidentiality

Explain when you can, and cannot, share the client’s personal information.

Sample wording:

I am bound by professional secrecy and may not disclose any of your confidential information without your written consent unless required to do so by law. I will not use any client’s information for personal benefit, regardless of whether or not it actually causes the client harm.
Use of third parties

Use this section to outline when third-party advisors will be used and who is responsible for finding them. When using other professionals, the advisor should also inform the client of the individual’s qualifications, method of compensation, as well as any referral fees that may be paid.

Remember that, before referring a client, you should use your professional judgment and make a reasonable investigation into the suitability of that third party to offer financial products, services or advice to your client.

Sample wording:

I am able to offer general advice about life insurance and insurance-related products such as segregated funds, annuities, disability insurance, critical illness insurance and long-term care insurance. Should we, however, decide that you require a particular insurance product, I will refer you to our in-house insurance specialist [insert name here]. With a Level II insurance licence and more than [X] years of experience in the insurance industry, he/she is better qualified to provide advice appropriate to your situation.

You will not have to compensate either of us directly in return for his/her insurance advice. This insurance specialist will be paid a commission by the insurance company from which you purchase your insurance policy, while I will receive a referral fee from the specialist him/herself.

Decision-making process

Are there special circumstances under which decisions must be made - for example, the presence of both spouses or several parties?

Sample wording:

It has been agreed by all parties that [insert name of person 1], [insert name of person 2] and [insert name of person 3] must be present at all meetings and that decisions can only be made subject to their unanimous approval.

Limits to scope

Are there any limits that either you or the client would like to place on the financial planning relationship?

Sample wording:

It is agreed by both the advisor and the client that telephone orders will not be accepted, and that the client must provide his or her signature as authorization for every transaction.

Goal setting

The advisor must make certain that he clearly understands the client’s financial goals, needs and priorities. What sort of criteria must financial goals meet in order to be included in the financial plan?

Sample wording:

Financial goals state intent, provide guidance and bring structure to the financial planning engagement. Goals must be specific, measurable, realistic and time-bound. I cannot choose your financial goals for you, but I will help you to clarify your goals, and I will discuss the merit and feasibility of any goal that appears to be unrealistic.
Necessary data

Your client must provide you with up-to-date and accurate information about his financial affairs. This obligation on the part of the client needs to be set out in the engagement and disclosure document:

Sample wording:

Before making any recommendation, I must first have a complete picture of your current financial situation. The information I need deals with, but isn’t necessarily limited to, your:

- Assets;
- Anticipated unusual income or expenditures (e.g., severance payment, inheritance, etc.);
- Liabilities;
- Income and expenses;
- Cash flow;
- Tax position/returns;
- Investment statements (registered and non-registered accounts);
- Will and power of attorney;
- Insurance coverage (life and general);
- Group benefits; and
- Pension plans.

If I am unable to obtain the information I require, you should understand that it could prevent me from giving you appropriate advice; if this is the case, I may be required to either revise or terminate our engagement.

Importance of income and cash flow statements

It is only possible for an advisor to make appropriate recommendations after he or she has had time to properly evaluate the client’s current financial position — and the only way to get a clear picture of a client’s situation is to first prepare income and cash flow statements.

Sample wording:

Before making any recommendations concerning your financial situation, I will first prepare income and cash flow statements based on the information you have provided me. These statements will form the basis of all subsequent analysis, and will be included as part of your written financial plan.

Assumptions

Let the client know when and where you may need to make assumptions in the financial plan.

Sample wording:

When considering the various financial strategies available in your particular situation, I may be required to make one or more assumptions. These assumptions may include, but are not limited to, your anticipated retirement age, life expectancy, retirement income requirements, government benefits, time horizons, special needs, rates of return and inflation and income tax rates.

Any assumptions I make will be both reasonable and realistic, and they will be disclosed to you in writing in the financial plan.
Recommendations

When the time comes to present the financial plan and make specific recommendations about the client's situation, it is essential that she fully comprehends the information presented.

Sample wording:

Having reviewed your financial situation, I will prepare a written financial plan for you to review. When discussing this report with you, I will do so in such a way so that you are able to understand:

- The advantages and disadvantages of the various alternatives;
- The costs of the various alternatives;
- The risks involved in the various alternatives;
- The time sensitivity of recommendations;
- The consequences of no action being taken; and
- The impact of a change in the assumptions on the projected results.

The client is obliged to inform the advisor if he or she does not understand any of the above points.

Reviewing and monitoring

How often should reviews take place and in what format? Are there specific areas that should be examined at every review?

Sample wording:

It is agreed that the advisor will conduct a review with the client by telephone every six months. The review process will include, but is not limited to, the following areas:

- Confirming if all of the approved recommendations have been implemented;
- Comparing current personal financial statements (net worth and cash flow) to previous statements;
- Comparing actual investment returns against previous projections;
- Discussing any changes that need to be made to the assumptions used;
- Discussing changes in the client's circumstances or the economic environment and their impact on the client's goals;
- Agreeing on any changes to the plan;
- Adjusting the recommendations, if required, to accommodate the changes;
- Assessing the achievement to date of goals and objectives;
- Adding new goals as needs are met;
- Updating the client's personal and financial information for material changes; and
- Updating the current economic conditions, including taxation, for material changes.
Tenure and termination

How long is the financial planning engagement to last? If it involves a fee-only planner, does he or she have an obligation to follow up next year even though the client really only wanted the plan and not subsequent service? What if the client decides not to go ahead?

Sample wording:

It is agreed that this financial planning engagement is limited to however long it takes the advisor to complete and present the completed financial plan. Should the client wish to terminate the relationship before the plan is delivered but after an engagement document has been signed, he or she is still required to pay the full fee of $500 to the planner. The client may terminate the relationship at any time, but the planner may only end it after having given 30 days’ notice.

Communication

Besides conducting annual reviews, how often will the advisor communicate with his or her client, and in what manner?

Sample wording:

The advisor will keep the client informed of important changes through his/her quarterly newsletter. In the event of changes that may affect the client’s personal circumstances (e.g., a change to the Income Tax Act announced in a federal budget), the advisor will contact the client by telephone or e-mail. Should the client’s financial circumstances change (e.g., as a result of marriage, birth of a child, inheritance, etc.), he/she is responsible for contacting the advisor as soon as possible.

Complaints

What is the process if the client should have a complaint?

Sample wording:

Should the client, for whatever reason, be unhappy or unsatisfied with the advisor’s services, he or she will contact the advisor first. If the advisor is unable to provide satisfaction, the client may call the Canadian Financial Services OmbudsNetwork at 1-866-538-FSON for advice on how to proceed.

Signed

______________________________  ______________________________
Client                                                                 Advisor

______________________________
Date

This engagement and disclosure document is not the only tool Advisor.ca offers to help you define the advisor-client relationship and protect both parties in the process. Check out our downloadable Investment Policy Statement at [www.advisor.ca/practice/practice tmpl_letters/article.jsp?content=21480](http://www.advisor.ca/practice/practice tmpl_letters/article.jsp?content=21480).
Dear [Client's name here],

Clients have often told me that they would like to have a better understanding of what’s really required in the financial planning process. How often can they expect telephone calls from their advisor? What exactly is confidential information? When should third parties like lawyers and accountants become involved? If a client had a goal that was unrealistic, would an advisor speak up or just let it pass? Can the advisor just dump a client?

In an attempt to answer some of these questions, I have drafted a new engagement and disclosure document.

This document is meant to reduce confusion and misunderstanding not only by disclosing important information about how I am compensated and the companies with which I do business, but also by clearly defining the level of service you can expect from me.

Actually, it's much more than just a service commitment on my part - it's a way of making sure that each party knows what's at stake and who's responsible for what.

In the interests of better defining our relationship, I hope that you won't hesitate to contact me at the address above so that we can make an appointment and review this important document together.

Sincerely,

[Your signature]

[Your name]

For a version of this template letter that you can open as a Word document and customize, please go to: www.advisor.ca/practice/your_practice/tmpl_letters/article.jsp?content=20031016_134925_4344