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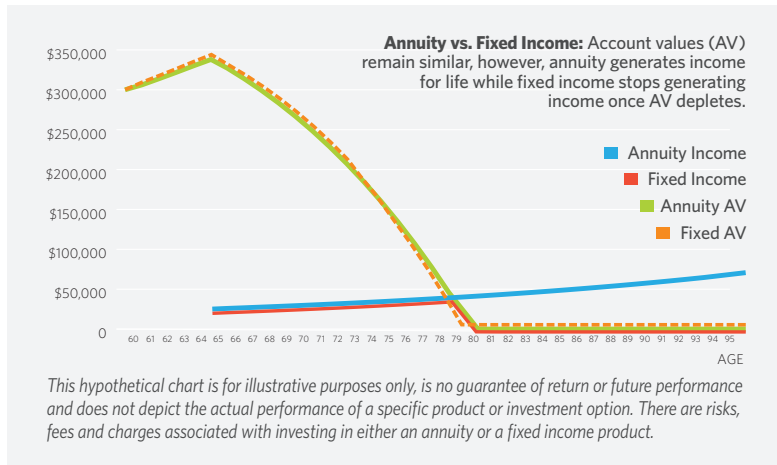
“I CAN'T

UNSEEL

THIS.”



FIDUCIARIES CAN'T IGNORE THE VALUE COMMISSION-FREE ANNUITIES CAN BRING TO CLIENTS.



"I can't unsee this."

When a fiduciary advisor sees the impact of a Commission-Free annuity on a client's financial plan for the first time, it can be sobering. One said, "I can't unsee this" when he realized how an annuity can outperform his fixed income strategy to deliver secure retirement income for his client. Like many RIAs, he wasn't using annuities in his financial planning process. So, what now?

For a fiduciary, the question becomes, "How can I ignore a solution that can deliver meaningful financial and emotional benefits to my clients over my current income strategies?" The answer must be, "As a fiduciary, I can't."

Why don't fiduciaries use annuities when the academic support for their value is so widely documented?

Because annuities have been commission-driven, RIAs' familiarity with the products is limited. A few persistent misconceptions can lead advisors to dismiss annuities. But here are the truths:

1) *Income is almost always generated through riders, not annuitization.* This

is a critical point because it addresses one of the primary reasons advisors and clients often resist annuities — losing control. But you don't. Assets can remain in your control until they have been depleted by distribution.

2) *Fee-only advisors can bill on annuities.* Historically annuities have been a conflict of interest for fiduciaries. With Commission-Free annuities, you can bill on these assets just as you would any other. Eliminating that conflict allows you to be a better fiduciary.

3) *Annuities can be used for efficient income generation — not just longevity risk.* Academic research illustrates the effectiveness of annuities to generate income more efficiently than fixed income portfolios.¹ Annuities should be considered for any client who is planning to generate income from their portfolio during retirement — not just for those at risk of running out of money.

Read the research.

Leading academics like Wade Pfau, Michael Finke, David Blanchett and many others provide insight into how annuities can generate income more

efficiently than traditional fixed income portfolios. This efficient income generation, along with the guaranteed income stream, can have a meaningful impact on financial outcomes for clients in retirement. "No other investment strategy can do a better job of supporting a safe income in retirement," says Michael Finke of annuities.²

Wade Pfau goes so far as to say bond funds "don't belong" in retirement portfolios.³

Commission-Free annuities put an advisor's fiduciary commitment to the test.

In the past eighteen months, 260 RIA firms have become members of DPL to implement annuities into their fiduciary practices.

They have answered the question, "How can I continue to dismiss annuities when the potential benefits to my clients are so widely documented?" Their answer has been clear: "I can't."

"Ideally, I can envisage an adviser sitting down with a client and saying, 'We talked about doing a four percent withdrawal for retirement income. Here's what would happen. And if you bought an annuity, here's what would happen.'"⁴

— Bill Sharpe

Nobel Memorial Prize-winning economist

Getting started with annuities is easy with DPL.

DPL is a turnkey insurance management platform and a true strategic partner that helps RIAs incorporate annuities and insurance into their holistic financial planning process.

Visit dplfp.com to read the research and do the math. Or, speak to one of our consultants at **844.259.2953**. [\[dpl\]](#)

¹ Advisor Perspectives, "Fixed Indexed Annuities: Consider the Alternative", Roger Ibbotson, Ph.D. ² Kiplinger, "Looking for Guaranteed Lifetime Income? Join the Club", Michael Finke, Ph.D. ³ Advisor Perspectives, "Why Bond Funds Don't Belong in Retirement Portfolios", Wade Pfau, Ph.D. ⁴ Retirement Income Journal, "Bill Sharpe's New Retirement Blog", Kerry Pechter

SPECIAL REPORT: RETIREMENT PLANNING

Financial Planning

INVESTED IN ADVISORS | SEPTEMBER 2019

MEDICARE MAZE

Help clients navigate the program's labyrinth



UNTANGLING HEALTH CARE COSTS

Advising clients on networks, deductibles and copays can add value to your practice



Aaren Strand
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An Article From the Brighthouse Financial Insights Panel

A group of leading independent experts to help you and your clients stay ahead of the curve.

Tailoring Advice to Every Stage of Life

How to support your clients' financial decision-making as they age

As your clients enter new stages in their lives, their approach to financial decision-making will likely change as well. Your clients will be looking for an advisor who can give them personal, tailored advice relevant to where they are in life. If you can show them that you understand their priorities and speak to their mindsets, your clients will be more likely to stay with you for the long term.

Behavioral economist Dan Goldstein, advisor champion Matt Oechsli, and social anthropologist Grant McCracken share their insights.

Supporting Clients in Their 20s and 30s

Some advisors aren't sure why they should engage younger clients. The main benefit is the earlier you start to work with your clients, the better you'll be able to develop a mutually beneficial, long-term working relationship.

When working with younger clients, consider these two key factors:

- Make it clear to younger clients that they're setting the foundation for the rest of their lives at this stage. As Grant says, "The decisions you make in your 30s will all make an enormous difference to who you are when you're 60 or 70."
- Though Matt has seen that clients will generally start to accumulate wealth and assets when they reach their 30s, these younger clients won't have the same level of financial experience as the older age groups. This means that you can genuinely help guide them when it comes to financial decision-making.

Supporting Clients in Their 40s and 50s

From Dan's experience, clients tend to make their best financial decisions in their 40s and 50s, "At 53, you have a lot of experience – and that pays off." According to Dan, people in their 40s and 50s tend to pay the lowest fees

and interest rates, which he says is a sign of good financial decision-making.

Though clients at this stage in life are likely to have a very good sense of their financial decision-making abilities and skills, there are still plenty of opportunities for an advisor to make sure that their clients get the most out of it. You can support them in these ways:

- Make sure that your clients feel that you're the best person to support their financial decision-making by keeping your own financial skills up to date.
- Bear in mind that some of your clients may look to "reinvent" themselves in their 40s and 50s, for example, by changing careers or starting a new business. Grant has seen that advisors can add genuine value by helping these clients adjust how they approach their planning. He believes that "as people choose different ways of living, they need different financial advice." To give your clients the most relevant advice, think about how you can help them expand on their financial knowledge tailored to their situation. For example, do they need to learn about new products?
- Be sure to engage your clients in the right way, adjusting your advice to their experience and confidence levels.

Supporting Clients in Their 60s and Beyond

This is a key demographic to consider since, as Dan points out, "There will soon be 65 million people over the age of 65."

Grant has seen a fundamental shift in how people see their retirement: "In the old days, the notion was you would try to manage your decline as gracefully as possible. You weren't going to try anything new." Now, he's noticed that people in their 60s are likely to say: "I might have another 30 years. If I have enough health and enough wealth, I'm good for another third of my lifetime."

As an advisor, you can engage your clients by asking them about what they're thinking and

where they are in life. You can then say, "Let me help you give more substance to those thoughts so that you can begin to plan for them in both a financial sense and in a more practical, lifestyle-construction sense." If you're younger than your clients, Matt says it can help build a connection when you clearly show that you respect their accomplishments.

It's especially important to make sure that your clients in this age group have planned for a range of scenarios, such as illness or reduced mobility. Matt emphasizes, "That should be there for everybody, but specifically for those who aren't aging gracefully."

Dan similarly points out that it's important for clients to make provisions for financial planning when they're in their 60s since half of the population around age 80 has some kind of cognitive decline that could impact their financial decision-making.

To anticipate this, Dan recommends putting concrete processes in place. He advises, "Make it a standard policy to meet with everybody around their 65th birthday to discuss cognitive decline, to discuss beneficiaries, and end each appointment with another appointment so that you have at least annual check-ins to see how the person's doing as they age."

Your clients' age and life stage will inevitably influence their approach to financial decision-making. Still, other factors will also feed into their mindsets – so regardless of where your clients are in their lives, you need to consider them as individuals and tailor your advice accordingly. In Grant's experience, it ultimately comes down to this: "People need nuanced, holistic advice that's specific to them."

Learn more about how to support your clients at different life stages by visiting brighthousefinancialpro.com/insightspanel



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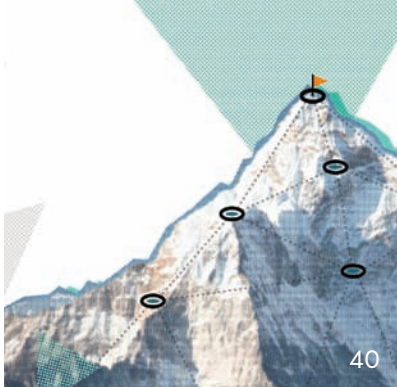
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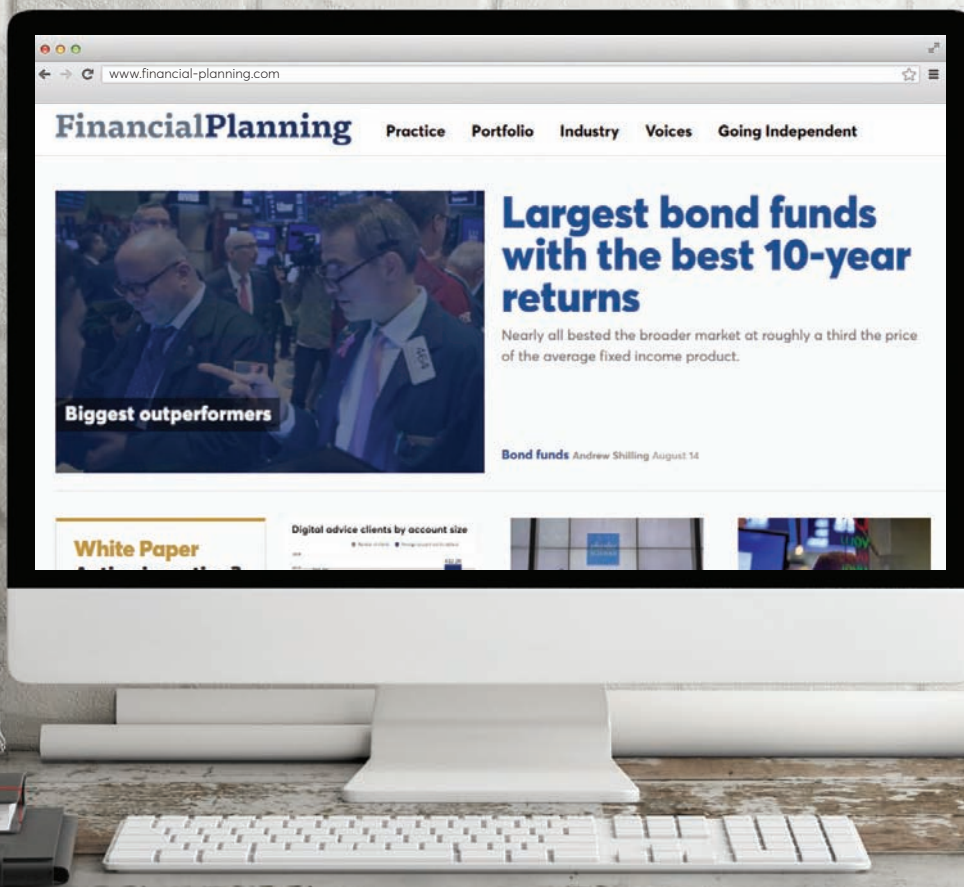
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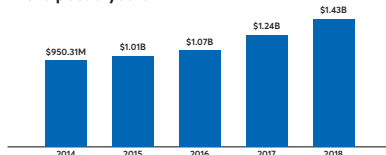


False Evidence

Were complaints from clients against an advisor actually written by someone at JPMorgan, a manager was asked in a FINRA deposition. "Absolutely not," she replied. The firm not only used false evidence — it tried to make sure no one knew. Read the story: <https://bit.ly/33brd8S>

GUIDE TO GROWTH

Commonwealth's revenue has jumped 50% in the past 5 years



Source: Company data

'The Secret Sauce'

Behind Advisor Satisfaction

Commonwealth receives about 5,000 advisor comments every year and answers 93% of them within a single day. This advisor feedback drives the firm's success, says the IBD's CEO, Wayne Bloom. Read more here: <https://bit.ly/2M5TpEL>

EVENTS

Oct. 1-4
NAPFA Fall Conference
Chicago
<https://bit.ly/2s29nFD>

Oct. 16-18
FPA Annual Conference
Minneapolis
<https://bit.ly/2OS2V0u>

Nov. 4-7
Schwab Impact
San Diego
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Dec. 5-6
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Editor's View

Health Care Spotlight

Medicare, longevity, medical expenses — these are some of the most pressing issues facing clients.



When advisor Shikha Mittra received a worried call from a client couple, she quickly learned they'd been far too hopeful about what Medicare could provide. The husband, nearing retirement, unexpectedly needed long-term care but did not have private insurance coverage. He and his wife, to their dismay, discovered Medicare would not cover LTC and they'd have to pay out of pocket.

It was an expensive lesson for the couple. It's also a wake-up call for advisors who would recommend LTC insurance for certain clients. "Tell clients to get coverage earlier," Mittra told *Financial Planning* senior editor Charles Paikert as he reported his feature, "Medicare Maze."

"Dealing with Medicare is unavoidable when preparing for retirement and issues involving aging," Paikert tells me. "As a result, financial advisors must be able to help clients navigate the critical choices they will have to make."

The program is complex, even bewildering, to clients and advisors alike, Paikert found in his reporting, such as surcharges levied on high earners. Advisors could do a better job of summarizing policies for clients clearly. In addition, he says, "find some good Medicare insurance brokers in your region who you can work with."

Medicare, longevity, health care costs — these are some of the most pressing retirement issues facing clients. This is one of several reasons we've been eager to make Carolyn McClanahan a *Financial Planning* columnist. McClanahan, a CFP and director of financial planning at Life Planning Partners in Jacksonville, Florida, is also a medical doctor and had been a contributing writer since 2015. In recent months, she's tackled topics that span her professional experience, such as helping clients with end-of-life planning, genetic testing decisions and handling bad news.

McClanahan is a vocal advocate for overhauling the health care system and improving clients' medical education, as well as planners' roles in both. I'm reminded of a key point she made to us last year: Many retirement savers struggle to manage their government benefit programs on their own. That means "everyone should utilize advisors to help make Medicare and Social Security decisions." —**Chelsea Emery**



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Benchmark

DATA-BASED INSIGHT FROM FINANCIAL PLANNING AND SOURCEMEDIA RESEARCH

Retirement Advisor Confidence Index

Geopolitical Tensions Fuel Jitters

Worries about global instability and potential recession cause confidence levels to sink to 2019 lows.

By Kenneth Corbin

Nervous clients are feeling less confident about their retirement plans amid global unrest and market volatility, according to the latest Retirement Advisor Confidence Index — *Financial Planning's* monthly barometer of business conditions for wealth managers.

"Clients are very cautious, and I think with good reason," one retirement advisor says.

"I think a lot of people are starting to pull back from the more volatile investments as they believe that a recession is only a matter of time," another advisor says.

The composite RACI dropped 2.9 points to 49.6 from the month before. It's the first time so far this year that the index has dipped below 50. RACI scores under 50 indicate a decline in confidence, while scores above that level signify an increase.

Clients' views on equity-based securities aptly illustrated their uncertainty.

The level of assets allocated toward equities tumbled 8.5 points from the previous month to an even 50, and was off 8.7 points from the year before.

This month's score was also the lowest measure of confidence in equities since December.

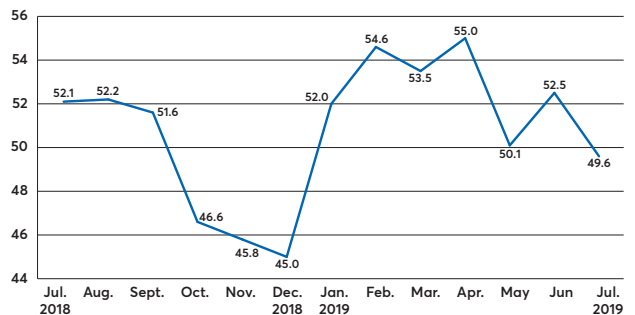
Advisors polled for this month's RACI survey expressed a common refrain: Clients were pulling away from equities in anticipation of a market correction and concerns that ongoing trade wars could even fuel a recession.

"Geopolitical turmoil is making predicting the near future virtually impossible," one advisor says.

Another advisor cites "more concern about slowing world economies, trade disputes and high valuations of U.S. equities."

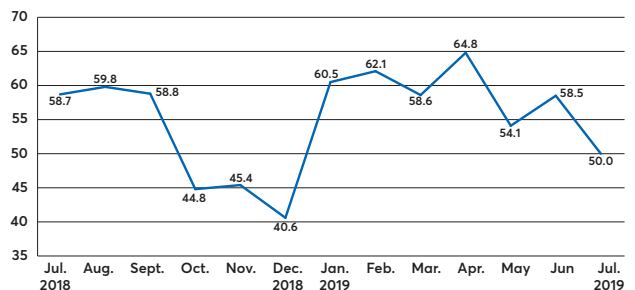
Clients weren't just running from equities in their retirement planning. The measure of assets used to purchase bonds or debt-based securities fell to 46.3, the lowest mark

RETIREMENT ADVISOR CONFIDENCE INDEX



Source: SourceMedia Research

CLIENT ASSETS USED TO PURCHASE EQUITIES



Source: SourceMedia Research

since June 2012. It's the first time that category checked in below 50 since April. The most recent score for bonds and debt-based securities was down four points from the previous month and off 6.1 points from last year.

While it may seem surprising given the move away from riskier assets, cash allocations also took a hit. Some advisors reported clients were moving assets from equities and bonds

The Retirement Advisor Confidence Index, published in partnership with ADP®, is created by the editors of *Financial Planning* and is based on a monthly survey of about 300 advisors. Visit financial-planning.com for more results.

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Benchmark

toward cash, but in aggregate, the RACI component that measures cash allocations fell 8.1 points from the previous month to 41.9.

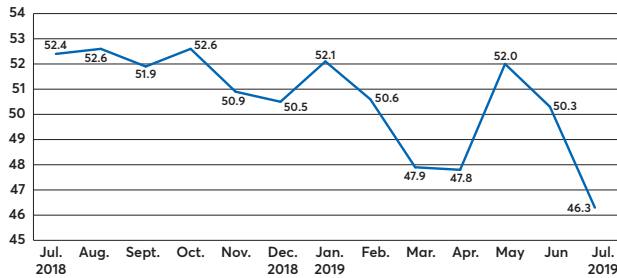
The drop in confidence in those individual categories was reflected in clients' diminished appetite for risk in retirement plans. Overall, clients' risk tolerance tallied a score of 46.3, down 4.7 points from the previous month and the third-lowest

mark of the year.

Still, some advisors are counseling clients to stay the course and think of their retirement plans in the context of the long term, rather than trying to time the markets.

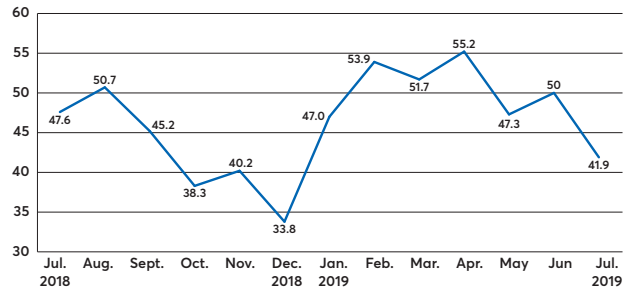
"People are concerned with the current politics, but [it's] important to stay in [the] market," one advisor says. "[It's] impossible to time a point to get out." **FP**

CLIENT ASSETS USED TO PURCHASE BONDS AND DEBT-BASED SECURITIES



Source: SourceMedia Research

CLIENT ASSETS ALLOCATED TO CASH



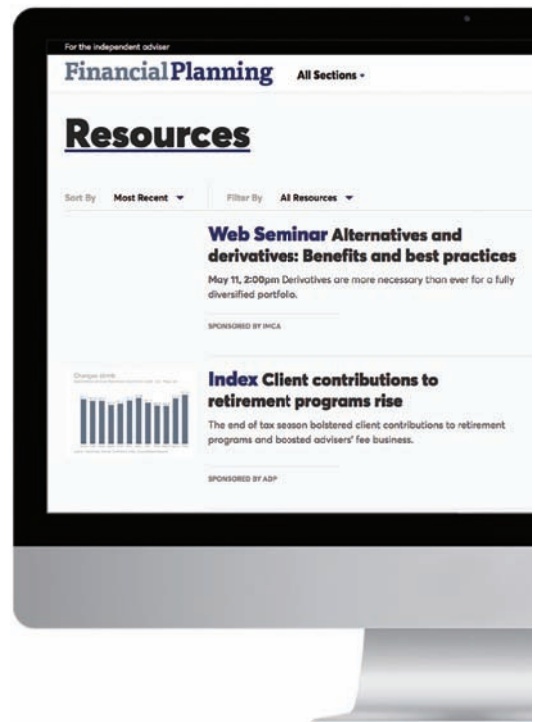
Source: SourceMedia Research

Kenneth Corbin is a Financial Planning contributing writer in Boston and Washington. Follow him on Twitter at @kecorb.

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In the Health Care Maze

Guiding clients through the fine print of narrow networks, deductibles and copays could add value to your practice.

By Carolyn McClanahan

Health care in the United States is a mess, and real reform is nowhere on the horizon.

This is not exactly breaking news for the general public, but for advisors it's a clear and present call to arms. Until Washington wakes up, educating clients to become knowledgeable health insurance consumers will help them save on health care expenses and add value to your practice.

Here's a primer on what they need to know — and how you can help them.

When it comes to health insurance, a majority of Americans are covered by employer-based plans. Such coverage continues, for the most part, to be the best deal, since the employer pays at least part of the premium for the employee. However, the employer often does not cover the family premium. Therefore, depending on the cost, it may be less expensive to have the rest of the family buy a separate policy.

But one potential drawback to having two

separate plans is having two separate deductibles. If the entire family is healthy and rarely uses health care, the two-plan approach is more likely to save money. But if a family member uses health care frequently, especially if the deductible is regularly met, one plan may prove to be the better deal.

When employer-based coverage or Medicare is not an option, individual insurance continues to be available on a guaranteed issue basis without underwriting, thanks to the Affordable Care Act. If a client's income can be reduced to less than 400% of the poverty level, they qualify for subsidies to help pay for the coverage. If income is greater than 400% of the poverty level, clients pay the entire premium.

A client who is not a high health care user will probably be best served by a high-deductible bronze plan. Because the Trump administration stopped reimbursing insurance companies for cost-sharing subsidies,

the companies are loading up their premium increases on mid-level silver plans, which are the most popular. Therefore, if a client is a frequent health care user, buying a gold plan, which offers more coverage, is usually the better deal.

A client who is not a high health care user is probably best served by a high-deductible bronze plan.

Clients are often confused when plans with vastly different premium costs have the same deductibles, copays and benefits. What gives? The cheaper plans have narrow networks, meaning they have fewer doctors and hospitals on their panel. If a client has a narrow network plan and goes out of network, the costs can be very high. Make certain clients understand these limitations.

One benefit of the current health care legislation is that every year people can change health insurance without underwriting. If they choose a cheap plan and then get a serious illness, they can enroll in a more robust plan during the next open enrollment period. Just hope they don't come down with a serious illness in January since they can't make a change until year-end.

Make sure your clients are aware of three common traps when using health insurance: unknowingly going out of network, going

McClanahan

out of network for emergency care and not making the most of coverage after out-of-pocket maximums are met.

Going out of network: Most doctors and hospitals will take any insurance, but — and this is a big but — they may be out of network. When making an appointment or scheduling a surgery, advise your client not to ask, “Do you take my insurance?” Instead encourage them to ask, “Are you in my network?”

Just because a doctor accepts a carrier’s insurance doesn’t mean they are in the company’s network. If they aren’t in network, the doctor can charge you the higher out-of-network prices. In the hospital, your client should insist that every person involved in their care be in network. Detailed documentation is very helpful if a client receives a bill that says some part of their care was out of network.

If in an emergency clients end up in a out-of-network hospital, they should be transferred as soon as they are stabilized.

Going out of network for emergency care: If, in an emergency, a client or family member ends up in a hospital that is not in their network, they should insist on a transfer as soon as the patient is stabilized. Call the insurer and let them know about the situation. Sometimes the hospital will agree to take in-network payment. The patient must get this in writing.

Making the most of coverage after out-of-pocket maximums are met: If a client has a year of bad health that forces them to meet the out-of-pocket maximum, make sure they make the most of their coverage for the rest of the year. In June 2016, my husband had a serious head injury. Thankfully, he is OK now, but while I was sitting in the

emergency room, my financial planner brain kicked in and I thought, “We are going to hit our \$10,000 deductible.”

After his recovery, he followed up with physical therapy for his multiple “old age” musculoskeletal complaints. We both had worrisome skin bumps removed. Finally, I refilled a year’s worth of expensive medicines. All of this was “free” because that one hospitalization was over \$30,000.

The health care system encourages us to be better consumers but isn’t friendly when we actually try to shop for cost-effective care. Because of the fee-for-service payment system, health care professionals are rewarded for providing more services, which most often do not equate to the best care.

Toward Collaboration

There are three profiles of physicians — paternalistic, informational and collaborative. Thankfully, paternalistic medicine is going the way of the dinosaur. Currently, informational providers are the most common. They share many options with patients but without understanding their health values and financial situation. They leave it up to patients to make decisions.

The happy medium is the collaborative physician, who takes time to provide the best and most cost-effective care based on their patient’s input. The most important part of a diagnosis hinges on the patient’s history. Providing the time-crunched doctor with a written narrative in advance of an appointment outlining current health issues, past history and everything a patient has done to address their situation will help a doctor ask the right questions to get the best diagnosis.

Most lab testing is used to confirm a suspected diagnosis or monitor

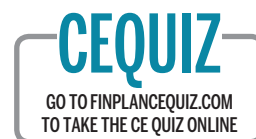
treatment. Too often, doctors order tests because of protocol, which can lead to false positives, which take patients down the expensive rabbit hole of further testing. To minimize unnecessary testing, the patient should ask the doctor, “How will this test help you with my diagnosis or treatment?” If the doctor doesn’t have a good answer, ask if the test is really necessary.

If a client meets the out-of-pocket maximum, make sure they make the most of their coverage for the rest of the year.

All patient questions should be answered in layperson’s terms. A patient should never leave the visit without clarity on three things: How to address their health issue, what to expect from their treatment and when the follow-up visit will be. Doctors often tell patients to come back if they aren’t getting better, but don’t give a time frame. By knowing the expected course of the illness, the patient can save time and money on unnecessary visits.

My final plea to advisors — who, after all, will double as patients at some point in their lives: We all need to drive our politicians crazy until they actually fix our health care system.

Pay attention to legislative proposals and take five minutes a week to call your representatives to let them know your stance. Kaiser Health News and Health Affairs are great resources to stay current. If enough people reach out, maybe we can get the system we need to best help our clients with health care costs. **FP**



Carolyn McClanahan, a CFP and M.D., is a Financial Planning columnist and director of financial planning at Life Planning Partners in Jacksonville, Florida. Follow her on Twitter at @CarolynMcC.

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Boomer



Taking a Chance on Talent

Seeking out interns, mentees and protégés in unlikely places can yield an impressive ROI.

By Allan Boomer

As advisors, we always look for investments with a positive ROI. Sometimes the best investments require very little capital at all.

When I graduated from high school nearly 25 years ago, I was fortunate to land an internship in financial services through a program called Inroads.

The goal of the program was to expose talented minority youth to corporate America and to prepare them to succeed in their future careers.

I was attracted to the program not by the lure of building a resume or career, but by the opportunity to earn \$3 more per hour than the minimum wage I was making at the local fast food restaurant where I was working.

Inroads provided several hours of interview preparation, which included advice on what to wear and how to sell myself. Then they set me up with three interviews with companies in the consumer goods and insurance industries.

Despite their tutelage, I bombed all three of my interviews.

At that point I had resigned myself to flipping burgers for the rest of the summer and preparing for college.

And then the phone rang.

Inroads was giving me one more interview opportunity — this time with Merrill Lynch.

After receiving bad driving directions (there was no Waze or even MapQuest back then) I arrived at the interview more than an hour late.

I walked in with low expectations and a nothing-to-lose attitude. Instead of offering the carefully crafted interview responses I had been trained to provide, I decided to simply be myself this time.

The interviewer and I seemed to hit it off well, but I had little confidence that I'd be called back for the job. Then when I left the interview, things got worse. I returned to my car and learned that my battery had died.

Mortified, I walked back into the office and sheepishly asked my interviewer for help jump-starting my car.

A few days later, I got the shock of my life — I had landed the Merrill Lynch internship. A stranger saw something in me and decided to take a chance.

During college, I spent every summer and winter at the company and accepted a full-time job offer upon graduation. That experience led me to job in management, an MBA and ultimately a VP role at Goldman Sachs.

I had resigned myself to flipping burgers for the summer. And then the phone rang.

Today, years later, I am still working in the financial services industry, except now I am running my own RIA.

This summer, my company hired its first class of interns, including one who worked directly with me. Unlike many financial advisor internships that involve compiling prospect lists and cold-calling, I made sure mine was substantive. My intern, a rising sophomore at my alma mater, Morgan State University, shadowed me all summer. He joined me at just about every client meeting, board meeting, research meeting and networking function.

I filled in the gaps in his financial knowledge and challenged him to write his own financial market commentary. He helped me

9

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complete my quarterly review books, which gave him insight into portfolio construction and the financial planning process. The result — an offer to intern again next summer or even this winter.

Below are ways to invest in young talent — ones I have found yield a handsome ROI.

Internships

Recruit a student to work for your company next summer.

Although internships can be unpaid, you should find room in your budget to pay them. Most college and graduate school students cannot afford to work for free, even if they are receiving college credit for their efforts. You would hate to miss out on a talented candidate just because they don't have financial means. What you are looking for is an intern with potential.

When recruiting for your internship program, you should be open-minded. Consider recruiting from community colleges as well as traditional four-year universities. With today's era of sky-high college tuition prices, many bright students are taking less-traditional routes to earning their degrees.

With today's sky-high tuition prices, many bright students are taking less-traditional routes to earning degrees.

Community colleges can be a great place to find hidden gems.

In planning the intern's tasks, think about their development, not just the needs of your business.

A successful internship is a win-win arrangement where you get some extra help and the student learns enough about the financial planning industry to

get an idea of whether it's a good long-term fit.

Even if things don't work out, they may help you attract other interns in the future or design a better program for next year.

Mentorship

Find someone to mentor. This relationship can be formal or informal. However, in my experience, the best ones are informal.

These endeavors require commitments on both sides of the aisle. Both parties must be proactive in arranging times to meet, asking questions and building the relationship.

Mentees have to be open to constructive criticism, and willing to commit to personal development goals.

Mentors must be flexible. It's not about guiding your mentee through the

steps it takes to be just like you. It's about helping your mentees find their own path. Mentors must also be selfless. Much like the fiduciary roles we play with our clients, we cannot provide



ALLAN BOOMER

Allan Boomer (center) with Tulsa Real Estate Fund intern Ana Pereira (left) and Momentum Advisors intern Tyler Holley.

advice to our mentees that simply benefits us.

It's worth noting that most of the people whom I've mentored over the years have never actually worked for my company.

In fact, one of my favorite mentees is a young man I met when he bombed a job interview with me. You never know where you are going to find the gems, and what role they will ultimately end up playing in your own life.

Sponsorship

A sponsor is someone who advocates on behalf of someone else, and leverages their goodwill and contacts to help the person succeed.

While mentors have mentees, sponsors have protégés.

Sponsors position their protégés to win by lending their own influence to

help advance the protégés' reputations.

Examples of sponsorship include helping a young advisor land a key client opportunity even if the sponsor sees no economic reward in return, or nominating a protégé for a nonprofit board position.

Like the fabled turtle sitting atop a tree stump, I did not get where I am by myself. I was lifted up by the people who took a chance on me, seeing potential that few others saw.

Most likely, someone did the same for you.

Now it's time for you to make the same investment in someone else. **FP**

Allan Boomer, a Financial Planning columnist, is managing partner and chief investment officer of Momentum Advisors in New York. He co-hosts a weekly radio show on SiriusXM Ch. 126 on wealth building and entrepreneurship. Follow him on Twitter @MomentumAdvice.

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A Wayward Client Returns

It doesn't always work, but sometimes good practices can win a defector back.

By Kimberly Foss

It was the calm Friday afternoon of what had been a rather serene week. Maybe that should have warned me.

My office administrator pinged me to say that a long-time client was on line 1. I was happy to take the call. After all, he was one of my favorite clients.

I had been managing his assets for more than 15 years, and we had been able to grow his portfolio at a nice rate, even during some tense financial times.

This client had stuck with me during the 2007-2008 market meltdown. More than once he had said to me, "Kimberly, just do what you think is best; I have absolute confidence in your judgment." Only three days ago, he had referred a multimillion-dollar client to me.

Yes, I was more than happy to take this call. Imagine, then, the 8.2-on-the-Richter-scale emotional earthquake I experienced when I heard his first words: "Kimberly, I just

want you to know that I'm moving my money from your firm."

Through waves of aftershocks, I listened as he explained his decision to me: "I'm getting close to retirement, and I just think I need to be a little more conservative."

This was a tough statement to process since this account was already overwhelmingly invested in fixed-income assets.

He went on to tell me that he planned to put his money in annuity products. He assured me that this had nothing to do with any dissatisfaction on his part, either with our services or the performance of his account. "I just think I need to make some changes," he said.

And that was that.

I'm sure you've found yourself on the receiving end of a similar call. If not, you're either very lucky or you haven't been in your practice very long.

I can guarantee you that it's not a

pleasant experience. Your first instinct is to ask yourself, "What did I do wrong?"

As you can imagine, I began replaying in my mind every interaction I'd had with my client for the previous six months. I retraced every portfolio review, every recommendation, but I just couldn't find anything that seemed like a likely reason for him to pull his account.

We had followed the playbook: systematic portfolio reviews, updated goals and target dates, agreement on long-term strategies, personalized recommendations.

Your first instinct is to ask yourself, "What did I do wrong?"

As far as I could see, we had done everything right. I just couldn't figure out what was going on.

Luckily, this client's son was authorized to discuss his dad's account with me, and I had a great working relationship with him. I decided to call him and try to find out what was happening.

Through our conversation, I learned that the decision came after my client had been influenced by a longtime business associate who, it turns out, was also marketing annuity products.

"You know how Dad is, Kimberly," he told me in an almost apologetic tone. "He makes snap decisions, and it's hard to talk him out of it. Honestly, I wouldn't be



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surprised if he comes back to you someday. I just hope this doesn't cost him too much money."

As it eventually turned out, the son was right.

Unfortunately for my client, though, he decided to come back only after he had absorbed some serious losses, and the steep surrender fees included in some of the annuity contracts only made it worse.

Sometimes we're able to persuade the client not to jump ship, and sometimes we aren't.

His retirement plans were now at risk, and one of the first things we did was to use the Monte Carlo simulation component of our eMoney planning tool to help him and his wife figure out how to rebuild their retirement lifestyle after taking this major hit.

We were able to work out a plan to reallocate some real estate assets, freeing up badly needed cash and significantly reducing the household's monthly overhead.

When the dust settled, the family was grateful, and I had recovered a client who, all things considered, really should never have left in the first place.

Long-Term Lessons

In our financial planning practices, most of us have had a similar experience. Sometimes we're able to persuade the client not to jump ship, and sometimes we aren't. Sometimes the client eventually comes back, and sometimes they don't.

But regardless of the specifics, there are some important takeaways that can help us forge relationships with our clients that are harder to break.

Color them unique. First, we have to recognize that each client is a unique

individual with a unique style of communicating and making decisions.

The son was right on target when he said that his dad was prone to shooting from the hip. I knew, from the time I heard "goodbye" that trying to talk him out of moving his account would probably be a waste of time.

One of the reasons I knew this is that I utilize the Color Code communication system to help me understand the way my clients receive and process information. When I know my clients' hard-wired inclinations for hearing and managing communication, I'm better able to adjust my spoken and written exchanges with them to match their individual preferences.

This client, for instance, is 65% "red," which means I should be putting all the facts right out front with no frills, then letting him decide. For another client, it might mean leading with emotion and carefully empathizing as they process the decision.

It really just depends on the results of the code. Knowing these aspects of my clients helps me "speak their language," and I credit this tool with helping me to build a level of trust that survived his time away from our firm.

Game the problem. Second, we need to use the available technology to provide our clients with the best and most accurate data on which to base their decisions.

In my conversations with the client couple, the eMoney platform and its simulation capabilities were absolutely crucial. We were able to input their sources of income, their liquid and illiquid assets, their monthly expenses, and everything else that factored into their current situation.

We played with different variables, scenarios and outcomes and finally

arrived at a solution that they felt confident about.

We've got your back. Third, and perhaps most important, we need to be constantly building our professional networks so we can provide above-and-beyond service for our clients.

In my case, that meant reaching out to a trusted real estate professional who could create maximum value for my client and his wife as we restructured their holdings.

The next time, I might need a CPA with a sharp eye for tax savings or an estate planning professional who can spot a creative solution to a thorny legal problem.

The more problems we can help our clients solve, the more we can move the conversation beyond fees and market performances.

One of the most valuable things we can do for our clients has little to do with AUM: We can become their doorway to the best and most professional experts; people who can help them overcome the barriers they face.

My firm's scenario ended happily — not least because it highlighted and reinforced fundamental lessons on how to run a client-centered practice.

The more problems we can help our clients solve, the more we can move the conversation beyond fees and market performance. When we focus on that kind of value-added service, put people before profits and focus on service above self, the fewer breakups we may be subject to.

Best of all, we can feel confident about the ultimate outcome — putting our clients' needs first — even when the phone rings late on a Friday afternoon. **FP**



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I Lost Clients. And That's OK

The departures after I set a \$10,000 fee minimum mean my practice is losing thousands of dollars in revenue — for now.

By Dave Grant

My six-year-old practice may be out of the startup phase, but I'm still undertaking major transitions that will alter the growth path of my company.

I'm confident the changes will help me build the practice I really want, but it hasn't been easy. One of the biggest shifts I've made is to my fee structure.

Obviously, every client has different needs, but in trying to make everyone happy, I was becoming inefficient.

A few months ago, I nailed down the exact service model I want: Instead of working with ongoing clients at various price points, all of my clients should fit into a model where a minimum fee of \$10,000 per year to do

financial planning, investment management and tax work is appropriate, given the assets that I'm managing.

I then told my clients this change would affect all new relationships, as well as those who are transitioning into retirement. For some, it meant a big fee increase.

Some clients left, saying the service was not for them. The departures mean my practice is losing thousands of dollars in revenue.

The Right Client

That's when I heard something that hit home: "The right client already values the result of the work you do — not the wrong client, the right client," said Sean McCabe, founder of seanwes, an online community for entrepreneurs, in a podcast.

Applying those words to my business has changed the philosophy of my business design and the way I work with clients.

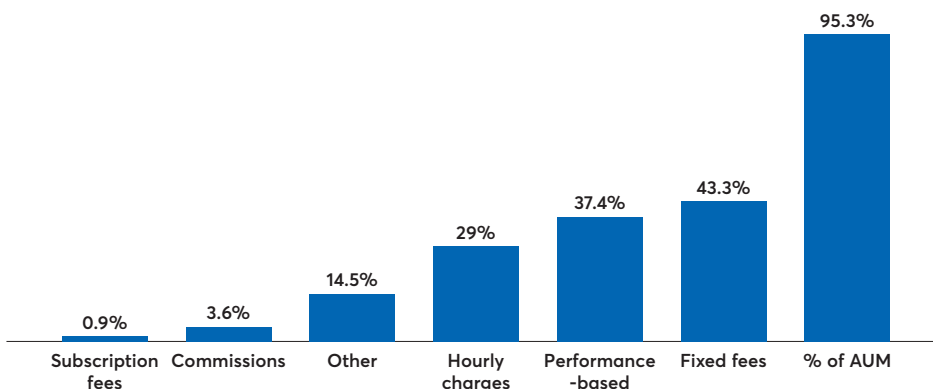
As I listened to McCabe, I realized the right client for me already values the result of this new service offering. My future client will value the service I provide and the results it brings — I just need to be patient until we find each other.

The message couldn't have come at a better time for me.

While my new approach isn't out of the norm for our industry, my level of confidence wasn't high enough to think I was worth the money.

I had to deal with that

How RIAs Charge for Their Services



Source: Investment Adviser Association and National Regulatory Services, 2018

Grant

crisis of confidence quickly when I met with a prospect who had over \$4 million in investable assets. Based on my fee model (which intentionally has no price breaks), I quoted my ongoing services at more than \$40,000 a year.

Waiting for the Sticker Shock

As I delivered the price, I had to show a face of assurance, but inside I was wincing, expecting the reaction of sticker shock. It didn't come.

I then had to have the same conversation with three other retiring clients who would be transitioning into my new model. Each time it got easier.

Even when it was rejected, I hung onto the notion that they were not rejecting me, but a service that wasn't

the right fit for them.

As time has progressed, the service model has become just a normal part of my business.

There was yet another worry that came with my new fee model: risk.

As I came away from the prospect meeting during which I quoted more than \$40,000 in fees, I felt I was exposing my business to a danger I hadn't encountered before.

While the value would be delivered in designing and facilitating a retirement income plan, along with other financial planning and income tax tasks, I don't want a large portion of my revenue to be generated by one client. This has great upside potential, but it has downside risk as well.

Given the opportunities for growth in this person's portfolio, it wouldn't be surprising for the future fee to start dwarfing those of my other clients.

If this client decides to leave in five years, my company's revenue could be decimated. With that in mind, I instituted a maximum \$30,000 fee.

This accomplishes multiple things. It limits the risk that one client can have on my company revenue.

Getting a Deal

Plus, once clients hit that maximum fee, they are likely to feel they're getting a deal because they're not paying any more money. Also, it streamlines multiple parts of my business, such as billing and income projections. Finally,

when comparing it with other companies, the service is beyond what many other planners are doing, so I still feel I'm providing clients with great value.

Being a solo lifestyle practice, getting to this point makes me very excited. That said, when I tell people my minimum fee is \$10,000, I get a wide range of reactions.

Some existing clients say they are very happy to pay, and when they find out there are more services included than they currently receive, they feel as if it's a bargain.

Prospective clients frequently walk away — and I'm OK with that. Being a lifestyle practice, I don't need 150 of these clients to support a team, multiple offices and other expenses.

I also reverse-engineered my practice to calculate the income number I need in order to meet my personal goals.

Our household requires about \$200,000 of gross income to achieve all of our savings and stretch spending goals. Between my income and my wife's — which doesn't fluctuate much — we're about \$50,000 per year away from that.

Providing Good Service

Now that I have a minimum fee, I know the number of ongoing clients I need if my practice design doesn't change. When I get to capacity, I know I'll have a lot of time to service these clients, provide a rich experience and travel the country to see them without having

to focus on growing at all.

I've told clients that, once this service tier is filled, I won't be open to new ones. They know they're securing a spot in a limited client roster. As long as they're happy — and still fit as clients — they'll get the service they're accustomed to.

I'm sure my practice will evolve in the future. But I'm going to stick to designing services I feel confident in offering, knowing that the right client already values the results of this work. **FP**

Dave Grant, a Financial Planning columnist, is founder of the planning firm Retirement Matters in Cary, Illinois. He is also the founder of NAPFA Genesis, a networking group for young fee-only planners. Follow him on Twitter at @davegrant82.



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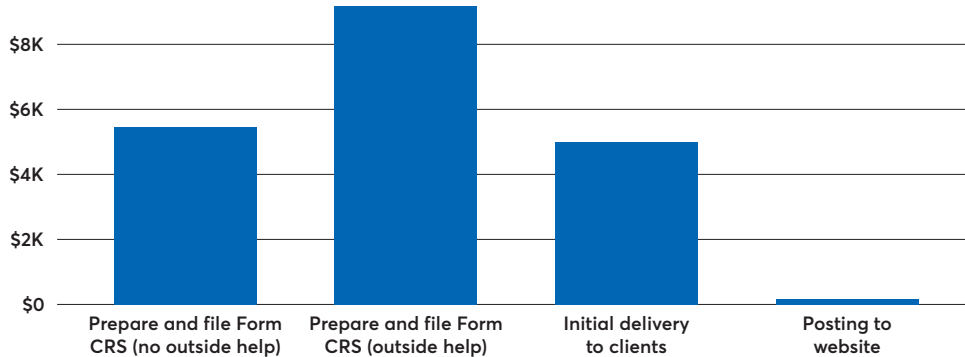
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Estimated Initial Cost of Form CRS for RIAs



Source: SEC, Form CRS Relationship Summary Final Rule

Conquering Form CRS

The SEC's new requirements could prove time-consuming, even vexing, for firms.

By Jessica Mathews

The SEC's new Form CRS, the ultra concise disclosure document that requires advisors to lay out their obligations to clients in "plain English," may be a bigger compliance lift than some firms realize.

According to the commission's 564-page rule, firms have until June 30, 2020, to craft a two-page document that includes affiliation and registration details, conflicts of interest, disciplinary history and suggested questions to bring up to a rep. (Dually registered reps are allowed up to four pages.)

That's a lot of detail to include in a short document, especially if firms stick to paper and don't use hyperlinks, warns a client alert about Form CRS from law firm Stradley Ronon.

"It is unclear whether it is practical, or even possible, to disclose such information in a paper-based format within these page constraints," the law firm wrote in the alert.

While it may be difficult, concise clarification is necessary, according to the SEC. "Research continues to show that retail

investors are confused about the services, fees, conflicts of interest and the required standard of conduct for particular firms, and the differences between broker-dealers and investment advisors," says the commission.

Sanjay Lamba, associate general counsel at the Investment Adviser Association, agrees it may be a daunting task. "It may not seem like a lot in terms of what you have to prepare and deliver. After all, it's only two pages," says Lamba, who laid out specifics of the document last week on a TD Ameritrade Institutional webcast on Regulation Best Interest. "But I think once you start going through the release, reading through the instructions and putting pen to paper, you'll realize that there are a lot of issues, a lot of questions, a lot of implementation challenges."

Here's what advisors should know about the form:

Upcoming Deadlines

Firms will be required to file their first Form

CRS to the SEC by June 30, 2020. After filing, advisors and firms will have 30 days to deliver the form to existing clients, according to the SEC.

"It's a relatively short compliance period — you have less than a year to prepare it," Lamba said on the webcast.

Firms have less than a year to craft a two-page disclosure laying out their obligations in "plain English."

The document must be in text-searchable format, and machine-readable headings are required, according to Lamba. "The idea here is, I think, to encourage third-party firms to collect the data that's in all these forms, the documents and offer comparison tools for retail investors with respect to your delivery obligations," he said.

Submitting the Form

Investment advisors will submit the form as part three of their Form ADV, according to the SEC.

Advisors can deliver Form CRS to clients in the same format they typically use to deliver disclosures, according to Lamba.

If by paper, it must be on top of any other materials delivered at the same time, according to the SEC. All advisors will need to make the form readily available on their

website, if they have one.

Which Clients Get Form CRS?

Every client who has retirement savings or whose investment objectives are included in the SEC's definition of a retail investor, regardless of net worth or investment sophistication, according to Lamba.

"Even Warren Buffett will be getting a Form CRS," he said on the webcast.

Clients seeking services for commercial or business purposes, such as services for small business or on behalf of a charitable trust, are excluded. However, clients who are seeking advice for a mix of personal and commercial purposes still count as retail clients.

"This does beg the question on how you will know whether a new client is seeking advice for something other than personal, family or household purposes," Lamba said. In circumstances when an advisor is unclear, the SEC suggests treating a client as a retail investor, he said.

When to Give Clients Form CRS

Initially, investment advisors will be required to give clients the form before, or at the time, they enter into a contract with a client, according to the SEC. Brokers must give a client the form before making recommendations, placing orders or opening a brokerage account. Dually registered reps must



After initially filing with the SEC, firms will have 30 days to deliver Form CRS to clients.

deliver it at the time of recommending a product, or of entering into a contract — whichever happens first.

In addition, advisors will need to deliver a subsequent Form CRS to existing clients when opening a new account for them, rolling over assets from a retirement account, as well as when recommending or providing a new brokerage or investment advisory service, directs the SEC.

"Even Warren Buffett will be getting a Form CRS," says Sanjay Lamba, Investment Adviser Association.

If there are material changes to the form, advisors must update it within 30 days and communicate those changes to clients within a 60-day period.

Advisors will be required to keep a record of the dates they give clients the form, according to the SEC.

Plain English

The document is intended to help clients better understand the relationship they have with their advisor. Therefore, "in terms of the presentation and format of Form CRS, [it] will be required to be written in plain English, avoiding the use of legal jargon," Lamba says.

Form CRS is in a Q&A format and encourages layered disclosure that references other disclosures and hyperlinks to other sources, according to Lamba.

"The final instructions include a mixture of limited, prescribed wording that firms must include. This is mainly for the heading, the conversation starters, the statement of your legal standard of conduct and to statements relating to fees and costs," he said.

Conversation Starters

Conversation starters in the new form

have raised the most concern from advisors, according to Lamba.

"Throughout Form CRS, there are going to be these sentences, these questions that are designed to encourage your clients or prospective clients to ask your reps questions," he said on the webcast. "Obviously this will require policies and procedures."

Questions found in Form CRS include: As a financial professional, do you have any disciplinary history? For what type of conduct? Who can I talk to if I have concerns about how this person is treating me?

While reps will not be required to proactively address the questions in the form, "obviously we'll need to be prepared to answer them — another compliance burden that was created here," Lamba said.

Conflicts of Interest

Form CRS requires advisors to disclose conflicts of interest in one of two ways: by summarizing one of the four conflicts provided in the SEC rule, which includes disclosing proprietary products and revenue sharing arrangements, or, if none of the conflicts apply, summarizing at least one other conflict of interest, according to the SEC.

"You'll have to think about your material conflicts again and how you want to present them in your form," Lamba said, encouraging firms to hyperlink to more detailed disclosures.

One advisor asked on the webcast whether a firm could report they had no conflicts of interest.

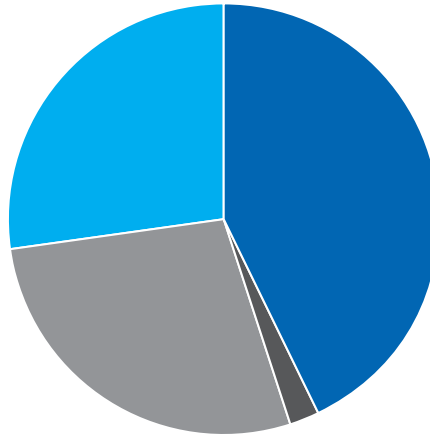
Gail Bernstein, general counsel of IAA, who also spoke on the webcast, recommended firms rethink what constitutes a conflict of interest.

"Just because you have mitigated a conflict, does not mean that a conflict does not exist," Bernstein said. **FP**

Jessica Mathews is an associate editor of Financial Planning. Follow her on Twitter at @jessicakmathews.

Fee Breakdown

- AUM only, 43%
- Commission only, 2%
- Various fee-for-service models, 28%
- Blended compensation models, 27%



Source: Kitces Research, 2018 survey of advisors

Keys to Subscription Pricing

Should you try today's hot model? First review fee flexibility, target markets, value, transitioning to AUM and branding.

By Charles Paikert

One of the most critical decisions for a financial advisory firm is its fee structure, and right now advisors are taking a closer look at the subscription pricing model.

It's little wonder: Charles Schwab's new subscription service brought in \$1 billion in new client assets in just three months, and Bank of America says it is considering creating a subscription service for its Merrill Edge service.

The industry's "pricing model needs to change," Bernie Clark, executive vice president at Schwab Advisor Services, said at the SourceMedia In|Vest conference, which was held in July.

While not everyone is as convinced — "the AUM model will prevail," David Canter, head of Fidelity's Clearing & Custody Solutions RIA segment, predicted at In|Vest — there's little doubt that subscription pricing is gaining momentum.

"We started to see some interest in this

model [from RIAs] about five years ago, and now it's become a mainstream concern," says Pete Dorsey, managing director of institutional sales at TD Ameritrade.

So if an advisory firm is considering the model, what should it take into account? Here are key factors:

Fee Flexibility

"It's critical that fee escalators are built into the [subscription] model," says Scott Slater, the vice president of practice management and consulting at Fidelity Clearing & Custody Solutions.

Services that firms will deliver for clients will change over time, says Abby Salameh, chief marketing officer at HighTower Advisors. "So when firms are considering subscription pricing, they need to look at service delivery and how they can move clients to the next tranche."

The XY Planning Network has been a

pioneer in employing the fee-for-service model, having used subscription pricing since it came into existence five years ago.

"It's especially crucial under a fee-for-service model to get clients in the habit of paying an additional 3% to 5% every year," XY co-founder Alan Moore writes in a Nerd's Eye View post titled, "How to profitably price fee-for-service financial planning."

It's "crucial under a fee-for-service model to get clients in the habit of paying an additional 3% to 5% every year."

Ideally, advisors can include the increase in the financial planning agreement. That means "the fee increases automatically under the existing agreement," Moore adds.

Target Markets

Young people who don't have a lot of liquid assets in the early stages of their careers are a natural target market for the subscription pricing model.

As TD Ameritrade's Dorsey puts it: "It's definitely a way to capture people early in the sales cycle. Subscription pricing is going to be more affordable for people in their 20s and 30s who are still building assets, and it's a model that they are used to."

But millennials shouldn't

be the only target market, says XY's Moore in an interview. "Subscription pricing can be the right service model for other client segments who don't have a lot of liquid assets," he says.

"Real estate developers, for example, have their net worth tied up in their buildings, and business owners often reinvest their excess cash back into their businesses," says Moore. "And while doctors are building wealth, they are often in debt into their 40s."

Many of the clients of Facet Wealth, another industry trailblazer, which has been using subscription pricing since the firm launched itself two years ago, "have a negative net worth but pretty high income," says Anders Jones, the chief executive officer. "The industry is not set up to service those folks, and subscription pricing can definitely expand the market."

Value

Switching to a subscription pricing model increases the need for firms to explain what they provide to clients, industry experts say.

"You have to articulate the value proposition and explain why it's better than charging a percentage of AUM or a commission," says Facet Wealth's Jones. "Clients are being charged every month, and they will want to know exactly what they're paying for."



"I believe the AUM model is antiquated," says Abby Salameh of HighTower.

Moore suggests providing an annual service calendar to clients as one way to demonstrate value to clients.

"The calendar shows clients everything the advisor will do for them throughout the year, from webinars and newsletters to investment and insurance reviews," he says. "It's a good way to help build confidence in the service being provided."

Indeed, when it comes to subscription pricing, "it's all about articulating what's in the service delivery," says HighTower's Salameh.

Transition ... or Not?

Subscription-based billing generally brings in less total revenue than AUM-based fees.

At the same time, there are fewer opportunities to add services since younger clients attracted to the model often have less complex planning needs than AUM clients.

"Clients are being charged every month, and they will want to know exactly what they are paying for."

Fidelity's Slater says advisors considering a subscription model should plan for how they will transition clients over time to a traditional AUM fee structure when they have "a broader set of needs."

But Salameh disagrees. Transitioning back to an AUM fee is not a good idea, she argues. "I believe the AUM model is antiquated," Salameh says.

"Subscription pricing is very appealing to 25-to-34-year-olds," she observes. In future years, "they will want to continue using it if advisors can price the service profitably and demonstrate the value."

An advisory firm considering subscription pricing should be committed to the model, Jones maintains.

"Don't do it halfway," he says. "The

firms who will be successful are not going to jerry-rig the model to get more AUM business. I believe a fundamental shift in the market is coming and the successful firms are adapting to it."

Branding

Advisory firms that have introduced subscription pricing are generally proceeding with caution.

"It's important how you put a subscription model out there," says TD Ameritrade's Dorsey.

"If you're charging less for a subscription model, you don't want to undermine your existing AUM business, so some firms are branding the new service differently."

The St. Louis-based RIA Plancorp, for example, has introduced a lower-cost digitized advisory service under the brand BrightPlan that uses a subscription pricing model.

For a monthly fee of \$20, BrightPlan automates investing of deposits, asset allocation, tax loss harvesting and dividend reinvestments for clients and uses Vanguard and Dimensional funds for their portfolios.

Clients can also set up a goal-based plan and speak to an advisor once a year.

BrightPlan is owned by Prumentum Group, which owns 40% of Plancorp. Most of BrightPlan's clients are younger, still building up their net worth and "not ready for our [AUM-based] service," says Christopher Kerckhoff, the CEO of Plancorp.

But BrightPlan clients may one day have more wealth and more complex investment needs.

When that happens, and they "decide they want a dedicated advisor, they can click to become a Plancorp client," Kerckhoff says. **FP**

Charles Paikert is a senior editor of Financial Planning. Follow him on Twitter at @paikert.

THE MEDICARE MAZE

From surcharge brackets to prescription drug plans, the details facing clients can be overwhelming. Here's how you can help.

By Charles Paikert

Helping clients navigate critical health care decisions as they approach retirement is perhaps the ultimate holistic added value financial advisors can offer — particularly when it comes to Medicare options.

"Clients can be overwhelmed and very confused about what to do when it comes to making decisions about Medicare," says Robert Tucker, a vice president and wealth manager at Plancorp. "They need help and Medicare has a lot of moving parts."

Tucker should know. He had been an orthopedic surgeon in St. Louis for 25 years when, in 1983, he and his wife hired Jeff Buckner, a co-founder of Plancorp, as their advisor. Over time, Tucker became more involved in the administrative side of his medical practice, went back to school to earn an MBA and became medical director of his group practice.

As he approached the target date in his financial plan to

By monitoring cash flows, advisors can help clients avoid unexpected income that could trigger Medicare surcharges, says Paracle's Aaren Strand.



Special Report: Retirement Planning

consider their next steps, Tucker discussed second career options with advisors at Plancorp and expressed his interest in financial planning.

Buckner offered him a job and Tucker transitioned from being a physician to an advisor in 2006. He went on to earn his Series 65 license and is also an accredited investment fiduciary, an Fi360 certification.

"There are a lot of similarities between the two professions," Tucker says. "As an advisor, I develop relationships with individuals, help them identify a problem and a solution to the problem, and then I monitor the solution to be sure that it taking care of the problem. That's exactly what I did as a physician."

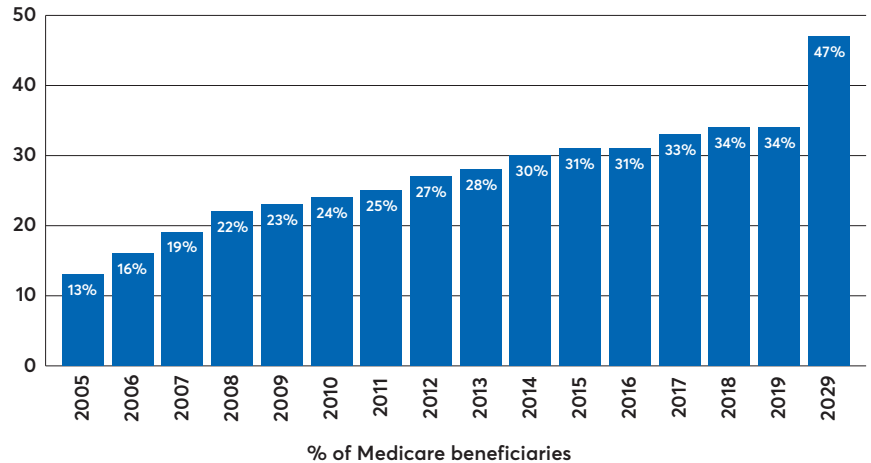
"Medicare has very strict rules. Deadlines are important, and if you don't meet them, you can lose important rights."

The initial task is to help clients pick which Medicare plan to choose: Traditional Medicare or Medicare Advantage.

Timing Is Critical

Advisors need to inform clients turning 65 who don't have existing insurance

Rising Medicare Advantage Enrollment



Sources: Kaiser Family Foundation, Congressional Budget Office

coverage that they face an important Medicare deadline.

Individuals have three months before the month of their 65th birthday until three months afterward to enroll in Medicare Part B. If a client is age 65 or over and goes on a COBRA plan, he or she has eight months to sign up for Medicare Part B.

If individuals miss this deadline, they will be subject to a 10% penalty of their Part B premium for every 12 months missed. For example, if they miss two years, they will pay a 20% penalty. What's more, the penalties will

continue for life.

"Medicare has very strict rules," says Sarah Caine, a CFP and financial strategist at Agili, a planning firm in Bethlehem, Pennsylvania.

"Deadlines are important, and if you don't meet them, you can lose important rights, such as Medigap's guaranteed issue right, which requires insurance companies to offer certain policies even if you have a pre-existing condition."

(Clients who are 65 or older have a "guaranteed issue right" to buy a Medigap plan with no restrictions on pre-existing conditions within 63 days

Adjustments for 2019 Medicare Part B Premiums

| Individual tax return | Joint tax return | Monthly adjustment | Total premium |
|---------------------------------|---------------------------------|--------------------|---------------|
| \$85,000 or less | \$170,000 or less | \$0 | \$135.50 |
| Above \$85,000 up to \$107,000 | Above \$170,000 up to \$214,000 | \$54.10 | \$189.60 |
| Above \$107,000 up to \$133,000 | Above \$214,000 up to \$267,000 | \$135.40 | \$270.90 |
| Above \$133,000 up to \$160,000 | Above \$267,000 up to \$320,000 | \$216.70 | \$352.20 |
| Above \$160,000 up to \$500,000 | Above \$320,000 up to \$750,000 | \$297.90 | \$433.40 |
| Above \$500,000 | Above \$750,000 | \$325.00 | \$460.50 |

Source: Social Security Administration



"Clients can be overwhelmed" when considering their Medicare options, advisor Robert Tucker says.

BILL SAMALUCH

of losing private health coverage.)

But beware, being on a COBRA plan does not qualify as being insured by your employer, warns Shikha Mittra, president of Retire Smart Consulting in Princeton, New Jersey.

“Many clients are unaware that there is income testing for Medicare. It can impact a lot of people.”

“If an employer is paying a COBRA premium, going into COBRA instead of signing up for Medicare can be a huge mistake people make,” she says.

Advisors helping high-net-worth clients navigate Medicare should also be up to speed on another potential minefield: surcharges on high earners.

Medicare will examine an individual or married couple's modified adjusted gross income on their tax return going back two years.

An individual with an annual income

over \$85,000 and less than \$170,000, and couples with income less than \$214,000 and over \$170,000 must pay an additional \$54.10 on top of a monthly premium of \$135.50. There are four additional surcharge brackets (see chart), including one added this year for individuals making over \$500,000 and couples with more than \$750,000 in modified adjusted gross income.

“Many clients are unaware that there is income testing for Medicare,” says Stuart Millard, an insurance broker for Senior Insurance Solutions in suburban Boston who is also a CFP. “It can impact a lot of people and it's important to plan ahead to try and anticipate or mitigate the cost.”

One of Millard's high-net-worth clients on Medicare affected by the surcharge was married to a younger spouse who went back to work. The client went on his wife's group plan and suspended his Medicare Part B

coverage to avoid the cost.

“When she stops working, he can resume his Medicare Part B coverage,” Millard explains. “In the meantime, it's more cost-effective for him to be covered by her plan. It comes down to doing the math.”

Advisors should also keep an eye on vested and restricted stocks that may increase a client's income in the two-year look-back period, according to Millard.

One way to avoid Medicare surcharges is to take steps to be in high tax brackets when required distributions begin.

Careful monitoring of cash flows from sources such as stock dividends and income from rental properties can help clients avoid unexpected income that could trigger surcharges, says Aaren Strand, an advisor with Paracle in Mercer Island, Washington.

Tucker employed a strategy using an

Traditional Medicare

Everyone who signs up for Medicare at age 65 is enrolled automatically in Medicare Part A, which covers inpatient services, including hospital stays. There is no premium for most, but this year the deductible is \$1,364.

Medicare Part B covers outpatient doctor visits, lab tests and a variety of outpatient services. The monthly premium is \$135.50, but individuals making more than \$85,000 and couples earning more than \$170,000 annually will pay more.

Medicare Part D covers prescription drugs and is purchased through private insurance companies, with costs varying by plan.

Individuals can buy supplemental insurance, or a fee-for-service Medigap policy, from private insurance companies. Medigap plan benefits are standardized by the federal government, but costs vary by insurance company and level of coverage.

Medigap plans allow patients to choose their own doctors and aren't restricted to a network or geographic region. Medigap insurers also can't deny coverage or

charge more for pre-existing conditions during the initial enrollment period. But there are no guarantees after that.

Medicare Advantage

This option is the popular name for Medicare Part C.

Individuals are covered for hospitalization under Medicare Part A and must also pay the monthly premium for doctor visits covered under Medicare Part B.

Clients choosing Medicare Advantage must choose an inclusive plan from a private insurer that covers everything covered in traditional Medicare plus drug prescriptions and additional benefits, such as vision and dental care, depending on the plan.

Medicare Advantage plans are either part of an HMO or PPO, and patients are restricted to doctors in a plan's network, which will be confined to a geographic region.

While Medicare Advantage plans tend to cost less than total costs for traditional Medicare, deductibles, copays and out-of-pocket costs can add up.

Detailed explanations can be found at medicare.gov.

—Charles Paikert

Special Report: Retirement Planning

IRA to help a retired married couple who had no earned income and were not yet taking required minimum IRA or 401(k) distributions.

"The couple had very low adjusted income for the year and was taxed at a very low bracket," Tucker says. "We converted a portion of the IRA to a Roth IRA at a lower bracket to avoid being in a higher bracket later when the required distributions begin so there won't be an onerous effect on the Medicare premium."

"Medicare is very hard to navigate alone. ... You end up spinning your wheels. You really want expert help."

Steering clients through the Medicare gauntlet also requires familiarity with the programs' Part D drug plan.

Participants in traditional Medicare should review their Part D Prescription Drug Program every year, Tucker cautions.

"Pricing structures change from year-to-year," he says. "We worked with a husband and wife who had vastly different medication lists. By reviewing the options, we were able to project prescription savings of literally several thousand dollars for the year."

Massachusetts alone has over two dozen drug plans, Millard notes, "and no plan covers every medicine."



If clients don't meet a certain deadline, they can lose Medigap's guaranteed issue right, says advisor Sarah Caine.

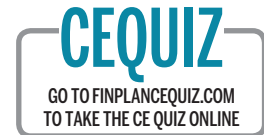
Make sure clients list all their medications, he says. "If a client doesn't include a prescription, and it's not on the drug formulary, they will have to pay out-of-pocket until the next enrollment period. And it's important to review every year, because medications may change."

Financial advisors also stress the importance of working with insurance brokers. Most, like Millard, don't charge either the client or an advisory firm a fee, but are paid a commission from an

insurance company.

"Medicare is very hard to navigate alone," Strand says. "You think you have the right form but you don't and you end up spinning your wheels. You really want expert help." **FP**

Charles Paikert is a senior editor of Financial Planning. Follow him on Twitter at @paikert.



Recent Changes to Medicare Plans

A new open enrollment period began this year that allows enrollees to move to a Medigap Plan and a Part D drug plan, or change to a new Medicare Advantage plan.

Beginning in January, Medigap plans will no longer be allowed to cover the Part B deductible for those turning age 65. The impact should be minimal for most clients since the deductible this year is only \$185.

In addition, Plan F, a popular plan which covered all of Part A and Part B, including the deductible, will no longer be sold starting Jan. 1, 2020, to those turning age 65.

While these impending changes are "scaring a lot of people, it's not really a big deal," says Stuart Millard, an insurance broker. "Plan G is still available to Plan F, which is nearly identical. And anyone who is 65 or older before Jan. 1, 2020, will still be able to apply for Plan F."

However, older clients enrolled in Plan F may want to switch to Plan G, says Sarah Caine, a financial strategist. "One of my clients who worked in the insurance industry pointed out that since Plan F is being discontinued, no new clients are coming in, and the pool of patients will diminish as people age out," she explains. "Without healthy people to replenish the pool, she was concerned that Plan F might not be as stable as it once was."

For high-net-worth clients, Medigap plans may be appealing because they are not restricted to doctors in a network or a geographical location.

"Medicare Advantage is not popular with clients who split their time between two homes and are active travelers," says Michelle Nguyen, a wealth manager at Aspiriant in San Francisco. "It's really important to understand your clients' lifestyle when you're working with them on this decision."

Among Aaren Strand's clients at Paracle in Mercer Island, Washington, a number live in nearby Seattle but also have homes in California and travel abroad frequently.

"Even though they're paying higher copays with traditional Medicare, they have more flexibility and are happy with that trade-off," she says.

For those types of clients, Millard says, "Peace of mind is worth a different price." —Charles Paikert

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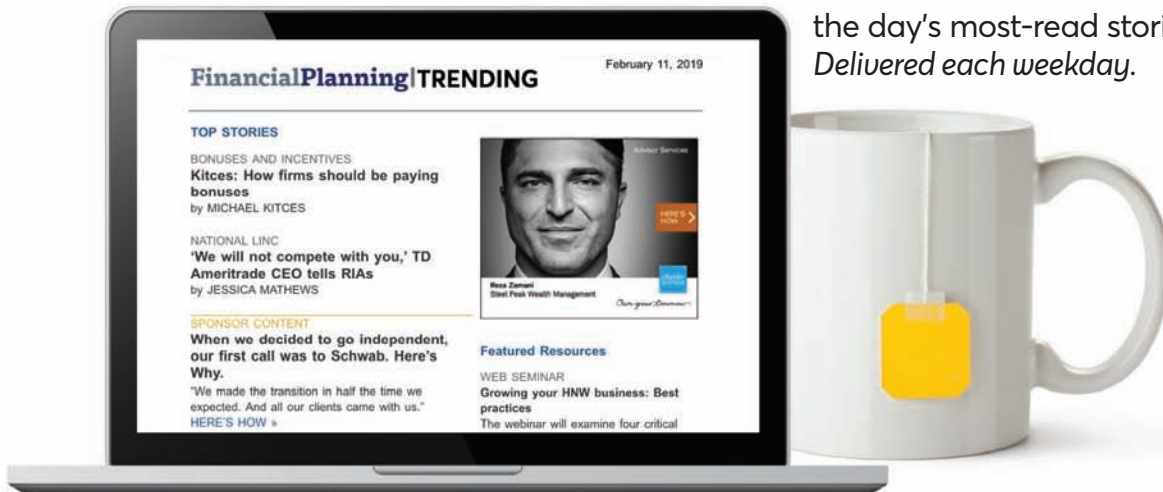


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A New Look at Discretionary Spending

The real issue lies not in classifying essential and optional expenses, but in defining core lifestyle costs.

By Michael Kitces

Retirement bucket strategies have recently been developed with an eye toward connecting portfolio allocations to specific expenditures.

These strategies commonly call for tying expenses a retiree cannot outlive to guaranteed income streams, or at least highly conservative portfolios with low withdrawal rates. Meanwhile, discretionary expenses are supported via more volatile portfolios, recognizing that, if the portfolio performs poorly, the expenses can be cut.

Yet from client to client, it's not always easy to determine what constitutes essential and what can be deemed discretionary. Because of that ambiguity, planners run the risk of identifying an expense as discretionary when the client may view it as vital to their well-being.

A defense against this is to attach

specific portfolio buckets to core vs. adaptive spending types, making it easier for retirees to see not only the security of their core spending, but also to gain an appreciation of a resource bucket earmarked for discretionary consumption. This in turn opens the door for retirees to decide how much they want tied to each of the associated retirement buckets.

A planner who's capable of doing this for retirees can not only provide peace of mind, but also value to the client relationship. Fundamental to the process of budgeting is to separate needs from wants.

Needs are the essentials, e.g., food, clothing and shelter costs, and also perhaps transportation and health care. Meanwhile, wants are generally viewed as more discretionary and flexible, e.g., travel and entertainment.

Yet the fundamental challenge of this approach is that, while expenses like travel and entertainment may be discretionary inasmuch as they are not critical to preserving the retiree's life, they do form the core of a household's lifestyle. Consequently, losing out on the ability to cover those discretionary expenses could be quite traumatic for the household.

Not all essential expenses are actually essential to the project of survival. Even a client's current home may not be essential.

The key takeaway is that discretionary expenses often relate directly to our social commitments and support the social aspects of our well-being.

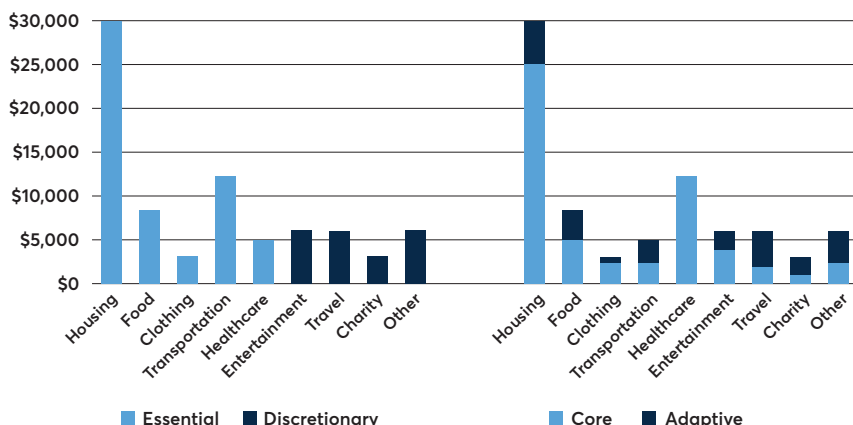
If we consider Maslow's classic hierarchy of needs, essential expenses may tie to the bare necessities for survival, but discretionary expenses aren't merely optional. Instead, those expenses typically just fund higher-level psychological needs.

On the flipside, not all essential expenses are actually essential to the project of survival.

For instance, while shelter is vital, living in a home of reasonable quality and safety doesn't necessarily mean a client's current home is essential. It may represent a substantial upgrade above what is truly necessary for physiological safety and survival, and for those who can afford a more upscale home, there's nothing wrong with indulging that impulse.

Still, it's important to note that, for

'Essentials' Aren't Always Actually Essential



Source: Michael Kitces

some, the core amount they may need to maintain the essential housing component could be 10%, 25% or even 50% less than they currently spend.

And while food is obviously essential, high-end organic groceries may best fit in a discretionary bucket. That also applies to the decision to eat out frequently instead of having friends over for a potluck dinner.

Clothing offers another illustrative moment. You may want blue jeans, but there's a difference between spending \$1,300 for a pair from Gucci versus \$130 for three pairs at the Gap — let alone paying a fraction of the Gap price at a thrift store.

Core Considerations

The real issue lies not in classifying essential and discretionary expenses, but in defining a core lifestyle cost, on top of which discretionary spending may be layered.

Core spending constitutes the true essentials of the household's entire lifestyle, recognizing that most people would not want to drastically curb spending on those things but that —

according to the strictures of a traditional bucketing strategy — they may be considered frivolous.

Clarifying what is core versus the discretionary expenses that stack on top is crucial to understanding how much the household really needs to fund their retirement, and how much risk the household can and should take on in a portfolio to satisfy those spending goals. The key distinction is that segmenting a household's budget into core versus non-core expenses means separating out core expenses within each category.

There's a difference between spending \$1,300 for a pair from Gucci versus \$130 for three pairs at the Gap.

Imagine a relatively affluent retired couple that spends almost \$80,000 per year. Almost 40% of their budget, \$2,500 per month, covers the home they've lived in for the past 25 years, including the mortgage and property taxes, along with home furnishings. They additionally spend \$1,000 per month on health care — Medicare

Part B and Part D, plus a Medigap supplemental policy for each of them — about \$700 per month on food and \$3,000 per year on clothing, all of which forms a core of about \$53,000 per year in essentials.

On top of this, they spend roughly \$500 per month on entertainment, another \$400 per month in car payments, \$6,000 per year for vacation travel, \$3,000 per year in charitable donations and about \$500 per month on miscellaneous expenses, bringing their discretionary total to almost \$26,000 per year.

The challenge is that many of these so-called essential expenses may not be essential at all. And if the retiring couple's advisor created a portfolio strategy that secured essential expenses but had a material risk of failing to sustain the couple's discretionary expenses, this would not be deemed an acceptable retirement plan. This couple cannot envision a life in which travel, entertainment and other traditionally discretionary expenses went down to zero.

So what's the alternative? Rather than segmenting each category of spending into essential versus discretionary tiers, the advisor should segment the spending within each category into the core level of spending that would sustain the household, and then the discretionary spending the couple would like to preserve on top — but realistically could live without.

For instance, the couple might decide they are unwilling to relocate, but they could scale back on landscaping and home furnishings expenditures. They could envision trimming their food and entertainment budgets by about 40%, selling one car, dialing down to just one vacation per year to see the grandchildren and making cuts to most other spending categories — save for healthcare, as their Medicare Part B

Maslow's Hierarchy of Needs and Funding Essential vs. Discretionary Expenses



Source: Michael Kitces

Special Report: Retirement Planning

and Part D and Medigap supplemental policy premiums are entirely fixed, and they can't control their out-of-pocket expenses any further if/when a health event should occur.

Notably, the relative breakdown of how much constitutes discretionary spending is substantively similar, with about 2/3 of the couple's annual spending, \$54,000, as core, and the other 1/3, or \$25,000, as discretionary. But unlike the prior budget, the couple could actually abide this one.

Fixed vs. Adaptive

Once expenses are segmented into a relatively unchanging core and a more flexible discretionary portion, an interesting phenomenon emerges: Many expenses that retirees ultimately label as discretionary above the core also tend to decrease with age.

In fact, recent retirement research has increasingly documented that retiree spending tends to naturally decline, at least in real dollar terms, throughout retirement, as even with a moderate rise in health care expenses in later years, discretionary spending tends to decline in a manner that more than offsets these costs.

That's not because retirees eliminate

entire categories of discretionary expenses in retirement. Rather, their previously scaled-up discretionary lifestyle is dialed back toward a lower-cost core as age and deteriorating health reduce activity levels.

Retirees in their later years tend to reduce their transportation costs, travel and dining out, and spending on clothing and entertainment. Those non-core discretionary expenses aren't just discretionary, they're also adaptive.

For many retirees, a significant portion of retirement spending, and core expenses in particular, may already be covered by Social Security. This arguably is a plus, as it more directly ties the most essential and core expenses to a stable and lifetime-guaranteed income stream, while the portfolio itself remains tied to the already naturally adaptive expenses left over.

Continuing the example, the retiring couple may be anticipating \$40,000 per year of Social Security benefits, which means their portfolio only needs to sustain a net of about \$15,000 per year of core expenses. At a 4% initial withdrawal rate, that would necessitate a roughly \$360,000 allocation.

Meantime, the adaptive expenses that naturally wind down only need to

be sustained for the next 20 years, meaning the couple may accept a 7% initial withdrawal rate because the plan anticipate this portion of the portfolio will be spent down over time, resulting in another \$350,000 allocation.

Accordingly, if the retiree started with a \$1 million portfolio, approximately \$360,000 would be earmarked for the core portfolio, the next \$350,000 would be allocated to the adaptive portfolio and the last \$290,000 could simply be held as long-term reserves for future use.

Of course, a key caveat is that, depending on exactly when the couple actually retires, Social Security benefits that cover the bulk of their core expenses might not actually be available right away.

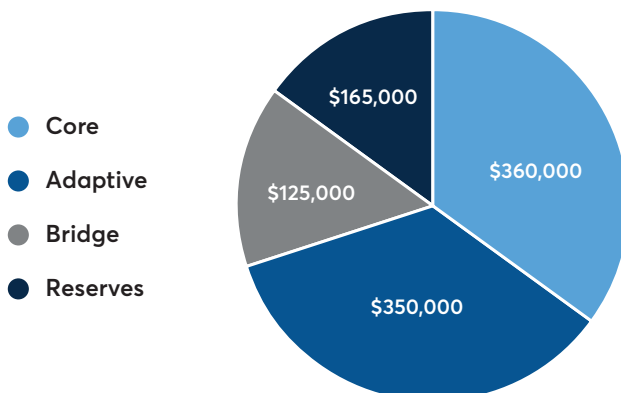
Many expenses that retirees ultimately label as discretionary above the core also tend to decrease with age.

If the couple were to retire at age 65 as Medicare becomes available, but only planned to take the lower-income spouse's \$1,250 monthly benefit while delaying the other spouse's benefit for five years until it rises to \$2,100 per month with delayed retirement credits, the couple would need another \$125,000 — at a pace of roughly \$25,000 per year for the next five years — to bridge spending needs until the rest of those Social Security payments begin.

Consequently, the couple would allocate \$125,000 of their reserves to a bridge portfolio, which must be allocated differently — and likely ultra-conservatively, given the short time horizon — with the remainder available to continue holding as reserves.

It's important to properly categorize retirement expenses to ensure retirement assets are allocated to cover them, and that withdrawal rates from those assets are reasonable given both

Allocation of \$1M Portfolio by Bucket



Source: Michael Kitces

the time horizon involved and the relative flexibility or adaptive nature of the expenses.

Thus, as noted earlier, core expenses might be tied to guaranteed income streams — e.g., Social Security, a pension or an inflation-adjusted immediate annuity — or at most an appropriately conservative safe withdrawal rate from a long-term portfolio.

For many retirees, a significant portion of retirement spending, and core expenses in particular, may be covered by Social Security.

Meanwhile, discretionary expenses might be tapped with a substantially higher withdrawal rate and a more growth-oriented portfolio, given expenses can be reduced if necessary or may naturally reduce over time. The key difference is that this portfolio would be constructed for the couple to enjoy the upside potential of a favorable sequence of returns, which would allow even more flexibility in their spending.

Bridge expenses, meanwhile, will generally be the most short-term and fixed in nature, and would therefore be allocated to the most conservative investments appropriate for the shorter time horizon. And to the extent not all of the retirement portfolio is needed for those three buckets, available reserves can simply be held or reallocated to one of the other buckets to lift spending.

A retiree who finds himself with substantial excess reserves could also simply chose to allocate them to their adaptive bucket, and actually spend the money by increasing their more flexible lifestyle expenses.

Alternatively, the retiree could allocate the reserves to is core expenses, lifting up his lifestyle.

However, because the withdrawal rate will by necessity be lower with the core bucket than the adaptive, the same dollars allocated out of reserves won't

have the same spending impact. Moving \$100,000 of reserves to the core portfolio increases spending by just \$4,000 per year. Allocating it to the adaptive bucket would lift it by \$7,000 per year, albeit for a shorter period .

On the other hand, when carving up spending within each category into core vs. adaptive expenses, it becomes clearer where retirees really do have spending flexibility to cut back.

And in turn, clarifying the relative amount of core vs. adaptive spending also makes it easier to determine how much in retirement assets should be allocated to each bucket, how the buckets themselves should be invested and whether the retiree actually has more than enough and could allocate some additional reserves to support even higher spending.

Perhaps the greatest benefit to a

clear separation of core vs. adaptive expenses — and the creation of separate buckets to support each — is simply that it clarifies for retirees exactly how much room they have left to spend, and allows them to see more directly the impact market volatility may have on their adaptive spending ability.


Ultimately, labeling expenses as core across essential and discretionary categories, then layering adaptive expenses on top, isn't just a matter of semantics. Clear words and labels help retirees stay on board with the plan, the truest indicator of a planner's value. **FP**

Michael Kitces, CFP, a Financial Planning contributing writer, is a partner and director of wealth management at Pinnacle Advisory Group in Columbia, Maryland; co-founder of the XY Planning Network; and publisher of the planning blog Nerd's Eye View. Follow him on Twitter at @MichaelKitces.

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ALSO IN PRACTICE: HALTING DISBURSEMENTS, P. 43



Advisors seeking to scale new heights in serving clients need to look beyond timeworn approaches.

5 Innovative Growth Tips

From curating trips to Italy to designing your own software, here are some creative ways to deepen client relationships.

By Ingrid Case

The routes to growth for financial planning practices have been well worn — until recently. Traditional methods of adding clients, increasing AUM and elevating productivity are increasingly in flux.

Instead, advisors are exploring new ways to curate client experiences, let technology lighten their loads and hang on to second-generation clients.

These new approaches are as diverse as the planners and firms who are charting them.

Here are five examples from advisors across the country.

Curate Experiences and Experts

In addition to creating financial plans and managing assets from her practice

in Portland, Oregon, Judith McGee curates experts and travel opportunities for clients who are looking to enrich their lives in a variety of ways.

"We've identified experiences for clients [from] all over the world," says McGee, who is the CEO of McGee Wealth Management.

For instance, a friend of McGee



Advisor Judith McGee (center) arranged a culinary event in Italy for her client, Dr. Kathleen Meyer (right), and her client's friend, Ginny Young.

opened La Cucina Sabina, an Italian cooking school in a private villa north of Rome. "Because I have a personal relationship with the owner, I've been able to arrange for clients to have this Italian cooking school experience," McGee says.

Advisor-as-travel-concierge is not such a far-fetched idea. Families with \$10 million — or even less — are demanding the kinds of experiential services once reserved for clients with \$100 million or more, according to Gabe Garcia, head of relationship management for BNYMellon|Pershing's Advisor Solutions group.

Families with \$10 million or less are expecting the kinds of services once reserved for those with \$100 million or more.

Offering this level of service has served McGee's practice well. "Our people feel like they're well taken care of," she says. "That's built our business over the years."

As of July, McGee Wealth Management's AUM had grown to \$643 million from \$463 million in 2016.

McGee says that she seeks opportunities to guide clients to other services as well.

Sometimes the connection she makes is to an architect or contractor. She has also recommended real estate agents and movers, as well as oral historians who interview a parent or grandparent on videotape.

In other instances, the practice has assisted clients as they make significant life changes.

"We have some aging clients who don't have close family, and we've helped them check out retirement facilities and decide where to move," she says.

Build Your Own Software

Shaun Erickson, founder of Single Point Partners, has used software and other tech tools to help his five-person team with a wide variety of planning tasks. And when he couldn't find the right technology for a particular problem, the firm built it.

"As a smaller financial firm, without the burden of a huge infrastructure to implement across, we've always had the luxury of being able to try new technologies," Erickson says. "If they



Planner Shaun Erickson (left) worked with Knudge co-founder Dave Connolly to develop the client reminder software that has drawn outside interest.

don't work, we can pivot off without much disruption."

There was, however, one pain point for which there was no technology fix: the ability to share a to-do list that let the advisors see where clients stood on their action items.

"Technology has allowed us to move upmarket. What we can deliver now attracts HENRYs — High Earners, Not Rich Yet."

For one thing, the firm needed to streamline delivery of reminders and give clients an easy way to say they had completed a task, such as naming account beneficiaries, or alternatively say, "I've hit a snag and I need help."

Single Point, which is based in Boston, worked with a technology and product team to create Knudge. A finalist in this summer's XYPN's FinTech

Competition, the product has generated interest from other planners.

"It will be a massive time saver for us, plus we think we'll learn a lot about what reminders generate a response," Erickson says.

Even without Knudge, he adds, technology (such as virtual meeting software, a client dashboard and file-sharing system, software that runs tax projections, a third-party billing solution and automated social media archiving) has helped Single Point triple revenue and grow to 90 families and six staff members from 45 client families and two employees at the end of 2016.

"Technology has allowed us to move upmarket and raise our fees," Erickson says. "What we can deliver now attracts HENRYs — High Earners, Not Rich Yet."

Create a Virtual Practice

Once a novelty, working remotely has evolved into a way to cut costs, enhance flexibility and attract clients from all over the U.S., advisors say.

Luis Rosa moved to Las Vegas from New York, setting up a virtual practice for the year he planned to be there.

"The large majority of my clients are still from the East Coast, so I work with them via phone, email and Zoom," he says.

Three and a half years later, much to his surprise, Rosa still runs a virtual planning practice.

Helping multiple generations with charitable strategies raises the likelihood that children will remain after their parents die.

"I found that some people like working virtually with me. It's been an advantage, especially with the younger generation," he says,

"No one really wants to sit with me,

no matter how much they like me," he adds. Rosa says his practice has gained \$4 million in AUM.

Working virtually lets him save office expenses such as rent, internet and phone lines, as well as commuting and wardrobe costs. He pays monthly dues of \$59 for a membership to shared executive suites and pays an hourly fee if he needs to use a room for a meeting. "In total, I'd say I'm saving at least \$750 per month," Rosa says.

Clients appreciate meeting with their planner without having to find a babysitter or deal with traffic and

Which Tech Is Likely to Transform Wealth Management?



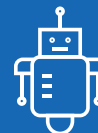
40%
Mobile apps



39%
Behavioral finance software



30%
Digital platforms (e.g. client portal)



27.5%
Robo



24%
Predictive analytics/
big data

Source: *Financial Planning's* exclusive Tech Survey of more than 300 advisors, 2018.

Practice

parking, he says.

"When they're done, they're home," Rosa says. "Plus when I have couples who are clients, it can be tough to get them both in the same place at the same time."

Carol Fabbri, a planner in Conifer, Colorado, created a virtual practice when she realized she couldn't meet with both a U.S.-based client and a business partner who moved to Belgium, Paris and then Hong Kong.

"Where I physically am has become less and less relevant," she says.

The only downside, she says, comes when clients have to make some difficult life decisions.

"It's hard to hold someone's hand from 3,000 miles away," she says.

Orchestrate Philanthropy

Guiding clients through tax-advantaged charitable giving plans can sometimes deplete assets under management, but Arlene Cogen measures growth by other metrics.

The Portland, Oregon-based planner helps multiple generations develop charitable strategies, in part because doing so lets her build relationships with clients' younger relatives.

"Between 60% and 90% of children fire [their] parents' advisors within the first year after the parents' deaths, because they don't have a relationship with those planners," she says. This is a pattern advisors should seek to change.

By forging these relationships, Cogen hopes to keep managing client

assets generation after generation.

This strategy also helps clients remember her when they come into a good amount of money.

"When people sell real estate or a business, that's both a charitable opportunity and an opportunity to bring new assets under management," says Cogen, who also provides consulting services to other advisors.

Orchestrating a multigenerational giving plan increases the chances that younger family members will bring her their business before they inherit any money from their relatives.

Cogen estimates that the planners she works with are keeping between 60% and 80% of their second-generation clients.

Rethink Fees

The traditional method of charging clients a percentage of assets under management is in flux, and innovative advisors are offering a menu of à la carte services and payment options.



Ian Bloom has found success by offering three service models. "We work together for a year on everything in a client's life that has a dollar sign in front of it for \$2,400 to \$6,000 a year," he says. The owner of Open World Financial Life Planning in Raleigh, North Carolina, takes half up front and bills the other half monthly. Clients can get a more limited project done for an hourly fee, and managing assets costs 75 to 100 basis points of AUM.



Ben Smith, who founded Cove Financial Planning in Milwaukee, charges a monthly fee for clients with less than \$250,000 in assets under management. "I've found that the traditional AUM-only fee structure limits access to people who may be high-income earners, but have not yet accumulated a sizable investment account," he says. "Before I started this firm, I was at a large RIA with a strict \$1 million asset minimum. I turned away a lot of people."



Colin Overweg, CEO of Advize Wealth Management in Grand Rapids, Michigan, has a blended fee formula: a percentage of AUM and fees must total a minimum of \$1,800 a year. "Being able to work with not only retirees but also with young people in the accumulation phase has really helped me grow my practice," Overweg says. In the first seven months of 2019, Overweg added nine client households paying an average fee of \$2,400. **FP**

Ingrid Case, a Financial Planning contributing writer in Minneapolis, is a former senior editor for Bloomberg Markets magazine. Follow her on Twitter at @CaseIngrid.

Halting Disbursements

To prevent elder fraud in a client account, advisors need to pay close attention to certain red flags.

By Alan J. Foxman

Q: May a member place a temporary hold on a securities transaction pursuant to Rule 2165?

A: FINRA Rule 2165 was a response to the growing concern of senior investors being defrauded. It's a fairly recent rule, approved by the SEC in 2017 and effective since February 2018.

Under the rule, a broker-dealer may place a temporary hold on the disbursement of funds or securities from certain clients' accounts under certain conditions.

It only applies to accounts of "specified adults" — individuals age 65 and older, or individuals age 18 and older who the broker-dealer "reasonably believes [have] a mental or physical impairment that renders the individual unable to protect his or her own interests."

For those specified adults, the member firm can place the temporary hold if the firm "reasonably believes that financial exploitation of the specified adult has occurred, is occurring, has been

attempted or will be attempted;" and, within two business days, the member firm notifies (i) all authorized parties on the account (unless a party is unavailable or the member firm reasonably believes that the party is the one involved in the financial exploitation; and (ii) the trusted contact person(s) (See rule 4512), (unless, again, the trusted contact person is unavailable or the broker-dealer reasonably believes they're involved in the financial exploitation).

The rule requires the broker-dealer to immediately initiate an internal review of the facts that caused the member firm to believe that there is (or will be) financial exploitation of the specified adult. The temporary hold is only good for 15 business days unless extended by a regulator or a court. Depending on the results of the member firm's investigation, the firm may also extend the hold for another 10 business days.

How do you know if you should bring an issue up to compliance with a recommendation that your firm place a hold on the disbursement? The ramifications of doing so when a hold wasn't warranted, or not placing a hold when one was needed, can have equally damaging results. Some red flags to watch out for include, but are not limited to:

- Sudden reluctance to discuss financial matters.
- Sudden, atypical or unexplained withdrawals or other changes in financial situation.

- Abrupt changes in wills, trusts, or power of attorney.
- Changes in beneficiaries on insurance policies or IRAs.
- Increasing lack of contact with, and lack of interest in the outside world.
- Admission of financial or material exploitation or suspected exploitation.
- Concern or confusion about missing funds in account.
- Unusual or first-time wire transfers, especially to foreign countries.
- Fear of eviction or nursing home placement if money is not given to a caretaker.
- Appearance of insufficient care despite having money.
- Reluctance to discuss or disclose the reason for the disbursement in front of a caretaker, especially if the caretaker is reluctant to leave the client alone.

Any one of these red flags alone may not, in and of itself, be reason to place a hold on an account, but taken in context of a particular client, or combined with other factors, they may be valid reasons to at least bring the matter to your compliance department. **FP**

Alan J. Foxman is a managing director at Fore-side Financial Group in Delray Beach, Florida.



Ramifications of placing a hold when not warranted, or not doing so when needed, can have equally damaging results.



Betterment has launched a savings account with a higher annual percentage yield than some of its competitors.

Robo Rivalry Revived

Longtime competitors Betterment and Wealthfront are going toe-to-toe again with new banking offers.

By Sean Allocca

One of the robo advice industry's fiercest rivalries is back in full force.

The push for bigger client wallet share among digital advice players has resulted in almost every brand offer checking and savings accounts in recent months.

No firm, though, has been more eager than Wealthfront, which raised the interest rate on its cash account three times after its February launch, to 2.57%.

Some competing banks in that time lowered the rates on their accounts, a point Wealthfront blogged about. (It later reduced the APY to 2.32% after the Fed's

July rate cut.)

The Silicon Valley-based robo continued that in-your-face tone as it advertised its account as the highest yielding in the market, as well as touting that it had attracted \$1 billion in assets as a result.

But now the high-yield bragging rights go its longtime New York-based digital rival Betterment, which launched a new suite of banking services, including a savings account with a 2.69% APY rate and a checking account with no account fees, overdraft fees, minimum balances or monthly maintenance fees, according to

the firm.

(The rate applies only to money deposited this year. Otherwise, Betterment's rate is 2.42%.)

Wealthfront was less than charitable. "It's disappointing to see Betterment play a bait-and-switch game that you'd expect from the traditional industry — offering a short-term promotional rate to lure new customers," a spokeswoman, Kate Wauck, said in a statement. "The new entrants in this space have to push the industry to do better than the same old tactics. It's why we exist, and we cannot lose sight of that."

"It's disappointing to see Betterment play a bait-and-switch game," says Wealthfront's Kate Wauck.

Betterment responded with a critique of Wealthfront's risk parity fund, which when the product launched automatically opted in client accounts worth more than \$100,000. Wealthfront maintains it has since stopped the practice and customers join the fund only if they choose.

"It seems implausible that a company would claim any sort of moral high ground while at the same time forcing customers into a heavily conflicted proprietary product," said

Joe Ziemer, who is Betterment's vice president of communications.

Betterment has stated its promotional rate will run through the end of the year. Wauck said Wealthfront's account rate was not a promotion.

The testy exchange was reminiscent of the early years for both digital-first firms, when they would trade public critiques. That dialogue lessened as the two companies diverged in models, with Wealthfront choosing to remain a pure automated advisor, while Betterment branched into hybrid robo advice and institutional offerings.

Betterment's chief technology officer, Michael Reust, says competitors' launches of cash products in recent months did not prompt on Betterment's decision to offer its own checking and savings account, known as Betterment Everyday.

"We were really looking at the needs of our own customers," he says. "However, we will be driving a much better rate than Wealthfront."

The Betterment Everyday savings app is available to all of Betterment's 500,000 clients as will be the checking account, expected to go online in September. Customers also receive a Visa-branded debit card issued by Nbc bank, a community bank based in Kansas City, Missouri, which has



Wealthfront offered one of the highest interest rates on its savings account in the industry and amassed \$1 billion in client assets in less than a month, according to CEO Andy Rachleff.

carved out a niche using multiple partnerships with fintechs, including Joust and Truebill.

"The biggest challenge for Americans when it comes to their money is saving for the future, and, unfortunately, a majority of the traditional banks they depend on charge extra fees, encourage cash-holding and upsell unnecessary products," Betterment CEO Jon Stein said in a statement. "Right now, it's nearly impossible to find a banking solution that has its customers' best interests at heart."

The testy exchange was reminiscent of the early years for both digital-first firms, when they would trade public critiques.

Funds transferred from checking accounts will move within one or two business days, while transfers from brokerage accounts generally take around five business days, Reust says. Betterment, which manages approximately \$18 billion in client assets, will also reimburse fees on ATMs nationally and internationally.

The move comes as Betterment's largest competitors have spread a buffet of services for its clients blending both banking and investment needs.

In addition to Wealthfront, Carson Wealth, Personal Capital, SoFi, Ally Bank and Marcus by Goldman Sachs have all launched products that are intended to encourage clients to store more of their assets on their respective platforms.

Carson Wealth, through a partnership with the digital banking provider Galileo, was one of the first big advisory firms to start offering checking accounts with direct deposit options and access to tens of thousands of ATMs. Carson's RIA clients

will now have access to offerings that include a Mastercard-branded debit card, online bill pay, mobile check deposit and ACH transfers.

Betterment launched a product in December called Smart Saver, which was designed to give clients a way to store cash in low-risk investment vehicles like high-yield government or corporate securities, Reust says. He expects most clients will now switch to the Betterment Everyday option.

William Brancaccio, co-founder of Rightirement Wealth Partners in Harrison, New York, says he expects products with such options to be well-received. "Most clients that choose to work with an RIA firm [do so] for transparency and to have someone independent of the [wirehouse] firms that might push certain products," he says. "Offering clients a transparent banking option that increases the interest rate when interest rates increase is a nice option to have."

Betterment partnered with five banks to offer the savings accounts services: Citi, Barclays, Valley National Bank, Seaside National Bank and Georgia Banking Company. Nbc bank will provide the checking account services.

While Brancaccio does not have clients interested in opening up a bank account through his RIA, the higher interest rates could prove a good option for clients with high balance emergency funds that are earning next to nothing in their traditional accounts.

However, the lure of banking accounts will ultimately be limited, Brancaccio says.

"A number of clients have several different bank accounts for various reasons," he says. "Replacing all of them to have everything under one roof is unlikely." **FP**

Sean Allocca is an associate editor of Financial Planning. Follow him on Twitter at @sjallocca.

Robo Advisors Defy the Pessimists

Although they were first written off by industry experts, independent digital-first firms now hold billions in assets.

By Sean Allocca

It wasn't very long ago that the diagnosis for most independent hybrids and robo advisors was terminal. But thanks to client asset infusions, a number are managing to thrive.

Personal Capital is the latest digital-first wealth manager to garner \$10 billion in assets under management — joining Betterment and Wealthfront as the third online independent to pass that milestone.

The firm, based in Redwood City, California, offers free planning software, with a goal to upgrade prospective clients with more than \$100,000 in investable assets to premium products. Assets have ballooned 60% since the fourth quarter of 2018, taking in \$2 billion, according to the company.

While the results are impressive, assets in the digital independent channel still pale compared with those managed by the largest incumbents.

Vanguard's Personal Advisor Services claims upward of \$105 billion, although competing incumbent offerings, like Schwab's Intelligent Portfolios, may soon take the top position.

Discount brokerages are expected to be the dominant force by 2023, with almost half of all digital assets, according to a report by Aite Group.

"It is a nice milestone for Personal Capital," says Joel Bruckenstein, the founder of the technology conference T3. However, the business model might be susceptible to newcomers. "I don't see a lot of proprietary [tech] there that can't be replicated," he says.

The disappearance of some upstarts is still reason for caution. Most robo operations that closed in recent months were startups, according to the Aite Group's research.

"It's clear that the hybrid model really rules the day, with Fidelity and Van-

guard in the lead," says William Trout, head of wealth management at Celent.

The robo advisory space may become large enough to support dozens of competitors with differing business models if analysts are right about its future growth. In total, assets managed on digital platforms are expected to soar to \$1.26 trillion by 2023, according to Aite Group.

And as the automated investment channel becomes more crowded and commoditized, robo advisors are getting creative with new offerings.

In total, assets managed on digital platforms are expected to soar to \$1.26 trillion by 2023, according to Aite Group.

Carson Wealth teamed up with a digital banking provider to offer checking accounts with direct deposit options and access to tens of thousands of ATMs.

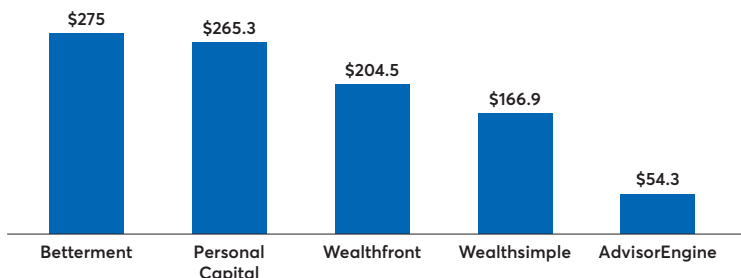
Personal Capital landed \$50 million in new funding in February and promptly expanded its marketing department and opened up offices in other geographic locations.

So will the majority of robo advisors eventually close their doors or will they attract enough funding from investors to eventually become profitable?

"The [independents] are going to stick around," Trout says. "Whether to compete or to be bought out is still to be determined." **FP**

Investing in Robos

Betterment and Personal Capital have raised the most funding of the independent robo advisors, in millions.



Source: Crunchbase

Sean Allocca is an associate editor of Financial Planning. Follow him on Twitter at @sjallocca.



Roth Conversions Can Escalate Capital Gains Taxes

If not addressed, they may see a higher tax bill than was planned. That won't go over well at tax time next year.

By Ed Slott

Can a Roth conversion affect the taxation of long-term capital gains?

Yes. Significantly.

That's because Roth conversion income, like all other ordinary income, reduces the benefit of the LTCG rates, increasing the overall tax cost of the conversion.

This interplay can easily throw off even the best tax projections, especially when they rely on low (or even 0%) LTCG rates stated in the Tax Code.

When there is additional ordinary income, such as Roth conversion income, those

favorable tax brackets are not as attractive as they appear to be.

As Roth conversions cannot be undone anymore — the tax law changes eliminated recharacterization of Roth IRA conversions beginning in 2018 — advisors should be careful to do an accurate projection of the tax effect of a Roth conversion. The tax will have to be paid. But the permanency of a Roth conversion does not mean these conversions should be avoided. Roth IRAs still offer long-term tax benefits — mainly tax-free growth and no lifetime required

minimum distributions, allowing more tax-free accumulation and a hedge against future tax increases.

The permanency of a Roth IRA conversion does not mean it should be avoided.

In fact, if IRA funds are not converted, eventually they will be subject to RMDs, and those RMDs will similarly cause an increase in capital gains taxes — and at possibly higher future tax rates. That's why Roth conversions should still be seriously considered while today's tax rates are at historic lows.

Accurate Projections

However, the tax cost of the conversion needs to be more accurately projected, because the tax due cannot be reversed.

Planners and tax advisors should evaluate additional so-called stealth taxes triggered when income is increased by a Roth conversion. Stealth taxes are other indirect tax increases that occur whenever income is increased.

Some of these stealth-type tax increases result from the increase in AGI from a Roth IRA conversion.

AGI is a key amount on the tax return, and an increase can cause the loss of valuable tax deductions, credits and other benefits.

Client

These well-known items include medical deductions; additional taxes on Social Security benefits and Medicare surcharges; education-related tax benefits (and financial aid eligibility); child tax credits; deductible real estate losses; Roth and IRA contribution limitations; and the new (as of 2018) 20% deduction for qualified business income.

The Stealth Increase Factor

These stealth increases add to the tax bill for a Roth conversion.

But Roth conversions can also substantially increase the tax on long-term capital gains.

Our tax system taxes ordinary income first. This means that ordinary income reduces the benefits of the lower capital gains.

These very favorable LTCG rates generally apply to capital assets held for more than one year. The rates have been made more attractive by the tax law change.

For example, the rate is 0% for capital gains of up to \$78,750 for a married couple filing jointly. But a Roth conversion can reduce or even eliminate the benefits of these zero capital gains rates.

This is something that is not widely

noticed until it is seen on the completed tax return, when, of course, it is too late to change.

Capital gains should be added to the list of stealth taxes to be considered when projecting the true overall tax cost of a Roth conversion.

Ordinary Income

Roth IRA conversion income is ordinary income and is taxed the same as wages, pensions and other IRA distributions and short-term capital gains.

Our tax system taxes ordinary income first, and then capital gains.

In its simplest form, a \$100,000 Roth conversion could completely eliminate the 0% capital gain rate bracket, pushing more of the capital gains into the higher brackets of up to 20%, or 23.8% if the 3.8% tax on net investment income is triggered

Consider this example: A married couple filing jointly has no income other than a \$100,000 LTCG. As of now, they will owe zero tax.

The LTCG of \$100,000 is first reduced by the standard deduction (assuming that both spouses are under age 65) of \$24,400, resulting in a net LTCG of \$75,600, which is under the \$78,750 limit for the 0% rate, so no tax will be owed.

Now let's add a \$50,000 Roth conversion. That will increase the tax on the LTCG from zero dollars to \$7,028. The tax on the Roth conversion is only \$2,684, but the total tax bill will be \$9,712.

The \$50,000 Roth conversion (or any other additional ordinary income) will get taxed first using the ordinary income tax brackets.

In its simplest form, a \$100,000 Roth conversion could completely eliminate the 0% capital gain rate bracket.

The \$50,000 Roth conversion (assuming this is the only other income) will be first reduced by the 2019 standard deduction of \$24,400, leaving taxable ordinary income of \$25,600, and that amount reduces the 0% capital gains bracket available for the \$100,000 LTCG.

Doing the Math

The \$25,600 is taxed using the regular tax brackets, so that tax is \$2,684.

Here's the math for this conversion if you'd like to follow along :

$$\begin{array}{r} \$19,400 \text{ at } 10\% = \$1,940 \\ \underline{6,200 \text{ at } 12\% = 744} \\ \$25,600 \qquad \qquad \$2,684 \end{array}$$

The \$100,000 LTCG tax now goes from zero to \$7,028.

That's a substantial — and often unexpected — increase.

The benefit of the zero to \$78,750 LTCG bracket is reduced by \$25,600, which was taxed at ordinary income tax rates, so only \$53,150 is being taxed at 0% (the \$78,750 less the \$25,600 = \$53,150).

The remaining \$46,850 of the \$100,000 LTCG is now being pushed into the 15% LTCG bracket, and the tax on that \$46,850 x 15% = \$7,028.

$$\begin{array}{r} \$53,150 \text{ at } 0\% = \$0 \\ \underline{46,850 \text{ at } 15\% = 7,028} \\ \$100,000 \qquad \qquad \$7,028 \end{array}$$

Long-Term Capital Gains and Qualified Dividends Tax

| Long-Term Capital Gains Rate | Married Filing Joint | Single |
|------------------------------|----------------------|----------------------|
| 0% | \$0 – \$78,750 | \$0 – \$39,375 |
| 15%* | \$78,751 – \$488,850 | \$39,376 – \$434,550 |
| 20%** | Over \$488,850 | Over \$434,550 |

*Taxpayers in the 15% LTCG tax bracket with MAGI over their 3.8% threshold (\$250,000 joint filers/\$200,000 single filers) will pay an effective rate of 18.8%.

**The top rate is effectively 23.8% for those subject to the 3.8% Medicare surtax on net investment income.

Source: IRS data; analysis by Ed Slott & Co

Bottom line: In this simple example, the \$50,000 Roth conversion was not only subject to its own ordinary income tax of \$2,684, but it also triggered a \$7,028 tax on the LTCG that, without the Roth conversion, would have incurred zero tax.

That's important information for a client, especially with larger amounts at stake than in this simple example.

Now let's say we make a change to the example by adding a Roth conversion of \$120,000 to the client's LTCG of \$100,000.

In some cases where there is a large capital gain, the tax rate on the capital gain could exceed the tax rate on the Roth conversion.

The \$120,000 Roth conversion eliminates the entire benefit of the 0% LTCG bracket, triggering a LTCG tax of \$15,000 — all at 15%, and none at 0% on a LTCG that, without the Roth conversion, would have incurred zero tax. In addition, there will be a tax of \$12,749 on the Roth conversion, for a total tax bill of \$27,749.

The 3.8% Tax Effect

If the income from the Roth conversion goes even higher, in addition to an increased tax on the LTCG, it could trigger the 3.8% tax on net investment income, resulting in a capital gain tax of 18.8% or even 23.8%.

In fact, in some cases where there is a large capital gain, the tax rate on the capital gain could exceed the tax rate on the Roth conversion, adding to the tax cost of the conversion.

The Roth conversion income itself is not subject to the 3.8% tax, because it is not treated as investment income for this tax calculation.

However, it can increase MAGI to the point where the 3.8% tax can apply to investment income like the LTCG or interest and dividend income.

Taxable Income Brackets for Ordinary Income Tax Rates

| Marginal Tax Rate | Married Filing Joint | Single |
|-------------------|-----------------------|-----------------------|
| 10 | \$0 – \$19,400 | \$0 – \$9,700 |
| 12 | \$19,401 – \$78,950 | \$9,701 – \$39,475 |
| 22 | \$78,951 – \$168,400 | \$39,476 – \$84,200 |
| 24 | \$168,401 – \$321,450 | \$84,201 – \$160,725 |
| 32 | \$321,451 – \$408,200 | \$160,726 – \$204,100 |
| 35 | \$408,201 – \$612,350 | \$204,101 – \$510,300 |
| 37 | Over \$612,350 | Over \$510,300 |

Note: The top rate is effectively 40.8% for those subject to the 3.8% Medicare surtax on net investment income.

Source: IRS data; analysis by Ed Slott & Co.

That, too, must be factored in when higher-income clients with capital gains are considering a Roth conversion.

Reverse Tax Benefit

The tax effect works in reverse as well to the taxpayer's benefit.

While additional income, such as a Roth conversion income, will increase the LTCG tax, reductions in income — for instance, making or increasing a pre-tax 401(k) contribution or deductible business losses — will reduce both the tax on the Roth conversion and on the LTCG.

All these examples are assuming the taxpayer is using the standard deduction, which, under the current tax law, many more taxpayers are.

If instead, the taxpayer had large enough deductions to itemize, that would obviously lower the tax cost of the Roth conversion.

However, this would also lessen the tax impact on LTCGs, allowing more of the LTCG to be taxed at lower brackets.

Remember that the Roth conversion, once done, cannot be undone.

Tax projections must be accurate

and take numerous related stealth taxes into account, including LTCGs.

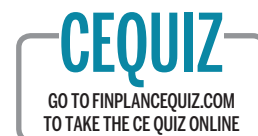
Don't Wait Until It's Too Late

All of these tax calculations happen automatically on the tax return, but by the time the tax return is prepared the following year and the actual tax impact is seen, it's too late to make any changes.

Tax planning programs can be a big help in these cases, because the actual tax return preparation programs won't be available until early next year.

By this time, it would be too late to deliver the news to clients. Advisors should work to prevent this from happening, so their clients don't get a nasty surprise next year. **FP**

Ed Slott, a CPA in Rockville Centre, New York, is a Financial Planning contributing writer and an IRA distribution expert, professional speaker and author of several books on IRAs. Follow him on Twitter at @theslottreport.



Portfolio

ALSO IN PORTFOLIO: A LOOK AT LEVERAGE IN CLOSED-END FUNDS, P. 53



The Hunt for Income

Retirement lineup: How did these six funds fare when put to the test?

By Craig L. Israelsen

Is your client looking for a mutual fund that specializes in producing retirement income? Such funds can be beneficial, but they aren't miracle workers.

Consider this analysis of six different funds that could be options for your retirement-income seeking clients; two are from Fidelity, three from Schwab and one from Vanguard. In addition, we'll consider how three traditional indexes fared when put to use as a retirement income vehicle: 90-day T-bills (aka cash), a traditional 60% stock/40% bond portfolio and the S&P 500.

As shown in "Retirement Lineup," the six

retirement income funds are highlighted in green, starting with Fidelity Managed Retirement Income (FIRMX), followed by Schwab Monthly Income Maximum Payout (SWLRX), Schwab Monthly Income Enhanced Payout (SWKRX), Fidelity Simplicity RMD 2020 (FIRWX), Vanguard Managed Payout Investor (VPGDX) and Schwab Monthly Income Moderate Payout (SWJRX).

There are other funds in this category, but these six provide a reasonable sample of what's available.

The common performance history among these funds dates back to June 2008. Thus,

the analysis of these funds spans the 11 years from June 1, 2008, through May 31, 2019. As can be seen, the only fund in this analysis that has amassed a meaningful amount of assets is Vanguard Managed Payout Investor (with \$1.7 billion). Based on asset accumulation, the demonstrated interest in retirement payout funds is tepid at best.

The three comparison indexes consist of 90-day Treasury bills, a 60/40 portfolio consisting of 60% S&P 500 and 40% Barclays Aggregate Bond Index and the S&P 500.

The listing of the six funds and three indexes in "Retirement Lineup" is based on allocation to U.S. equity — from low to high.

The six funds in this analysis had equity allocations ranging from about 18% to 63% (combining U.S. equity and non-U.S. equity).

The six funds and three indexes were subjected to an 11-year withdrawal stress test in which each was assigned a starting balance of \$250,000 on June 1, 2008.

For the next 11 years, each fund had 0.333% of its balance withdrawn at the end of every month.

This monthly withdrawal rate equates to an annual withdrawal of 4%. Admittedly, this particular analysis period provided a severe test, because it started in

mid-2008, at the height of the global financial crisis.

An Impressive Performance

Shown in "Retirement Stress Test" are the results of the analysis. The average ending balance among the six funds ranged from \$234,642 (SWLRX) to \$292,446 (FIRWX). The important takeaway is that all but one of the funds finished this challenging period with a balance exceeding \$250,000.

That's impressive. By comparison, 90-day T-bills had an ending balance of \$169,750. In short, an all-cash retirement portfolio simply won't get the job done for most retirees.

On the other end of the spectrum, the 60/40 portfolio finished with

\$341,460, and the S&P 500 ended the analysis with \$401,313.

Thus, if judging the six funds on the basis of ending portfolio balance at the conclusion of the test period, they were dominated by the 60/40 portfolio and the 100% S&P 500. All the funds performed considerably better than having the \$250,000 entirely in cash.

The average monthly withdrawal for the six funds ranged from \$802 to \$849. The highest average of \$849 was achieved by FIRWX, whereas the lowest average of \$802 was experienced by VPGDX.

Perhaps a more important consideration is the range between maximum and minimum monthly withdrawal. Consistency of monthly withdrawal is

undoubtedly what many retirees seek. The clear consistency winner was SWLRX. While its average monthly payout of \$813 ranked it 5th out of the six funds, the range of monthly payout was \$848 to \$744, which is very narrow. Both FIRMX and SWLRX had equity allocations of roughly 17%, yet SWLRX had a considerably smaller range in the monthly withdrawal amount.

Narrow Ranges

Interestingly, the high to low range of monthly withdrawals for SWLRX was even more narrow than cash.

By comparison, FIRWX had the highest average monthly payout, but the retiree experienced a range of monthly withdrawals that went from a

Retirement Lineup

| Fund | Ticker | Assets (\$ in millions) | Expense Ratio % | Allocation U.S. Stocks % | Allocation Non-U.S. Stocks % | Allocation U.S. Bonds % | Allocation Non-U.S. Bonds % | Allocation Cash % |
|---|--------|-------------------------|-----------------|--------------------------|------------------------------|-------------------------|-----------------------------|-------------------|
| 90-day Treasury bill (cash) | ---- | ---- | ---- | 0 | 0 | 0 | 0 | 100 |
| Fidelity Managed Retirement Income | FIRMX | 6 | 0.45 | 7.7 | 9.54 | 59.75 | 4.18 | 18.55 |
| Schwab Monthly Income Maximum Payout | SWLRX | 44 | 0.21 | 12.09 | 5.79 | 72.43 | 5.72 | 3.78 |
| Schwab Monthly Income Enhanced Payout | SWKRX | 78 | 0.35 | 22.19 | 10.45 | 58.66 | 4.63 | 3.91 |
| Fidelity Simplicity RMD 2020 | FIRWX | 39 | 0.61 | 24.97 | 20.45 | 36.37 | 3.53 | 14.21 |
| Vanguard Managed Payout Investor | VPGDX | 1,745 | 0.32 | 30.32 | 33.05 | 12.71 | 6.79 | 9.1 |
| Schwab Monthly Income Moderate Payout | SWJRX | 42 | 0.5 | 32.3 | 15.22 | 45.21 | 3.57 | 3.57 |
| 60% S&P 500 / 40% Barclays Aggregate Bond Index | ---- | ---- | ---- | 59 | 1 | 40 | 0 | 0 |
| S&P 500 | ---- | ---- | ---- | 99 | 1 | 0 | 0 | 0 |

Data as of 6/1/2019

Source: Steele Mutual Fund Expert, analysis by author

Special Report: Retirement Planning

paltry \$514 to \$1,040.

So what's the best way to structure a portfolio that needs to produce retirement income?

Of course, there is no absolute answer to that question. There are surely a number of wise approaches for your clients.

A Blended Portfolio

One logical course of action is to build a blended retirement portfolio that has a number of different components. One component could be cash, often in the form of a money market fund, or simply a savings account.

An allocation of 20% to cash is reasonable. Then, add a retirement income fund to the mix, with an allocation of 30% of the total retirement account assets.

The remaining 50% could be committed to an all-equity fund, or to a fund that has a majority in equity (such

as a 60/40 balanced fund).

This approach allows the retiree to withdraw money from the cash fund when the equity-based funds have a decline (such as in 2008). If this looks like the so-called bucket approach, that's because it is.

There may also be a less visible advantage to utilizing a retirement income fund, which is often a conglomerate of funds within a particular fund family.

For example, VPGDX is made of up 10 Vanguard funds.

Of those 10 funds, two have initial investment requirements of \$250,000, making them unavailable to the average retiree.

Those two funds are Vanguard Market Neutral (VMNFX) and Vanguard Alternative Strategies (VASFX).

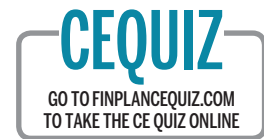
Another fund that is embedded into VPGDX is the Vanguard Commodity Strategy Fund (VCMDX), which has a

minimum of \$50,000 — also a tough hurdle for many retirees.

Thus, the prepackaged retirement income fund gives easy access — in some cases — to funds that would otherwise be unavailable to a typical retiree client.

In summary, it's clear from this analysis that retirement income funds offer no magic bullet for clients. However, they likely deserve a place in a client's overall retirement income portfolio. **FP**

Craig L. Israelsen, Ph.D., a Financial Planning contributing writer in Springville, Utah, is an executive in residence in the personal financial planning program at the Woodbury School of Business at Utah Valley University. He is also the developer of the 7Twelve portfolio.



Retirement Stress Test

| Fund | Ticker | Ending Balance After 11 Years (\$) | Average Monthly Withdrawal (\$) | Maximum Monthly Withdrawal (\$) | Minimum Monthly Withdrawal (\$) |
|---|--------|------------------------------------|---------------------------------|---------------------------------|---------------------------------|
| 90-day Treasury Bill (cash) | ---- | 169,750 | 684 | 833 | 566 |
| Fidelity Managed Retirement Income | FIRMX | 257,063 | 818 | 893 | 577 |
| Schwab Monthly Income Maximum Payout | SWLRX | 234,642 | 813 | 848 | 744 |
| Schwab Monthly Income Enhanced Payout | SWKRX | 250,320 | 830 | 881 | 682 |
| Fidelity Simplicity RMD 2020 | FIRWX | 292,446 | 849 | 1,040 | 514 |
| Vanguard Managed Payout Investor | VPGDX | 266,119 | 802 | 965 | 502 |
| Schwab Monthly Income Moderate Payout | SWJRX | 260,264 | 833 | 924 | 624 |
| 60% S&P 500 / 40% Barclays Aggregate Bond Index | ---- | 341,460 | 915 | 1,178 | 566 |
| S&P 500 | ---- | 401,313 | 936 | 1,435 | 432 |

6/1/2008-5/31/2019. Assuming \$250,000 starting balance; monthly withdrawal rate was 0.333% of portfolio balance (equal to 4% annual withdrawal rate)

Source: Steele Mutual Fund Expert, analysis by author

Portfolio



Closed-End Funds: A Close Look at Leverage

There's volatility but also potential long-term gains for clients.

By Donald Jay Korn

When it comes to closed-end funds, clients need a stomach for volatility — and a good dose of patience.

That's because these investments have characteristics that can be unsettling.

For one, many CEFs trade at moving premiums or discounts to net asset value, a factor that can significantly impact shareholders' returns.

Another, perhaps more important, wrinkle is CEFs' widespread use of leverage. At the end of 2018, at least 332 funds (nearly two-thirds of closed-end funds) were using some type of leverage, according to the Investment Company Institute.

"Leverage in a CEF magnifies both income and the volatility of the fund's NAV over time," says John Cole Scott, chief investment officer at Closed-End Fund Advisors, a data, research and investment management firm in Richmond, Virginia. Still, Scott adds, "as long as the cost of leverage is less than the added income from buying more investments, the leverage is positively additive to returns."

Structural Leverage

Leverage, for a CEF, may not always be comparable to using a mortgage for buying a home. These funds may use structural

leverage, which is generally created through borrowing money or issuing preferred shares, according to the Nuveen website CEF Connect. Alternatively, portfolio leverage is created through certain derivative instruments, including tender option bonds, non-deliverable forward contracts and total return swaps.

This extensive list might seem to indicate a no-holds-barred approach to CEF leverage, but there are regulatory limits. For example, a CEF must have at least \$3 in assets for every \$1 borrowed (300% ratio) and at least 200% asset coverage for every dollar raised by sales of preferred stock.

Leverage, for a CEF, may not always be comparable to using a mortgage for buying a home.

"If a fund violates these minimums, it won't be allowed to pay dividends to common shareholders until it sells down debt or preferred stock," says Tom Roseen, head of research services at Lipper.

Many leveraged CEFs maintain a cushion to avoid going over the relevant limit. "However, if we have a market event that turns the markets south, the higher the leverage, the higher the likelihood that the asset coverage test will be

Portfolio

breached," says Roseen.

"The manager may be forced to deleverage before being allowed to pay out a dividend to ordinary shareholders," he adds. Lenders and preferred shareholders must be paid first.

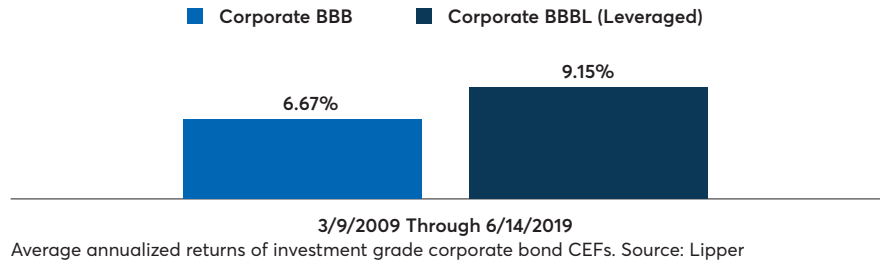
Deleveraging in such a situation may reduce risk to clients. On the other hand, lower leverage will decrease returns in any subsequent rebound.

Given all the possible moving parts, how might advisors approach the idea of using leveraged CEFs? Checking results during good times and bad could be instructive. Looking at the 2008 market crash and the 2009 recovery, for example, you can see returns for CEFs holding investment-grade corporate bonds. (See "Bouncing Bonds")

Deleveraging in downturns may reduce risk to clients. On the other hand, lower leverage will decrease returns in a rebound.

This data shows leveraged CEFs can be much more volatile than unleveraged entries: Larger losses in a bear market, larger gains in the following bounce-back. The steeper losses made it more difficult to regain lost ground. In this two-year period, over 2008 and 2009, the unleveraged fund category had a positive return of around 11%,

Patience Pays Off



versus about 8% for its leveraged cousins.

But the long-term results tell another story: "If an investor had a thick skin and could deal with the huge swings, this leveraged group would have produced better returns from what many consider the financial crisis market bottom," says Roseen.

These numbers are from one section of the CEF universe, during a chosen time frame, but they indicate that investors in leveraged funds can do better if they're willing to make long-term commitments.

Boosting Yields

If advisors conclude that leveraged CEFs are appealing for certain clients, how can they get their message across?

"Advisors can tell clients that a given fund can access cheap leverage in order to fuel higher yields, which is the most

common application," says Scott. Thus, CEFs can pay more to investors without the need to pick higher-yielding — and generally riskier — investments.

Checking results during good times and bad could be instructive in approaching the idea of using leveraged CEFs.

Scott contends that what his firm calls leverage-adjusted NAV yield generally is appreciably higher than what investors receive from non-leveraged choices.

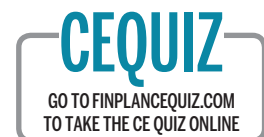
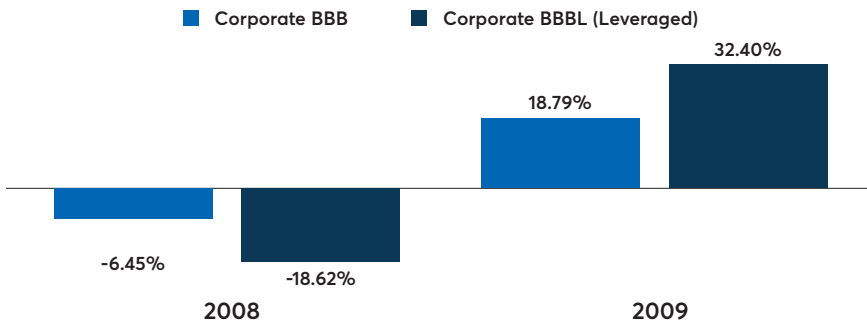
"Our analysis has found that leveraged municipal CEFs get an extra 1%+ of yield, taxable bond & REIT CEFs get 2%+, MLP CEFs get 3%+ and BDCs get 4%+," he says.

The use of leverage is a "minor risk," in his view, because most funds have good leverage management.

With hundreds of leveraged CEFs to choose among, advisors can look into past performance, in good times and bad, to see which CEFs really have managed leverage well and delivered higher payouts to common shareholders. **FP**

Donald Jay Korn is a contributing writer for Financial Planning in New York.

Bouncing Bonds



This article was originally published as part of a special editorial series on closed-end funds sponsored by Nuveen. For the full package, please see: financial-planning.com/news/closed-end-funds-from-all-angles.

CE Quiz

VISIT FINPLANCEQUIZ.COM TO TAKE FINANCIAL PLANNING'S CE QUIZ.

From: The Hunt for Income

1. Which of these funds, from June 1, 2008, through May 31, 2019, had the most favorable ending balance after starting with \$250,000 and having 0.333% of its balance withdrawn at the end of every month?

1. Schwab Monthly Income Maximum Payout (SWLRX)
2. Vanguard Managed Payout Investor (VPGDX)
3. Fidelity Simplicity RMD 2020 (FIRWX)
4. Schwab Monthly Income Moderate Payout (SWJRX)

2. During this same time period, which of these funds had the least favorable amount in the minimum monthly withdrawal category?

1. Vanguard Managed Payout Investor (VPGDX)
2. Schwab Monthly Income Enhanced Payout (SWKRX)
3. Fidelity Simplicity RMD 2020 (FIRWX)
4. Fidelity Managed Retirement Income (FIRMX)

From: Closed-End Funds: A Close Look at Leverage

3. To pay dividends to common shareholders before selling down debt or preferred stock, a closed-end fund must have at least how much in assets for every \$1 borrowed?

1. \$2
2. \$4
3. \$3
4. \$5

4. For the same scenario, what is the percentage of asset coverage a closed-end fund must have for every dollar raised by sales of preferred stock?

1. 100%
2. 150%
3. 300%
4. 200%

5. From March 2009 to June 2019, what was the average of annualized total returns for corporate BBB leveraged funds as compared to corporate BBB unleveraged funds?

1. 9.15% versus 6.67%
2. 6.67% versus 9.15%
3. 18.79% versus 32.40%
4. 32.40% versus 18.79%

From: Untangle Health Care Costs

6. For a client to be able to qualify for subsidies to help

pay for individual health insurance coverage under the Affordable Care Act, what income level applies?

1. Less than 200% of the poverty level
2. Less than 400% of the poverty level
3. Less than 300% of the poverty level
4. Less than 250% of the poverty level

From: Halting Disbursements

7. Under which rule, approved by the SEC in 2017, may a broker-dealer place a temporary hold on the disbursement of funds or securities from individuals age 65 and older under certain conditions?

1. FINRA Rule 5130
2. FINRA Rule 2100
3. FINRA Rule 2165
4. FINRA Rule 6400

From: How Roth IRA Conversions Can Escalate Clients' Capital Gains Taxes

8. A married couple filing jointly in 2019 can enjoy a 0% capital gains rate with an income up to what amount?

1. \$75,780
2. \$68,780
3. \$80,000
4. \$78,750

From: The Medicare Maze

9. If you have a client turning 65 who does not have existing Medicare coverage, how much time do they have to enroll in Medicare Part B?

1. Three months until their birthday month and three months after
2. One month until their birthday month and three months after
3. Five months until their birthday month and three months after
4. Six months until their birthday month and three months after

10. What is the 2019 deductible for Medicare Part A?

1. \$1,575
2. \$1,364
3. \$2,100
4. \$850

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First Divorce, Then Lawsuit

After a harrowing year, I know something about helping clients in duress chart a course toward financial health.

By Sharon Reese

A few years ago, I thought I hit rock bottom when my former employer sued me at just about the same time my husband and I decided to get a divorce. Then my husband sued me, too.

I was beyond broke — \$160,000 in debt. After working as an institutional equity salesperson and financial advisor, as well as saving for 21 years, and being married for five, I handed over a third of my net worth to my ex-husband.

As a mom and career woman, I went from running a family out of an ultramodern house to cobbling together meals for my son and myself in a rental with a kitchen plucked from the 1950s.

While enduring the divorce process, I found myself in a waiting area at the Children's Hospital of Pittsburgh, where I had taken taking my then-5-year-old son for therapy to manage this major change. That's when I realized what it is that matters most to me: his well-being.

The wisdom gained from this hardship is now part of my practice. When I meet

clients, we talk about life first — and what's important — not portfolio strategy or retirement income.

And when a client approaches me with an obstacle, I tell them to visualize themselves on the other side of that obstacle. Think only about what you're going to gain from surmounting it, I tell them, versus what you may lose from it. That, and only that, will get us where we want to go.

My circumstances forced me to do some financial juggling, which taught me how to look at each client's unique challenges creatively. I rented a home while my husband lived in the house we had shared as a couple. We put that house on the market and I knew the proceeds of the sale would ultimately help me cover my losses incurred from legal fees, alimony, living costs and other expenses.

I chose to take a 60-day rollover from my individual retirement account for a down payment on a house. To pay the loan back without incurring a penalty, I got a loan from SoFi at 10% interest, which was lower than the IRA



interest penalty (plus tax). Then I opened eight zero-interest credit cards to absorb my mounting bills.

When a client comes to me with an obstacle, I tell them to visualize what they will gain from surmounting it.

That's when my husband sued me — and it was the first and only time I cried in this process.

My harrowing divorce gave me a new degree of respect and compassion for each client's distinctive situation. It also helped me teach them how to be resilient under moments of complete duress.

At first, I blamed myself. How could I have let the circumstances get this bad? It's in moments like these, I've learned, that we have to check ourselves. Misplaced guilt impedes progress. There is only one direction — forward.

Financially speaking, however, you may have to take a few steps back to be able to learn what's really important, and it's a point that I continually stress when speaking to clients and prospects.

Together, we've always been able to chart a course toward a better, financially sound life. **FP**

Sharon Reese is a partner and director at Snowden Lane Partners in Pittsburgh.

To submit a Selfie commentary, email fpeditor@sourcemedia.com. Post your comments online at financial-planning.com.

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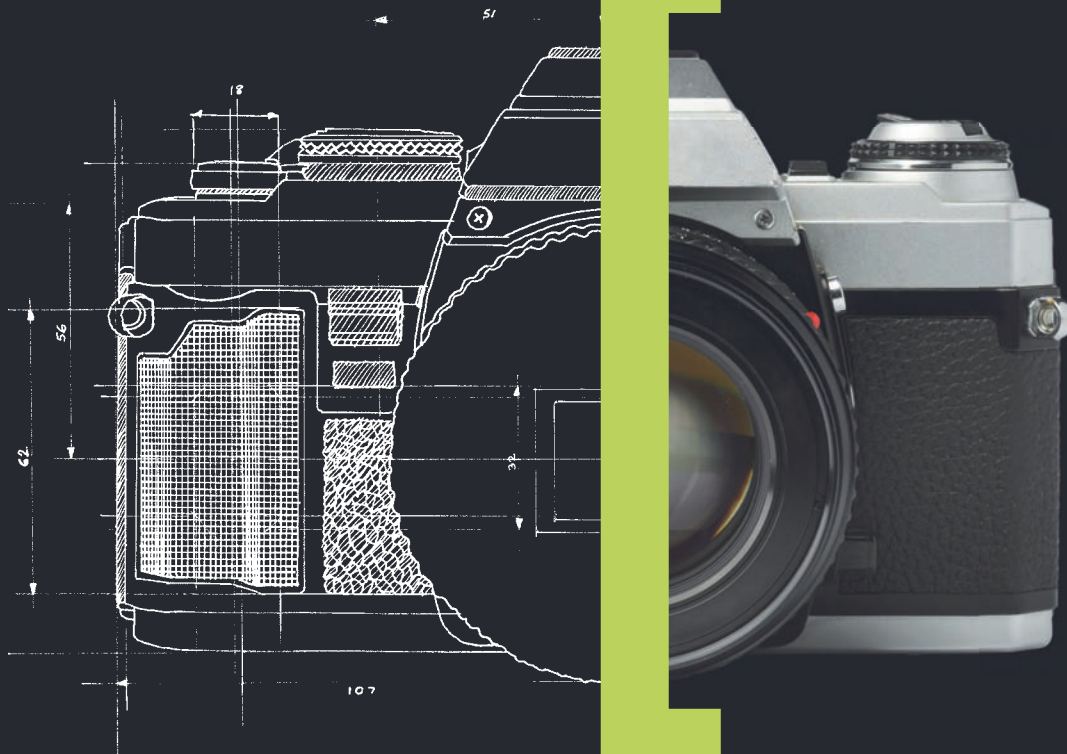
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