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The logo for DPL (Diversified Planning Limited) features the lowercase letters 'dpl' in a white, sans-serif font, enclosed within a white square border that has a slight 3D effect.

The power of Commission-Free insurance + fiduciary control.

Fiduciaries need to be involved in their clients' insurance. But insurance is a commission-driven industry and that's hugely problematic for fee-only advisors. Anything that incentivizes selling a particular product rather than growing wealth for the client is simply antithetical to RIAs.

Additionally, commissions can cause significant pricing problems. So, while eliminating commissions from insurance products opens the door for fiduciaries to be involved in their clients' insurance, it also allows products to be re-priced to deliver better consumer value.

RIA clients want, need and already own insurance. Until now, while RIAs may identify clients' insurance needs, they have been unable to fulfill them in a fee-only practice.

By leveraging low-cost, Commission-Free insurance, RIAs can assure their clients' insurance needs are fulfilled with products and solutions they recommend. This opens up an enormous set of assets for RIAs to incorporate into their practice, as the insurance industry is more than double the size of the entire RIA industry.

Why is insurance important to RIAs and their clients?

Most RIAs agree that insurance is a critical component in each of their clients' holistic financial plans. They discuss life insurance, long term care, disability and ask if their clients own annuities, but there's little

they can do with them. DPL works closely with carriers on behalf of RIAs to re-price products to create unique, fee-only options without high commissions or extreme complexity. Carriers recognize the need to modify their products to meet the needs of the fee-only market. The first step is getting rid of commissions and other buried fees in classic insurance products.

For example, the M&E fee for a traditional variable annuity is about 125 basis points per year. That's before fund expenses, administrative charges and riders that can double the cost. Working with our insurance company partners, we've crafted products specifically for fee-only advisors where the fee is as low as 20 basis points a year, many with institutional share class funds.

How do RIAs work with DPL?

DPL serves as an RIA's "insurance department" with an independent point of view. To get RIAs started with insurance, DPL will compare their clients' current policies against our suite of low-cost alternatives. Our insurance-licensed and carrier-agnostic consultants analyze RIA clients' policies to assure that their products are best suited to help them meet their financial goals. We often find that clients can benefit from saving significant amounts in fees alone, while the advisor has the benefit of providing a valuable service and added AUM to their practice.

For example, we worked with an RIA in California to switch out a client's legacy annuity for a Commission-Free

alternative, saving the client about \$7,500 a year in fees. In addition, DPL's knowledge of the carrier's buyback program for legacy policies generated a five-figure check to the client for surrendering.

Academic research shows tangible value in the peace of mind that comes from insurance. After helping RIAs evaluate their clients' existing products, we expand their insurance advisory service to help RIAs utilize insurance as an investment. Insurance products can provide guaranteed income, longevity protection and protect against sequence of return risk — all benefits that clients need and want.

Can you explain DPL's membership concept?

Member firms get full access to our low-cost, Commission-Free and transparent product suite. Our team of experts provides analysis and insight to help RIAs find better, value-driven solutions to meet their clients' needs and goals.

Beyond the service and value we provide directly to firms, DPL's membership forms a buying co-op to drive innovation and negotiate new products on behalf of the fee-only RIA industry.

Are the insurers on board?

Absolutely. We've partnered with nine top-tier carriers offering life products — term, variable universal, guaranteed universal — and more than a dozen annuities. We are working to add more to our offering, including carriers in long-term care and disability.

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← Ryan Marshall
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Planners' own financial results might be better if only they would actually do what they tell their clients to do.

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Ryan Marshall of ELA Financial Group in Wyckoff, New Jersey, reviews clients' retirement plans annually, but he does his own only every four or five years.



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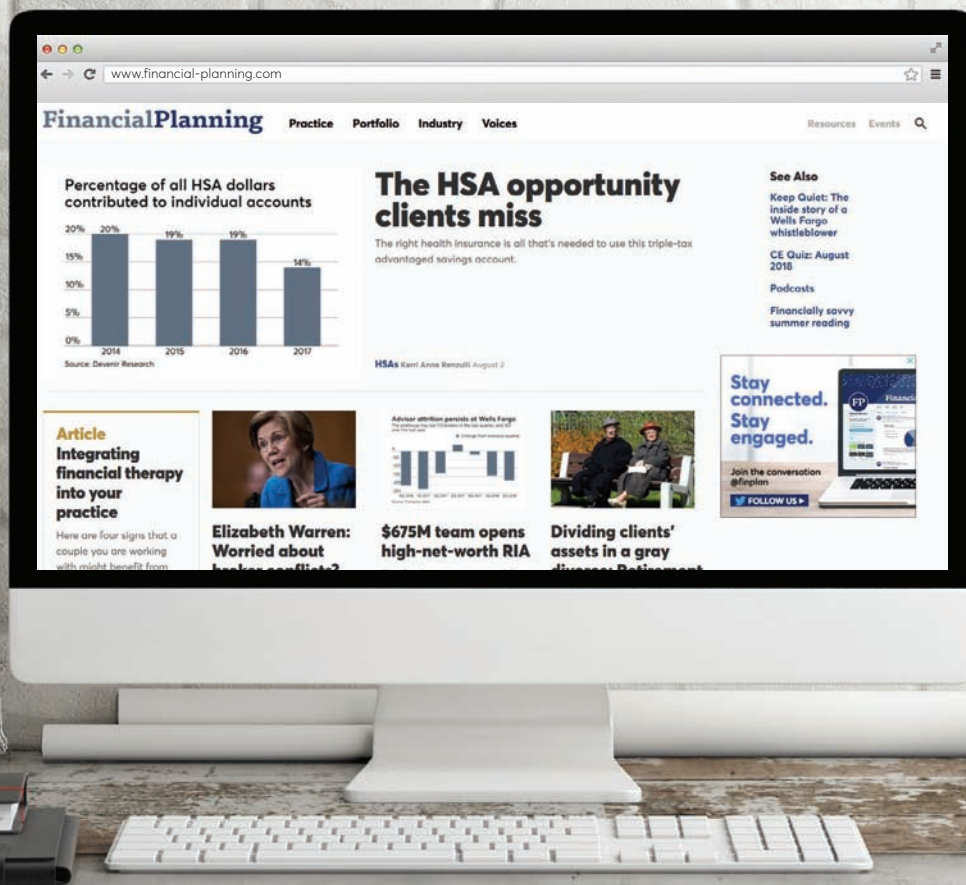
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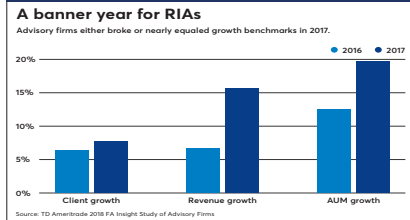
CHALLENGING AUTHORITY



'Keep Quiet'

Confidential emails reveal a top Wells Fargo advisor's despair after he cried fraud. Christopher Lewis could have stayed at Wells if he was silent, but spoke up anyway. Read the behind-the-scenes story of how one advisor challenged authority and how much it cost him. Go to <https://bit.ly/2MdnEGb>

GUIDE TO GROWTH



Encore, Encore

To build on last year's strong client, revenue and AUM growth, firms should focus on strategic planning. Last year, firms grew their client base at a median of 7.8% in 2017, according to TD Ameritrade Institutional's 2018 FA Insight Study of Advisory Firms. Go to <https://bit.ly/2OxR6Y>

EVENTS

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FPA Annual Conference
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Oct. 15-18
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Philadelphia
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Editor's View

Confession Time

Psychological traps keep planners from following the advice they give clients.



What planning advice do you give others but fail to heed yourself? The question might spark a wry smile of recognition. From avoiding paperwork to taking on too much risk, advisors fall prey to the same bad financial habits that bedevil clients.

"I was surprised by some of the more simplistic planning steps advisors don't follow," says *Financial Planning* associate editor Amanda Schiavo, who wrote our main feature, "When Advisors Ignore Their

Own Advice." Failing to update estate documents is one example, Schiavo noted. "Also surprising were the advisors who don't put a lot of effort into their own retirement."

Blame status quo bias. This psychological tendency means we prefer to keep things the same. It results in paperwork avoidance, ducking tough conversations and spending paralysis. Overconfidence, too, plays a role. Advisors who consider themselves experts in financial topics often assume too much when it comes to their own planning, Schiavo tells me.

"I think planners — and anyone really — can get themselves into trouble when they end up suffering from a mix of both status quo bias and overconfidence," she says. "When you are advising others and know exactly what must be done, you can end up telling yourself you're in no danger and you'll get to it eventually. But at some point, eventually can become too late."

Succession planning may be one area where planners struggle most with status quo bias, notes consultant Matt Sonnen in his piece, "Cementing a Future Generation."

"The industry continues to remain woefully underprepared," he writes. "Advisors owe it to themselves, their firms and their clients to build a career track for the next generation of advisors." And you owe it to your family to get those estate planning documents in order. — **Chelsea Emery**

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DATA-BASED INSIGHT FROM FINANCIAL PLANNING AND SOURCEMEDIA RESEARCH

Retirement Advisor Confidence Index

Improving Economy Spurs Optimism

Robust economic performance and business earnings push trade war fears out of the spotlight, advisors say.

By Harry Terris

Solid economic numbers and corporate earnings reports are helping to support client sentiment and investment flows, advisors say.

Client allocations to equities increased sharply and positions in bonds also grew, according to the latest Retirement Advisor Confidence Index — *Financial Planning's* monthly barometer of business conditions for wealth managers. The component tracking client holdings of stocks jumped 6 points to 58.7 and the component for bond holdings rose 2.9 points to 52.4. Readings below 50 indicate a decline and readings above 50 indicate an increase.

"People are becoming more encouraged by a seemingly improving economy," one advisor says, echoing peers who report that brisk economic activity and healthy business earnings are feeding optimism.

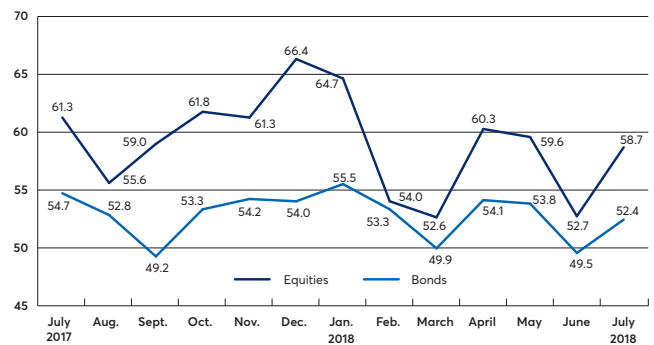
Advisors say that investment flows are also being propelled by gains in employment and personal income that are adding to the pool of investable assets. "Economic growth is leading to new enrollees in the workforce and more participants are contributing," one advisor says.

Further, advisors say that better personal financial practices are enabling clients to focus on saving and planning for the future. One advisor attributes increased interest in new retirement accounts to clients' adoption of "more aggressive saving-toward-retirement goals."

The increases in the index components tracking flows into stocks and bonds helped swing the composite into positive territory with a gain of 2.3 points to 52.1. In addition to asset allocation, the composite tracks investment product selection and sales, planning fees, new retirement plan enrollees, client risk tolerance, and client tax liability.

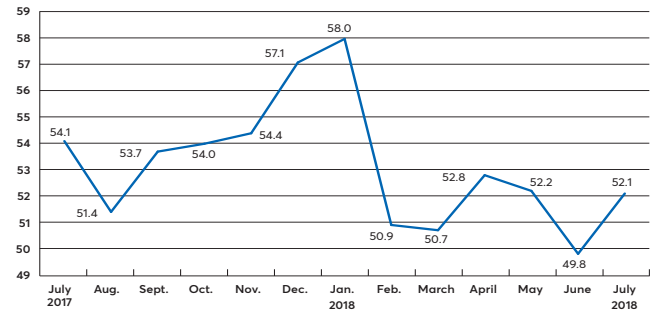
The composite was also helped by the component track-

CLIENT ASSETS USED TO PURCHASE EQUITIES AND BONDS



Source: SourceMedia Research

RETIREMENT ADVISOR CONFIDENCE INDEX



Source: SourceMedia Research

ing contributions to retirement plans, which rose 0.4 points to 55.5, consonant with the readings on stock and bond holdings. Advisors cite several additional factors that are supporting retirement investment flows in their practices, including a rise in the number of clients at or near retirement age.

One advisor says that business-owner clients now have a clearer picture of their likely earnings for the full year and

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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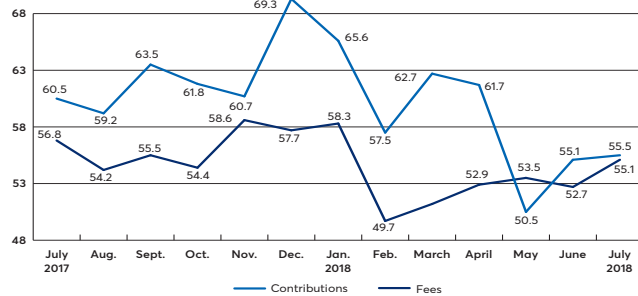
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are therefore more comfortable allocating money to retirement portfolios. The index component tracking fees for retirement services added 2.4 points to 55.1, consistent with trends in assets under management indicated by readings on contributions and asset allocations.

While advisors say that overall confidence in the economy is helping to drive investment flows, the index signaled a

CONTRIBUTIONS TO RETIREMENT PLANS AND FEES FOR RETIREMENT SERVICES

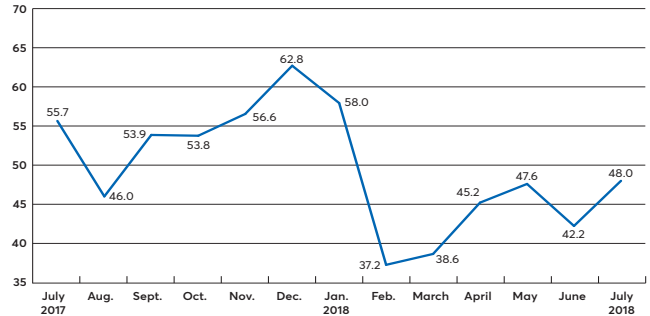


Source: SourceMedia Research

persistent undercurrent of client nervousness. At 48, the component tracking client risk tolerance registered its sixth consecutive month in negative territory, and continued to weigh down the composite.

Advisors say that unease continues to center around trade tensions, "dysfunction in Washington," and volatile relations between the U.S. and other countries around the world. **FP**

CLIENT RISK TOLERANCE



Source: SourceMedia Research

Harry Terris, is a Financial Planning contributing writer in New York. He is also a contributing writer and former data editor for American Banker. Follow him on Twitter at @harryterris.

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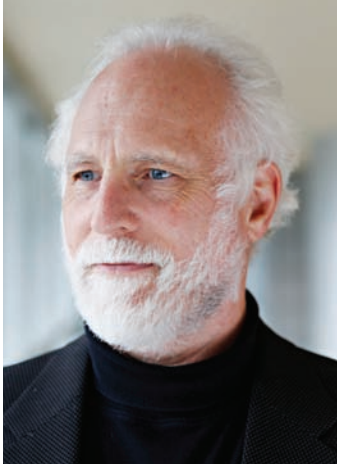
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Veres



On Dangerous Ground

The Focus Financial IPO calls attention to the problems that outside investors may bring to the planning-client relationship.

By Bob Veres

I've been watching, with increasing dismay, the trend of nonfinancial planners taking over ownership of planning firms. We have private equity firms buying financial services firms, and financial services firms that are either going public or promising to as part of their roll-up pitch to independent advisors. The distress became especially acute when Focus Financial Partners went public and raised just over \$600 million from its new shareholders.

Don't get me wrong; I don't have anything personally against Focus founder and CEO Rudy Adolf, or Stone Point Capital, which now owns more than 50% of the Focus firm and its portfolio of disparate planning offices around the country.

I don't know anything troubling about Lee Equity Partners (investors in HighTower Advisors and Atria Wealth Solutions), Hellman & Friedman (majority owners of

Edelman Financial Services), Long Ridge Equity Group (Carson Group), Pantheon Capital (Hanson McClain Advisors), or any of the other firms looking for a high payout from the labors of financial planners.

I have nothing against the public markets.

What troubles me are the incentives that these outside investors may be injecting into the planning-client relationship.

When a planning firm is owned by one or more planner partners, the terms of the relationship with clients takes place between two parties: the client and the advisory firm. Moreover, the service model and the delicate budget balance between how much time and treasure is expended on serving clients versus going into the pockets of the firm owners, are typically dictated by people who sit in front of clients and have motivations not to scrimp on their services. Insiders are motivated to improve the lives of clients.

But what happens when a third party — be it shareholders or a private equity firm — is introduced into this cozy dynamic? Suddenly, there's an additional mouth to feed, and the planner (and planning firm) now owes obligations to both the client (for excellent service) and to the outside investor (for increased profits). This creates a significant conflict of interest that can detract from the services provided by the purchased planning firms to the public.

Ideally, we do not want consumers to be working with professionals who are primarily beholden to others.

In fact, the nature of this conflict is so substantial and serious that it is actually prohibited in other professions. A CPA firm may not let its total non-CPA ownership exceed 49% (in this country), and working in the firm must be the principal occupation for all equity participants in the firm.

Those non-CPA shareholders must, at a minimum, have graduated with a baccalaureate or higher degree and the principal executive officer of any CPA firm must be a licensed CPA.

Similarly, U.S.-based lawyers are specifically prohibited from allowing nonlawyers to own any interest in their law firms. Nor can a nonlawyer be a corporate officer or director

of the law firm, and nonlawyers can't have the right to direct or control the professional judgment of a lawyer.

These prohibitions were put in place to address exactly the concerns that I have about the roll-up going public and private equity phenomena. Ideally, we do not want consumers to be working with professionals who are primarily beholden to others. We don't want the professional sitting across the desk to be cutting corners or making recommendations that are more in the interests of shareholders than the client or customer.

The Focus Financial IPO particularly bothered me because the prospectus made it clear that the money raised from shareholders would be used to finance more acquisitions of planning firms. More importantly, company stock would provide Focus with a powerful new acquisition tool.

A Real Danger

I had, in the past, worried that the prepublic Focus was siphoning off revenues from its planning offices, and these worries were not totally alleviated when I saw, in the Focus offering documents, that Adolf received a salary of \$736,837 last year, with a bonus of \$1,779,692 and option awards valued at \$1,269,102. The document cited "additional compensation" of \$131,820, and later, it said that he is also reimbursed for the expenses of his personal aircraft.

There is a real danger that this train will have left the station before anybody thinks to enact the sort of safeguards that have been applied to CPA and law firms. In the next few years, we could see enough advisors, late in their career, sell out to newly public roll-ups or alert private equity

investors whose loyalty is to provide the highest return possible to their shareholders, rather than the best service possible to the public.

By the end of the decade, we might have too many planning firms in the hands of nonplanners for there to be any hope of imposing a professional restriction on ownership.

Clients may receive an inferior form of financial planning as our profession falls into a conflict-of-interest position.

In an efficient marketplace, this might not matter. The firms that provide the best service will win the loyalty of the most clients, right?

Alas, this only works if the public truly understands what financial planning means. In the current marketplace, insurance agents routinely call themselves planners or advisors, sell annuities and skip away from one credulous customer to another.

The SEC is debating whether brokers can hide in "wealth manager" clothing. The answer is apparently yes, so long as they don't refer to themselves as "advisors."

It is not hard to envision a new class of firms that claim to offer full-service financial planning — many of which once *did* offer full-service financial planning — that will be operated as corporate providers of something that looks like financial planning. But it will be financial planning where every shortcut is taken and every corner cut in order to squeeze the last ounce of profit from each relationship.

The firms will look much more like independent planning firms than the wirehouses ever did. The folks wearing green eye shades in some remote corner office will be making decisions

on what to recommend, how much time a planner can spend with clients and what products to recommend under whatever group agreement is designed to generate the most profits. We might see sales contests and incentive trips slipping back into the profession through the back door.

That doesn't mean these firms will ultimately win the majority of consumers. After all, Vanguard and TIAA are the largest mutual fund and annuity firms in the marketplace, and they don't have public shareholders. There's an advantage to having fewer conflicts. The more the people who sit face-to-face with clients can concentrate on the client's welfare with the fewest distractions, the more likely the firm is to hold its own in the marketplace.

The Temptation

But in the meantime, many thousands of clients — I guess I would recharacterize them as "customers" — may receive an inferior form of financial planning as our profession falls into a conflict-of-interest position that other professions wisely avoided. I know that there are a lot of advisors out there near the end of their careers who are attracted to the temptation of a well-financed buyout. All that private equity money, and stock ownership in a publicly traded firm, seems like the perfect reward for all their years of working hard for clients.

I hope, before they reach out their hands, that they think about how financial planning services will be offered by the new owners. And I hope that somebody, somewhere, finds a way to stop this manifest conflict of interest from invading what has been a very client-focused profession — before it's too late. **FP**

Grant



Cultivating Culture

Why do some firms become toxic places to work, while others nurture employees who then perform at their best?

By Dave Grant

Company cultures fascinate me. Two RIA firms can offer the same services and produce the same revenue, but one can be a toxic place to work and the other can nurture employees to perform at their best.

How do these firms differ in establishing and maintaining their cultures?

It starts at the top. All employees look to the leaders of the company to establish a vision, mission and patterns of behavior. On a more granular scale, staffers are continually evaluating how managers treat their fellow colleagues.

If staff members see managers frequently raising their voices, then that same behavior will be deemed acceptable for meetings not involving management. If managers make important decisions without encouraging employee involvement, then employee buy-in might not be as high, either.

In a positive environment, supportive

managers can propel their teams to achieve surprising results.

A Sense of Confidence

One young advisor told me how he was taking over a portion of a book that a veteran advisor was passing down upon his retirement. This newer advisor was in his 20s, but his superiors encouraged him to work with C-suite executives and start managing a book of more than \$40 million.

When he reflected on the transition 12 months later, he could not speak highly enough of his senior advisors and company leaders. Because they had instilled in him a sense of confidence, he felt ready for the transition and had the skills he needed.

The new advisor's colleagues had also encouraged him to ask questions whenever he felt unsure of anything — technical or otherwise.

He worked closely with the company's founder to maintain strong client relationships throughout the transition and noticed how his superior had the utmost care for the client as this change occurred. He spoke about how that behavior now drives him to be a better advisor.

Culture needs to be nourished throughout its infancy, fed to ensure its growth and maintained constantly to ensure any weeds don't take root.

With beaming pride, he also shared with me how he was able to keep bringing in held-away assets and convert referrals from current clients, ensuring that he wasn't just a servicing advisor but could add to the company's growth.

Without the support of the company leaders, I fear it could have been a different story.

In contrast, negative cultures can leave scars.

Early in my career, I saw how poor communication can adversely affect culture.

In the early weeks of joining an RIA, team members disagreed about how prospects should be onboarded.

One advisor who brought in the majority of the firm's business didn't feel like his views were being taken into consideration. So he stood up in front of the entire planning team and yelled that he was shutting down

Grant

his book and leaving.

As a new member of that team, I was shocked to see this company crumple before my eyes.

If an advisor doesn't take care to maintain or weed client relationships, then services can become superficial.

The next day, however, everything went back to business as usual. The outspoken team member was at the office when I arrived, as were the rest of the team.

Colleagues tolerated his outburst, which, unfortunately, was not a one-off occurrence. Not surprisingly, this advisor's behavior left colleagues on edge about what else might occur.

This toxic environment spawned other unproductive behaviors: Team members often had closed-door

meetings to talk about other staff members. Certain staff members would purposefully not show up for company meetings because they didn't get along with one another. Others would send hotheaded emails that should never have been written. All of this bad behavior happened in clear view.

Needless to say, the toxic culture at this firm resulted in bad morale, high staff turnover and an inconsistent client experience.

Communication makes or breaks culture: A former colleague described recently how the culture of his company suddenly changed when the company executed a succession plan.

A new owner came in to succeed the retiring owner and the communication rules changed overnight. The family atmosphere, in which everything was

discussed as a staff, evaporated, and it now became a top-down "here's what we're doing" regime.

Staff members no longer took time to get to know one another over lunch or early-morning cubical visits, after the new owner commented how people were spending too much time away from their desks.

The new owner thought he was making the firm more efficient, but in reality, he was eroding the culture that had made the firm successful.

Twelve months later, two key members of the support team left, citing the change in ownership and culture as their main reason for leaving.

Culture has to be nourished and maintained: Culture is like a garden. First, it has to be planned mindfully before anything material can happen.

Then, it needs to be nourished throughout its infancy, fed to ensure its growth and maintained constantly to ensure any weeds don't take root.

While top managers are the main groundskeepers of corporate culture, every staff member has a role in feeding wilting plants.

A good culture praises publicly those plants that are showing their fruit, ensures new plants get everything they need to grow at their own pace, and either removes weeds when they appear or brings in the groundskeeper when the weeds become too much to handle.

If the staff ignores any part of the garden, its growth is stunted, weeds take over and, in the worst case,

much of it has to be ripped out and be replanted.

Culture for solo advisors? Promoting a positive culture is essential for companies with staff, but what about solo advisors? Does corporate culture even exist when there is just one worker? I think it does, but it is tightly linked to the personality and vision of the advisor.

In order to understand the culture of a solo-advisor firm, look to his or her clients. They are in the same place as staff members in a large firm.

The clients communicate directly with the advisor and try to understand the nuances of his or her communication style.

If the personality and culture of a solo advisor resonates with many clients, and the advisor nurtures those relationships just as managers do with larger staffs, the advisor will find himself with many healthy, fruitful planning relationships.

But instead, if the advisor doesn't maintain client relationships, services become superficial — or, at worst, transactional. A solo advisor's culture then depends on how well they cultivate their client relationships into long-lasting bonds. Culture is a living entity inside every practice, regardless of whether staff is present. When leaders tend to their culture with care, it can become the lifeblood of a company and ensure its long-lasting success. **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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Help Clients Boost Savings

Clients can increase their IRA retirement savings by thousands with this strategy.

By Kimberly Foss

If you have high-net-worth clients who are looking for ways to put away more in their retirement accounts, it may be time to show them how to supersize their retirement accounts with the mega-backdoor Roth IRA contribution strategy.

When Congress raised the income limits on eligibility for Roth conversions in 2010, higher-income taxpayers were able to contribute to a nondeductible traditional IRA and then convert it to a Roth IRA a short time thereafter.

For married couples filing jointly whose income is \$199,000 or greater in 2018, contributions to a traditional IRA are not deductible, and they're disqualified from contributing to a Roth IRA.

However, a high-income individual might make a nondeductible contribution to a traditional IRA and subsequently convert it to a Roth account in order to make tax-

advantaged withdrawals from the account in retirement.

Their ability to make contributions to a Roth IRA is curtailed, but not their ability to convert an existing traditional account to a Roth account. (The 2018 tax law ended the ability to reverse a Roth conversion by converting it back into a traditional account.)

Some clients run into a complication from the IRS aggregation rule while executing this strategy, though. IRC 408(d)(2) stipulates that "all individual retirement plans shall be treated as one contract" and that "all distributions during any taxable year shall be treated as one distribution."

This means that if a client had any traditional IRA accounts in place at the time the Roth conversion was performed, the distributions from the converted accounts would be treated the same way as the distributions from traditional accounts, since

the IRS rule aggregates all accounts for tax purposes.

Fortunately, though, 401(k) accounts are not subject to the aggregation rule. This means that any assets held in such employer-sponsored plans will not fall afoul of IRC 408(d)(2).

In fact, clients may roll over funds from traditional IRA accounts into 401(k) accounts and thus ensure the aggregation rule will not apply to subsequent distributions from those assets.

This assumes, of course, that the client's 401(k) plan permits rollover contributions from outside tax-qualified accounts.

Now the good part. Assume you have a high-net-worth client who is highly focused on both saving for retirement and leveraging tax-advantaged growth in her invested assets.

The crucial step for the tax court is to establish the client's intent to bypass the income limits on Roth contributions.

She has already made the maximum allowable contribution to her other tax-qualified plans, including her health savings account, her IRAs and her regular 401(k) contribution. But she wants to do more. What do you tell her?

You suggest that the client make a non-Roth after-tax contribution to her 401(k). You will need to help her check her plan docu-



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1. Source: BlackRock and Morningstar as of 6/30/18. 7 of 8 funds accounts for 88% of our active municipal bond mutual funds. Over the 1, 3, 5 and 10 year periods, 6, 7, 7 and 7 of BlackRock municipal bond funds are in the first quartile of their respective Morningstar categories. Based on the institutional share classes of BlackRock open-end municipal fixed income funds.

2. Source: BlackRock and Morningstar as of 6/30/18. Based on Morningstar's U.S. Category Group Municipal Bond. Total universe consists of 48 ETFs. iShares National Muni Bond ETF (MUB) and iShares Short-Term National Muni Bond ETF (SUB) are the least expensive ETFs in this universe based on prospectus net expense ratio. Both funds have a net expense ratio of 0.07%.

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ments to make sure that the plan allows such contributions.

Provided her plan document was drafted to permit these contributions, she can contribute up to the maximum allowed for all types of contributions (employee contributions, employer contributions and non-Roth after-tax contributions). For 2018, the maximum allowed for all contributions is \$55,000.

So, supposing that your client's employer (likely the client herself) had contributed \$10,000 to her 401(k), she would be able to put in another \$26,500 (\$55,000 - \$10,000 - \$18,500).

Her contribution is nondeductible, but it may be withdrawn tax-free. It will accumulate in a tax-free environment, and when the earnings are withdrawn, they would be taxed as ordinary income. Unless, of course, you advise your client to take the next step.

Once the client has contributed the after-tax funds to the 401(k), she can roll them over into a Roth IRA. The rollover is a tax-free event, and because the assets are now in a Roth IRA, both the contribution and the subsequent earnings may be withdrawn tax-free.

The only portion of any distributions that would be taxable is the amount earned by the assets while they were in the 401(k). Ideally, the rollover took place relatively soon after the 401(k) contribution, and as such, any earnings would be negligible.

There's a major caveat I must mention: The IRS step-transaction doctrine, which originated in 1935, holds that separate steps in a chain of transactions that have no inherent business purpose may be treated as a single tax event.

In other words, if the rollover happens too soon after the non-Roth contribution, the Tax Court may rule that the intent was to make an

otherwise impermissible Roth contribution, which might be disallowed. This would likely result in a 6% penalty for excess contributions to a qualified plan.

Advisors take different positions on the best way to avoid triggering that issue. The most conservative planners advise waiting a full year before rolling over the funds from the 401(k) to the Roth IRA. Others suggest waiting a month (a typical account statement cycle) to make the move.

If a rollover happens too soon after a non-Roth contribution, a court might disallow it, which could result in a 6% penalty for excess contributions to a qualified plan.

But perhaps the most important measure in avoiding the application of the step-transaction doctrine is to avoid red-flag terms, such as "backdoor Roth" or "Roth conversion," in your written communications with the client.

The crucial step for the Tax Court is to establish the client's intent to bypass the income limits on Roth contributions.

By avoiding those terms in your communications with your client, you won't be assisting the IRS in making its case, should anyone become curious about your client's Roth assets.

Especially for non-CPA practitioners, whose records are typically not protected by advisor-client privilege, it is vital to be careful what you say and what you write.

On the other hand, some experts believe the IRS is unlikely to come after taxpayers who have done backdoor Roth conversions.

For example, Jeffrey Levine says he was unable to find a single case where the IRS has faulted a conversion by appealing to the step-transaction doctrine.

In summary, here are a few caveats and tips for implementing this strategy.

- This only works for clients with significant resources and income who have already maxed out contributions to their other retirement accounts.

- The client's 401(k) plan must allow for non-Roth, after-tax contributions to the plan.

- You (perhaps in concert with the client's tax advisor) will need to help the client carry out the strategy in a way that avoids the IRS aggregation rule and prohibition on step transactions.

- Don't forget the HSA. When maxing out annual contributions to tax-qualified plans, including the 401(k).

- Using the 401(k) avoids the IRS aggregation rule.

- When possible, advise self-employed clients to design their 401(k) plans to permit non-Roth employee contributions.

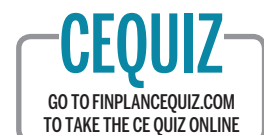
- Take care to avoid red-flag language in your communications with your client.

- It's smart to allow some time to elapse before the rollover. Just remember that any accrued earnings before the rollover will be taxed upon withdrawal.

When implemented properly, the mega-backdoor Roth strategy can help your high-net-worth clients set aside tens of thousands of extra dollars each year. These assets will accumulate tax-free and provide nontaxable income in retirement.

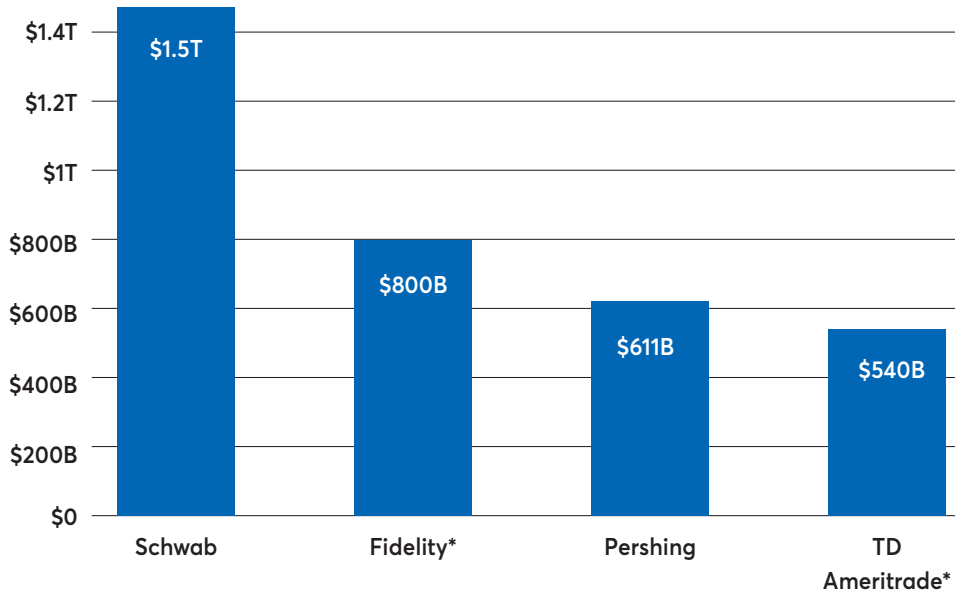
This back door can lead to huge benefits both for your client and for the advising relationship. **FP**

Kimberly Foss, CFP, CPWA, is a Financial Planning columnist and the founder and president of *Empyrion Wealth Management* in Roseville, California, and New York. Follow her on Twitter at @KimberlyFossCFP.



Total custodied assets from RIAs

Data as of year-end 2017



Source: Company data; industry estimates*

It's Time for a Custody Fee

The change is needed to better align the interests of RIAs and the custodians that serve them.

By Michael Kitces

A custodian is one of the most crucial vendors for RIAs. From the core services of trading, holding and maintaining records of electronically owned securities, to the ancillary technology that custodians provide to help advisors run their businesses, a good RIA custodial relationship can help firms attract and retain clients.

However, as the advisory industry has shifted from a focus on sales to advice, custodians and the RIAs they serve are increasingly in conflict with one another. Indeed, many of the ways in which RIAs help their clients reduce costs and further grow their wealth are actually detrimental to the

bottom lines of RIA custodians.

To better align the interests of RIAs and the custodians that serve them, it's time that the platforms start charging the RIAs they serve a custody fee. A basis-point custody fee would ultimately allow custodians to focus on providing the best services and solutions to RIAs, instead of just seeking new ways to make money off of an RIA's clients.

The idea of paying a basis point fee for a custodial platform that, for the better part of the past 20 years we've gotten for free, may sound horrible. But the reality is that RIA custodial platforms aren't free in the most literal sense. As the saying goes, "If you're not

paying for it, you're the product." Our clients are the product, and we are effectively bringing them to the RIA custodian.

To understand why, we have to look at how RIA custodial platforms actually make their money:

1. On cash:

The few percentage points of cash that are held in a client's portfolio may seem insignificant, but when that money sits the RIA custodian makes money on the money.

A basis-point custody fee would ultimately allow custodians to actually focus on providing the best services to RIAs.

With the cash held in a proprietary money market fund the custodian might earn a 50-basis point expense ratio. With the cash in a related bank subsidiary, the custodian earns a net interest margin of maybe 1% or 2%.

This may sound trivial, but bear in mind that companies like Charles Schwab have almost \$1.5 trillion on their RIA platform, which means even if the average client has just a couple percent in cash, that could be \$50 billion in cash assets earning 50 basis points on money market funds, or 1% more in net interest margin.

In fact, if you look at

Schwab's annual report, you'll see that over 50% of Schwab's entire revenue for the whole company was interest revenue. Which is technically not just things like net interest margin from Schwab Bank but also a little bit of interest on margin loans and securities-based lending, etc. But as Schwab itself acknowledges, most of it is making money on cash. Schwab generated \$4.6 billion last year in interest alone.

2. On fees:

That includes both the subtransfer agent fees or what are called sub-TA fees that mutual fund companies pay to custodial platforms to hold and administer their mutual funds, which can be anywhere from 5 to 15 basis points. Technically, this is part of the expense ratio of the underlying fund, but the fund company collects the expense ratio from the client and then pays those dollars to the RIA custodian to be on the platform.

The problem is that custodians have put RIAs in a position where we look better to our clients when we stick it to the custodian.

In addition to sub-TA fees, RIA custodians also make money through their increasingly popular no-transaction-fee (NTF) platforms. You may not pay a ticket charge when buying funds through one of these, but clients typically do pay a 12b-1 fee because the platforms deliberately put funds only into their NTF platforms that pay a 12b-1 fee. That's what the custodian uses to cover the cost.

In the case of Schwab, about \$1 billion in fees was collected last year just on mutual funds — either through Schwab's OneSource NTF platform or through other sub-TA fees from third parties and platform payments. And that's not including the few hundred million in fees they generated from

their own proprietary Schwab funds.

3. On ticket charges:

Looking at Schwab again, all those trading commissions in the aggregate represented only 7% of total revenue, or about \$600 million. This may sound like a big dollar amount when you're doing commissions at \$5 a trade, but bear in mind that Schwab has between the RIA institutional and retail divisions close to \$3 trillion in assets. And so on \$3 trillion, earning just \$600 million in trading commissions amounts to about 2 basis points of revenue on their aggregate assets.

The key point here is to acknowledge that RIA custodial platforms are free to advisors precisely because custodians want us to bring them clients — and then feed our clients into their money-making machine.

Misalignment

This means RIA custodians operate a business model that is fundamentally misaligned with the advisors they serve. And it has created a situation where we as RIAs can create value for our clients by trying to systematically dismantle the custodian's revenue and profit lines.

Custodians make most of their money off the money market and bank sweep that pays ultra-low interest rates. Consequently, a custodian can profit, while we use rebalancing software to always keep clients fully invested so they don't have more than, say, a 1% allocation. Alternatively, we buy ultra-short-term bond funds just so we don't have to keep anything in actual cash, or we tell our clients to keep their cash somewhere else that gives them better yields if they're not about to invest it.

There's even a service now called MaxMyInterest, which will help automate the process of taking client cash away from custodians and send it to

third-party banks that pay drastically higher yields, boosting client cash returns by as much as 1%-1.5% a year.

Similarly, if RIA custodians make money off of sub-TA fees, we choose mutual funds or ETFs that don't pay sub-TA fees. The major reason Vanguard and DFA funds have lower expense ratios than most of their competitors offering similar solutions is because their expense ratios don't include all the back-end payments to the custodians. So we seek the lowest-cost funds for clients and dismantle the custodian sub-TA fee line.

The same thing happens with 12b-1 fees in NTF platforms. It's usually not a good deal for most clients to use mutual funds in those NTF platforms because they have higher expense ratios — owing to their using the share class with the 12b-1 fee, which still indirectly comes out of the client's pocket and goes to the custodian.

So what do we do? When clients have sizable assets, we skip the NTF platform entirely and instead pay the ticket charges because it's cheaper for our clients — at the expense of the custodian's revenue. The only clients we put in NTF funds are those whose accounts are small, where the 12b-1 fee is cheaper than the ticket charge. This means we're making sure as advisors that it's lose-lose for the custodian.

Then of course there's the ticket trading charges themselves, which are completely commoditized and getting pressured lower and lower, for which we as advisors then regularly ask for more concessions. "New clients coming on board with a whole bunch of trades. Can we have a break so we can get the client?" That's another lose-lose situation for the custodian.

Again, the problem is that custodians have put RIAs in a position where we look better to our clients when we stick it to the custodian. The more we

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play the game and dismantle the custodian's profit centers, the more money we save our clients. Ironically, that means the more fee pressure there is on advisors, the more incentivized we are to put pressure on the custodians to reduce their profits, because it reduces the client's costs and that makes our fee look more manageable.

A New Baseline

This is why I think that in the future, we as RIAs will simply pay a basis point custody fee to the custodian.

Imagine that an RIA custodian charged us a custody fee to use their platform, tools and technology, as well as for access to funds, ETFs, stocks and bonds. But instead of getting it all for free — where they then try to extract the value from our clients — we pay for it directly, maybe for something like 10 basis points, tearing down to 7 and 5 and 3 basis points as our assets grow.

This is meant to be an approximation of how much the RIA custodian already makes off the typical RIA, but instead of making a basis point or two on average in ticket charges and a few basis points off the sliver of client assets and NTF funds — and then the 50-100 basis points that they make off a few percent of cash that we hold — they just charge us one uniform custody fee on everything, with breakpoints at higher asset thresholds.

The point here is to charge a fee that simply averages out to the same amount the custodian was already making from us when calculated as a percentage of revenue based on the total assets of their platform. In such a model, the custodian would simply be incentivized to make the best darn RIA custody platform out there.

And because the custodian will be making the fee, I would expect they then would go back to all the fund providers and renegotiate new versions of true, clean shares. No 12b-1 fees, no sub-TA fees — a special version of advisor class shares where no back-end fees were needed because the custodian would be earning his custody fee.

This would guarantee us access to the cheapest funds that exist of any fund company at any time. You wouldn't just have to go to Vanguard or DFA to find the cheapest funds; you could go anywhere because the costs would come down for all of them.

In the aggregate, advisors would then be incentivized to consolidate assets into a common platform that clients would want to use — because it would have the best solutions, and not because it would be the one that made the custodian the most money.

And the more we consolidated, the bigger the RIA custodian would get as well because it would earn the custody fee on all the assets, regardless of type. That's what happens when all our models get aligned.

Making the Pivot

Ironically, the fact that not all RIAs are equally profitable would be among the biggest blocking points for reinventing the RIA custody model. Indeed, those of us who are already good at playing the game essentially get a below-average fee and have little incentive to switch.

This was never an issue for broker-dealers, who simply received a slice of those transactions; if a custodian charged \$5 or \$10 a trade, the broker-dealer would charge \$15 and take the markup. If the custodian made 50 basis points on cash, the broker-dealer would

get another 10, and so on down the line. The RIA custody model, then, is more closely aligned to broker-dealers than to the RIAs they're serving now.

That's why I believe a shift has to occur. RIAs would avoid constant conflict with their custodial platforms, while the platforms would grow without being gamed by their RIAs.

Gone would be the requirements for having minimums for cash or trades, and in their place would be just one guideline that simply said, "Hey advisor, you want a break on your fees? Grow bigger and hit the next asset break point." This would also prevent the custodian platforms from ever begging us to make our clients more profitable for them by trading more frequently, holding more cash or using more expensive funds.

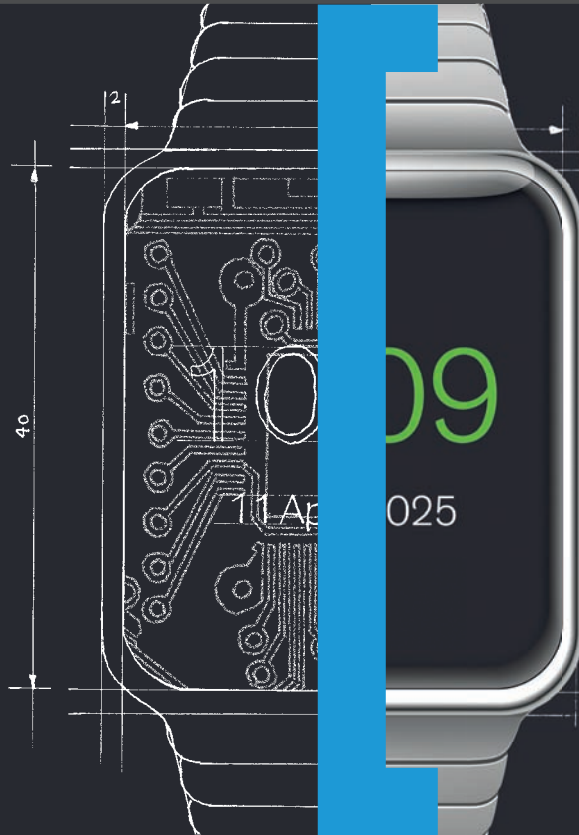
As RIAs get better at gaming the system, revenue lines get lower for custodians as a percentage of assets.

My gut says that an RIA custodian is going to offer this soon — if only because as RIAs get better at gaming the system, the revenue lines get lower for the custodians as a percentage of assets. And more efficient cash management tools, which allow us to move cash off of custody platforms, constitute very material threats to the entire custody business model. Or perhaps some RIA custodian will just do it to be the disruptive innovator that challenges the rest of the custodians.

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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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WHEN ADVISORS IGNORE THEIR OWN ADVICE

Planners' own financial results might be better if only they would actually do what they tell their clients to do.

By Amanda Schiavo



Just like a doctor who pops outside for a cigarette break,

advisors sometimes develop bad habits in their own financial lives.

Although they do their utmost to hammer home the importance of proper planning, advisors don't necessarily follow their own words of wisdom. They can fall victim to the same behavioral biases as their clients and end up making questionable financial decisions.

Overconfidence is one such cognitive bias that often affects advisors, says Stephen Wendel, head of behavioral science at Morningstar. He calls it the Lake Wobegon effect, named after the mythical town in the radio show "A Prairie Home Companion," where "all the women are strong, all the men are good-looking and all children are above average."

Part of the joke is that not everyone can be above average. But advisors can get caught up in the idea that since they're experts, they are assured of not doing worse than those who aren't experts. As a result, they can end up neglecting their own best interests.

"We might give advice to somebody else thinking they are average, but of course we're not average, so that advice

When Ryan Marshall, a partner at ELA Financial Group in Wyckoff, New Jersey, speaks, Ryan Marshall the investor doesn't always listen.

Special Report: Retirement Planning

doesn't apply to us," he says.

Of course, this is true of people across many professions. The saying that doctors make the worst patients is a cliché for a reason.

Academics in the field agree. Advisors can also fall victim to status-quo bias, procrastinating or experiencing inertia "where we make all types of decisions, especially financial decisions," says Victor Ricciardi, a finance professor at Goucher College. "The idea is that people don't like change ... and even advisors will not necessarily update their own estate planning."

Although it's impossible for someone to avoid all behavioral biases, Ricciardi suggests that planners need to understand these instincts better to help them in advising clients who are facing the same issues.

Confessing Financial Sins

To that end, some brave advisors were willing to fess up and admit their financial sins to *Financial Planning*.

The most commonly cited issues were failures to budget, a tendency to shy away from tough conversations with family members or knowingly taking on overly risky investments.

Some were even more basic — for instance, not updating important documents or not reviewing retirement plans for years.

Doug Boneparth of Bone Fide Wealth in New York City acknowledges he doesn't always put money away for his own retirement, which is far in the future, and instead lets it build up in a reserve fund. He says he's "on this kick of accumulating cash" in order to "feel better" about moving retirement savings down on his list of goals after he and his wife had a child and bought a home a few years ago.

Essentially, he says, he's being even more conservative for himself than he would recommend for clients.

"Does that conflict with the advice that I give?" he asks. "Not necessarily, but it's a challenge. Maybe I should be looking closer at that mix about how much goes into retirement versus cash reserves."

Similarly, Ryan Marshall, a CFP who is a partner at ELA Financial Group in Wyckoff, New Jersey, concedes that he doesn't review his retirement plans once a year as he does with his clients. Instead, he does such a review only "once every four or five years."

Risk management is another area where there is a discrepancy between what advisors say and what they actually do.

Matthew Gaffey, senior wealth manager at Corbett Road Investment Management in McLean, Virginia, notes the traditional strategy of having retirees ramp down the risk in their portfolios, which he notes should be more akin to "pumping the brakes rather than slamming them."

Whereas Gaffey might advise clients to progressively reduce risk in their portfolios over time, he's more comfortable holding risk in his own investments. He noted that other advisors take that same approach.

On a lighter note, Marshall questions whether retirement will be in his future at all. "I don't think I want to retire ever," he says with a laugh. "I'm giving people advice to retire [but] I really like my job. Granted, I'm still young. I'm 36 years old, so I have a lot of time. But I truly enjoy my job."

Here are some of the major shortcomings that these and other advisors acknowledge when they reflect on things that they're saying to clients but not actually doing themselves:

Lacking the Patience to Budget

Marshall confesses that he believes his biggest fault is putting off creating a monthly budget.



Instead, he takes a shortcut. "I calculated how much I need to save for the retirement that I would like to have and just make sure I save an additional 5% more than that amount each month," he explains.

"As long as I am putting that away and I have my emergency fund set up, I don't budget. However, some clients really need to budget. But I don't have the patience or time to sit down every month and come up with a plan."

Delaying Updates on Documents

"What I advise my clients to do periodically, and what I am not particularly good about doing for myself, is checking on, and updating when necessary, my estate planning documents every three to five years," says George Gagliardi, the founder of Coromandel Wealth Management in Lexington, Massachusetts.



"Yes," Gagliardi concedes, "this shoemaker is barefoot with regard to estate planning advice."

Lacking Necessary Discipline



Scott Bishop, executive vice president and director of financial planning at STA Wealth Management in Houston, says one of his flaws in his manage-



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Special Report: Retirement Planning

ment of his personal finances is having an investment plan and then not having the discipline to stick with it.

"I think financial advisors see so many investment opportunities that they don't stay disciplined," he says. "I have done that at times in my career."

Paralyzed in Budget Reviews

"Developing a good understanding of your budget is an invaluable tool to help you prioritize your spending and build your net worth," says Marielle Schurig, a CFP who is an account vice president at UBS Financial Services in New York City.



"However, budgeting seems like such a restrictive thing, which is why many people freeze up when they talk about it and why they don't stick to it," Schurig says.

"Since a budget isn't static, I often don't take the time to do an emotional audit of my spending and review my budget as often as I should," she says.

"This is one of the many reasons that working with a financial advisor is so important because they can hold you accountable and remind you to check in when necessary," she adds.

Avoiding Tough Conversations

Scott Pedvis, managing director of investments at Wells Fargo Advisors in New York City, cites the tendency to avoid tough conversations as a common failing. He got a first-hand demonstration of how to do it.

"I once had a client with an adult child, perfectly capable of working, who lived off the client," Pedvis recounted.

"One day, after the child asked the client for money to buy a luxury residence, the client asked me what I thought he should do.



"I explained that while it's ultimately the client's decision, I thought the residence in question was too extravagant and that if the client wanted to really help the child, he should explain why the child needs to start to fend, at least in part, for himself financially.

"No one likes conflict, especially in family relationships, but I felt it was my job to give the client my honest opinion ... I know if the roles were reversed, it would be very hard for me to financially deny a family member because I understand the strain and stress that would put on a relationship."

Not Mastering Cash Flow

"I found myself asking my clients to review and analyze their expense data in order to become masters of cash flow," Boneparth says. "However, reconciling and categorizing expense data can be time-consuming, so I didn't find myself practicing what I was preaching.



"However, at the end of last year, I did commit to the practice so that I could truly understand what I was asking my clients to do and look into finding solutions to reduce the heavy lifting," he says. In the end, "it was a

very rewarding experience."

Living Too Lavishly

Bishop, the Houston planner, cites another common problem among advisors. "[Planners aren't] disciplined in their spending and [need to be] more thoughtful about toys like cars and boats," he says. "I think that as many financial advisors grow their practices, they tend to make more money and thus have lifestyle creep.



"[They are] buying a larger home, nicer car, better trips and other toys without having a good budget and/or disciplined savings plan."

Taking on Too Much Risk

In discussing advisors' apparent willingness to personally assume more risk than they endorse for clients, Gaffey says, "While we consistently discuss the reduction of risk over time with our average client, many of the advisors we work with do not want to follow that same glide path and prefer to remain much more equity-driven within their own portfolios.



"I believe much of this is driven by our underlying faith in the market performing well over time. Many planners are comfortable taking on that risk with their own money but would be reluctant to ever suggest a client do the same." **FP**

Amanda Schiavo, is an associate editor of Financial Planning. Follow her on Twitter at @SchiavoAmanda.



ANOTHER MOMENT IN HISTORY WHEN TWO GREAT THINGS HAVE COME TOGETHER TO MAKE SOMETHING GREATER

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Cementing a Future Generation

Not planning for succession is the biggest risk that advisors can take.

By Matt Sonnen

Although the drumbeat for succession planning has been getting louder over the years, the industry continues to remain woefully unprepared.

We have all seen the headlines screaming about the more than two-thirds of advisors who don't have succession plans, yet the average age of those advisor principals who are owners is getting closer to 60.

Clearly, there is a wide gap here, yet for many advisors, they aren't feeling the urgency to groom the next generation to take over. These advisor-owners tell us that they aren't concerned, haven't found the right successor or simply want to keep the status quo.

What many of these advisor-owners aren't thinking about is a new industry trend that has been named Breakaway Advisor Movement, Version 3.0, and it has massive implications for ramping up the urgency for succession planning.

The first breakaway movement began more than 20 years ago and continues as captive wirehouse advisors leave their employers for a better way to run their businesses as registered

investment advisors. To help facilitate these breakaways, a cottage industry of aggregators and roll-ups came on the scene to provide start-up capital and transition assistance for an equity stake or continuing basis points in the newly established firms.

As these RIA firms matured, they quickly realized that they had the experience and scale to replicate these platforms on their own at a much lower cost, and many have since broken away from these service providers. This realization by advisors led to Breakaway Advisor Movement, Version 2.0.

In a similar fashion, existing RIAs are starting to see another wave of breakaways among the younger, more entrepreneurial employees at their firms. These up and comers, who are wondering what future they will have at their firms, are also beginning to say to themselves, "There has to be a better way" and are looking to start their own RIAs in direct competition with the firms that they are leaving.

Most of this is driven by the firm's lack of succession planning and the

younger employees feeling as if they will never get a meaningful piece of the ownership pie. As a result, these entrepreneurial advisors who have learned the RIA craft see that, due to the owner's lack of planning, their only option is to break away, taking their business development, relationships and technology-savvy skills with them.

When this happens, the aging advisor's firm's valuation takes a big hit. After all, what is left to acquire in a firm that is losing its best talent and client relationships?

Advisors who haven't cemented a future generation of leaders are at extreme risk of not being able to monetize their decades of hard work.

Succession planning isn't easy. However, not planning is the biggest risk that advisors can take as they consider their retirement futures.

The good news is that there is still time, but it is rapidly running out as Breakaway Movement, Version 3.0 gains momentum. Advisors owe it to themselves, their firms and their clients to build a career track for the next generation of advisors to play a meaningful role in the future of their businesses.

For prepared firms, this process is a healthy one that brings needed vitality into the business while richly rewarding the founders.

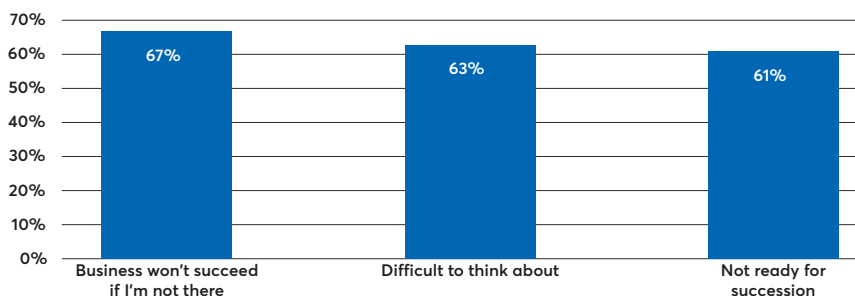
(A version of this story originally ran on financial-planning.com in May 2017.) **FP**

Matt Sonnen, is the founder and CEO of consulting firm PFI Advisors. Follow him on Twitter at @mattsonnen_pfi.


Head in Sand

73% of advisors don't have a succession plan in place.

Here's why



Source: Financial Planning Association, 2018



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Practice

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THE BIG KAHUNA

THE HEAD HONCHO

THE GRAND POOBAH

Avoid a Grand Poobah Trap

If your practice revolves around a lead advisor, you may be headed to big problems. Here's a way that works much better.

By Carolyn McClanahan

Most financial advisory firms, both large and small, have lead advisors who manage client relationships and who are surrounded by underlings who help them serve those clients.

These advisors position themselves as wise sages, and most matters concerning clients must go through them. They are the Grand Poobah within their firm — they run the show.

In general, a Grand Poobah is someone who has a worthless title and an inflated sense of self-importance. (The term originated in the 1880s in Gilbert and Sullivan's comic opera "The Mikado," although you

may remember it from Fred and Barney's secret lodge society in "The Flintstones.")

Most advisors are not like this, yet some structure their practice under a lead advisor as their business matures. It's not the best model. How can you avoid falling in the Grand Poobah trap?

There are a number of problems with this approach: the egocentricity of the advisor; a lack of clear career paths for support staff; and overreliance on a single person, who could suddenly disappear because of death or incapacity.

To be sure, many lead advisors work hard,

care about their employees and clients, and worry about how to transfer duties to the next generation.

But there are other lead advisors who think others couldn't possibly do the work as well as they can and feel they are not easily replaceable. Their practice gives them purpose and validates their worth. For some, this evolves into a sense of power and self-importance. It is not easy to extract oneself from this situation.

Most junior advisors don't want to hang around waiting for their boss to retire. More often than not, a junior advisor leaves to start his own practice or goes to another firm.

As a lead advisor's workload increases, junior advisors are hired to increase capacity. The junior advisor may be in the background for years — running reports, researching client questions, taking meeting notes and various other duties.

Yet, they do not manage client meetings. Over time, they are encouraged to develop their own books of business and they may be handed the less profitable clients to manage.

The junior advisor is often given an additional carrot — a vague promise that one day they will take over the

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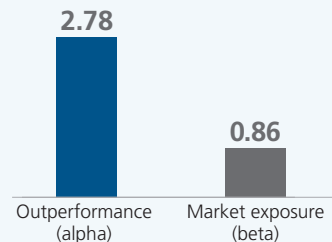
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Practice

lead advisor's practice. Think about the problem with this. Most advisors are hitting their stride in their late 40s and early 50s.

They hire an energetic 30-year-old junior advisor. That young advisor toils behind the scene for years. If they are motivated and smart, they can learn most of what they need to know to be a lead advisor in five to 10 years. Now their boss is 60 and they are 40.

The beauty of the financial planning profession is you can work for a really long time. Most junior advisors don't want to hang around waiting for their boss to retire. More often than not, the junior advisor leaves to start their own practice or go to another firm.

Sadly, the Grand Poobah is left in the lurch and their succession plan is in ashes. Their years left in the workforce are numbered and they don't have a lot of time to regroup.

An Ensemble Model

There is a common-sense answer — move to a true ensemble model. Instead of forcing a junior advisor to toil in the background, make this advisor the lead for a particular component of the client's financial life.

I started out as a solo practitioner. As my practice grew, it was unsettling to me that so many people relied only on me for their financial well-being. Life can be precarious.

I also realized that I loved financial planning but did not enjoy the nuts and bolts of managing investments. Finally, it was challenging to manage clients alone as my involvement in leadership and education blossomed.

To me, the perfect answer was hiring out what I did not enjoy. My first hire was an investment manager. He did the investments and I did the planning.



As in sports, cross-training to fill multiple roles in an advisory firm is a valuable training technique.

After making certain that the clients understood how we worked together and were reassured they would be well cared for, they embraced this change.

My next hire was another financial planner. She personified why younger advisors leave firms — for more than a decade she had worked for a lead advisor who had no intention of quitting any time soon.

The beauty of an ensemble approach? There is a deep bench, clients know they have a team they can rely on and it is difficult for one person to leave and take clients with them.

We cross-trained to create a consistent planning process, then she took over the insurance and projection planning for each client. It took about two years to get her fully integrated, but, again, the clients were delighted with this expansion.

Our most-recent hire is a 25-year-old financial planning graduate. He came with some experience but was still quite green. We immersed him in the insurance planning, and he is now working directly with clients in this realm, though he is not yet having meetings on his own.

His current project is to do all the

college planning and he will lead the meetings on this subject.

Additionally, he will do the education for employees holding the 401(k) plans we manage for our clients with businesses. Our goal is for him to start having his own meetings next month, less than a year after he was hired.

We are all cross-training, so we can fill each other's roles at the drop of a hat. The beauty of our approach? We have a deep bench, the clients know they have a team they can rely on, and it would be difficult for one person to leave and take clients with them.

How is this working out for our 25-year-old? He is delighted with his significant responsibilities and shares the details of his role with his cohorts at other firms. They are envious.

It should be easy for firms with the Grand Poobah model to make this change. Once your younger planners can be prepared to take over one part of the planning process, announce to your clients that you are going to an ensemble approach and let it run from there.

Your clients will thank you, you'll retain the next generation and the world won't fall apart the day you are no longer there for the many who depend on what you do. **FP**

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

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Up to \$85,000	Up to \$170,000	\$0.00	\$134.00	\$0.00	\$0.00
Over \$85,000 to \$107,000	Over \$170,000 to \$214,000	\$53.50	\$187.50	\$13.00	\$66.50
Over \$107,000 to \$133,500	Over \$214,000 to \$267,000	\$133.90	\$267.90	\$33.60	\$167.50
Over \$133,500 to \$160,000	Over \$267,000 to \$320,000	\$214.30	\$348.30	\$54.20	\$268.50
Above \$160,000	Over \$320,000	\$294.60	\$428.60	\$74.80	\$369.40

Source: Medicare.gov; analysis by Ed Slott & Co.

Avoiding a Medicare Hit

A hefty IRA can sometimes mean higher health care costs. Don't let this happen to your clients.

By Ed Slott

Without the right planning, accumulating a large IRA can come with some unexpected consequences for clients, including higher Medicare costs.

Forward-thinking advisors can help by recommending a number of strategies to keep Medicare costs in check, once clients take distributions from their IRAs and other retirement plans.

How does the situation arise in the first place? Medicare charges premiums to participants in Medicare Part B, which covers doctor visits, and Part D, the prescription drug benefit.

In 2018, the basic premium for Part B is \$134 per month, while it varies for Part D

depending on the plan.

However, high-income individuals are required to pay more. A high-income client, in this case, is defined as one with a modified adjusted gross income over \$85,000 on a single tax return, or \$170,000 on a joint return.

These clients' premiums are subject to a surcharge known as an Income Related Monthly Adjustment Amount, or IRMAA. These surcharges increase with income and can more than triple what Medicare participants pay for their benefits, costing thousands of dollars each year.

In 2018, for example, the largest premium surcharges apply to persons with MAGI over

\$160,000 on a single return, or \$320,000 filing jointly. For Medicare Part B, the largest surcharge is \$294.60 per month, or \$3,535.20 per year.

This increases the monthly premium to \$428.60, which is 3.2 times larger than the base premium of \$134.

If a client's income spikes temporarily, for only one year, IRMAA surcharges apply accordingly.

For Part D, the largest surcharge is \$74.80 per month, or \$897.60 per year. Combined, the two surcharges can total \$369.40 per month, or \$4,432.80 per year.

In 2019, a new additional income level of "over \$500,000 single or \$750,000 joint" will apply.

A 6% Hike

Premium amounts for 2019 will not be announced until the end of 2018.

However, as the surcharge at the new over \$500,000/\$750,000 income level will be set to collect 85% of plan costs, up from 80% at the current top level, the largest 2019 premiums can be estimated to be about 6% larger than the largest are for 2018.

These IRMAA income thresholds are fixed through 2019. They'll be adjusted for inflation starting in 2020. IRMAA surcharges apply on a so-called cliff basis. When

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you reach the first dollar of an IRMAA income level, it causes the full corresponding surcharge to apply to all premiums paid for the year.

Example 1: If Bob has MAGI of as much as \$85,000 on his single return, he'll owe no surcharge. But if his income reaches \$85,001, then a monthly surcharge of \$53.50 for Part B plus \$13.00 for Part D, or \$66.50 total, will apply for all 12 months of the year. Bob's \$1 of additional income increases premium cost by \$798 for the year.

You can help clients control income to minimize surcharges. For IRMAA purposes, MAGI is defined as Adjusted Gross Income (AGI) with adjustments for some income that is exempt from federal tax, such as interest from state and local bonds. Medicare uses the MAGI reported on the federal tax return from two years ago.

For example, to determine whether someone will pay higher premiums for 2018, Medicare uses 2016 MAGI.

Similarly, the tax return filed for 2018, which can be strategized for the rest of this year, will be used to calculate IRMAA surcharges for the year 2020.

If income spikes temporarily, for only one year, surcharges apply accordingly. This may result from an event such as a large Roth IRA conversion, taking a large investment gain or even winning a lottery.

There is no "it's only a one-time gain" exemption to owing a surcharge. However, if income drops the next year, then that year's surcharge will be reduced accordingly.

Be Aware of the RMD Effect

Required minimum distributions can result in much higher health care costs. Don't forget that this includes older beneficiaries who are subject to RMDs on inherited IRAs.

An RMD is included in the MAGI used to determine Medicare Part B and

Part D costs two years later.

Example 2: Jason is single and reached age 70 ½ in 2016. He took his first RMD of \$5,000 in 2016, increasing his MAGI to \$108,000.

For 2018, his monthly Part B premiums will be \$267.90 (base premium of \$134 plus surcharge of \$133.90) and his Part D surcharge will be \$33.60 a month.

To avoid a current income spike from a Roth conversion, consider making a series of partial conversions over many years.

Without the RMD, his MAGI would be \$103,000, so his monthly Part B premium would be \$187.50 with a Part D premium of \$13.00. That's a combined \$101 less.

In other words, Jason's RMD will cost him an extra \$1,212 in 2018 for Medicare ($\$101.00 \times 12 = \$1,212.00$).

Check a client's tax return to see if reported MAGI is near one of the threshold amounts.

When MAGI is close to a threshold amount, take steps to keep it under the threshold. If income is close enough, any of a number of tax return strategies may do the trick.

Looking ahead, plan realization of income and deductions to keep MAGI below the nearest threshold.

How Roth Conversions Can Help

A Roth IRA conversion can be useful in minimizing future IRMAA surcharges, as distributions from the Roth IRA can be tax free, reducing MAGI.

To avoid a current income spike from a Roth conversion, consider making a series of partial conversions over a number of years so income will not be pushed into higher tax brackets.

This is a strategy that requires long-term advance planning.

Clients who are in their early retirement years may want to consider

converting to a Roth IRA sooner rather than later. By doing so, they can minimize the impact of RMDs on Medicare costs. RMDs are not required from Roth IRAs during the account holder's lifetime.

When a client converts, the conversion is included in the MAGI used to determine Medicare Part B and Part D costs two years down the road. Therefore, clients will ideally want to consider converting to a Roth IRA before the extra income would affect their Medicare costs.

This is a strategy that should be discussed with clients in their early 60s. As the examples below show, thinking ahead and doing the conversion before it can impact Medicare premiums may save a client thousands of dollars.

Example 3: In 2015, Maria, age 62, became concerned about how future RMDs from her million-dollar IRA would affect her Medicare costs.

She converted her IRA to a Roth IRA. The conversion is taxable in 2015 and included in Maria's MAGI for that year. However, it will not affect Maria's Medicare premiums, because 2018 is the first year that Maria will participate in Medicare.

The MAGI reported on Maria's 2016 federal tax return will determine Maria's premiums for 2018.

By converting in 2015, Maria avoids the fate of her conversion impacting Medicare costs.

Example 4: Maria's twin sister, Kathy, gets wind of Maria's successful strategy. She decides to convert her million-dollar IRA too, but delays doing so until 2016.

Her conversion is taxable in 2016 and included in her MAGI for that year. Unlike her sister, Kathy will see a big impact on her Medicare premiums.

This is because 2018 is the first year Kathy will participate in Medicare, and the MAGI on her 2016 return will

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determine the size of her premiums. Converting her million-dollar IRA in 2016 increases her MAGI to the highest IRMAA income level.

For 2018, she will owe a Medicare Part B premium of \$428.60 and Part D surcharge of \$74.80, monthly.

Converting later may still be an effective strategy. A Roth conversion will negatively affect MAGI for Medicare purposes for only one year. It may make sense to take that hit to eliminate all RMD concerns in the future.

Example 5: Kathy from our previous example got hit hard with Medicare costs in 2018 due to her conversion in 2016. However, she will never have to take RMDs from her Roth IRA. She will avoid having RMDs increase her Medicare costs in all years after she reaches age 70 ½.

Health Savings Accounts

Younger clients may want to consider funding an HSA rather than an IRA, if they have a choice. No one is expecting the cost of medical expenses in retirement to decrease.

A client may borrow against a life insurance policy rather than take a taxable distribution from a retirement plan.

Clients can make deductible HSA contributions in their working years, and then access their HSA tax- and penalty-free to pay for qualified medical expenses in retirement. This is the best of both worlds. These qualified distributions are not included in MAGI for Medicare purposes.

Qualified Charitable Distributions

Qualified charitable distributions can also minimize income. For older clients, QCDs may help minimize the impact of an IRA on Medicare costs. As a result of the new tax law's increased standard deduction amounts, many clients won't

be deducting contributions, so QCDs are more valuable for income tax planning. And they can help avoid Medicare premium increases as well.

With a QCD, an IRA owner (or beneficiary) who is age 70 ½ or older can transfer up to \$100,000 annually from their IRA to a charity, tax free.

A QCD can satisfy an IRA owner's RMD for the year, and the RMD is never included in income at all, so it is not included in MAGI.

Keeping the RMD amount out of MAGI can result in big savings. This is not the case, however, if an IRA owner takes an RMD and then donates to charity and claims a charitable deduction. With that approach, the RMD would still be included in MAGI.

Example 6: Jason, from our prior example, decides to do a QCD of \$5,000 to satisfy his RMD in 2016.

The \$5,000 RMD is not included in the 2016 MAGI used to determine his Medicare costs for 2018. Jason's QCD will save him \$1,212 in Medicare costs for 2018. If Jason had instead taken his RMD and made a charitable donation of \$5,000, this would not have lowered his Medicare costs.

A client not using QCDs to satisfy RMDs can start doing so and see benefits two years later. Depending on income levels, clients may benefit in some years but not others, but this strategy is worth looking into annually.

If a client is charitably inclined and would be making a donation anyway, why not do a QCD and save hundreds or even thousands in Medicare costs, as well as income taxes?

As a reminder, the QCD is only available for IRAs, not company plans. Also, donor-advised funds and private foundations are not eligible recipients.

Other Strategies

Here are other ways you can help clients manage MAGI to minimize

Medicare surcharges.

- Timing investment gains and other income by accelerating them onto a tax return for a year before IRMAA calculations occur, or deferring them to a year when income is expected to be lower and there may be offsetting losses.

- Obtaining spending funds from tax-free sources. For instance, a client may borrow against a life insurance policy rather than take a taxable distribution from a retirement plan, or use tax-free proceeds from the sale of a principal residence (as much as \$250,000 for a single filer, or \$500,000 on a joint return).

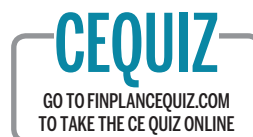
- Home equity is another source of tax-free cash, which can be tapped via a reverse mortgage (a home equity conversion mortgage). The HECM credit line can be drawn on tax-free, with no corresponding mortgage payment expense.

- Investing in appreciating assets and for tax-deferred income, rather than current income.

Clients approaching their Medicare eligibility years obviously need planning help. Advisors cannot afford to be caught off guard when it comes to assisting these clients.

Careful planning with IRAs can help minimize the bite of Medicare costs. Roth conversions, HSAs and QCDs are all strategies worth discussing with clients. An advisor with expertise in these matters can stand out from the rest. **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.



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An essential starting point for clients is to decide whether the HSA is mainly an account to pay current medical costs or an investment vehicle to save for medical expenses in retirement.

How to Help With HSAs

These triple-tax-advantaged savings accounts can be great, but tracking down the right one may involve several decisions.

By Kerri Anne Renzulli

Odds are your clients are struggling with higher insurance costs and worried about incurring future medical bills. Here's one option advisors can help them explore: health savings accounts.

These accounts, which are offered in combination with high-deductible health insurance plans, provide a unique opportunity for clients to save. Better still, they afford triple tax advantages.

Widespread confusion about how these accounts work, however, can keep clients from establishing HSAs or taking full advantage of them. Unfortunately, advisors

are often at sea as well, particularly in helping clients establish their own account outside of an employer.

"A lot of planners focus on investments rather than insurance, so unless they themselves are purchasing individual health insurance or have lots of clients who do, they're usually not very familiar with independent HSAs and don't know in-depth details about them," says John Chan, a planner with Alamo Insurance and Wealth Management in San Antonio.

Because HSA savings enjoy triple tax advantages — contributions are tax-deduct-

ible, earnings accrue tax-free and tax-free withdrawals can be made for qualified medical expenses — failing to help clients establish their own HSA can be a big missed opportunity.

"Advisors I've spoken with know the basics of an HSA, but I feel many advisors under-stress HSAs with clients," adds Stephen Jordan, a planner with CyrilWoertz Financial Group in Peoria, Illinois. "I think it is a really important tool."

Not all HSA providers are created equal; huge variations exist in interest rates, fees and investment options.

But advisors who do have a solid grasp on HSAs can build client loyalty. "Most clients did not know HSAs existed, but were excited they could get an additional tax deduction," Chan says. Those who did open HSAs "felt it was very beneficial and appreciated that I brought the account to their attention."

Here are a number of key issues that advisors should address with clients:

HSA Eligibility

First, clients will need to confirm that their health insurance plan can be paired with an HSA. For many, this will be fairly obvious, as plan names will often include HSA in the title. But clients should

check with their insurer.

"Try to discourage people from making such a determination on their own," says Roy Ramthun, the president and founder of HSA Consulting Services.

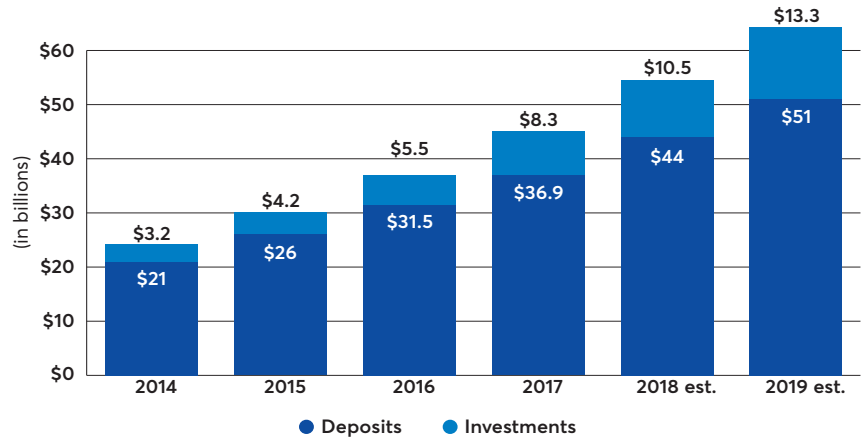
To qualify for use with an HSA, the IRS says, a plan must have a minimum annual deductible of \$1,350 for individuals or \$2,700 for families and a maximum annual deductible of \$6,650 for individuals and \$13,300 for families.

Clients cannot have any other health insurance coverage, be enrolled in Medicare or be covered by another plan, say through their spouse, Ramthun says.

And they cannot be claimed as a dependent on someone else's tax return. If they're covered by a high-deductible health plan that's already paired with a flexible spending account or health reimbursement arrangement, they typically can't contribute to an HSA. For further help determining if your client can open an HSA, consult IRS Publication 969.

Encourage clients to do this check as soon as they've joined a high-deductible plan. Any medical expenses they accumulate before opening the HSA will not be reimbursable, even if they were in an eligible health insur-

Total HSA Assets



Source: Devenir Research

ance plan at the time, says Paul Fronstin, director of the Employee Benefit Research Institute's health research and education program.

Where to Open an HSA

Hundreds of financial institutions offer HSAs. But not all providers are created equal; big variations exist in interest rates, fees and investment options.

How your client intends to use the HSA will have a huge impact on which features should take top consideration. If they will be using it to pay current medical costs, account maintenance fees should be the main concern. Features like a debit card and easy

online bill paying are also worth looking into, Ramthun adds.

If, instead, the HSA will be used as an investment vehicle to save for medical expenses in retirement, the focus shifts to the plan's investment menu, the managers and fund fees.

An analysis by Morningstar from 2017 of the 10 largest HSA-plan providers found that Alliant Credit Union was the best option for clients using an HSA for current spending.

It also recommended SelectAccount (the company has since changed its name to Further) and the HSA Authority because, like Alliant, they offer checking accounts without monthly maintenance fees.

For those looking to invest HSA savings, Morningstar found that HealthEquity was the only plan offering "a well-designed investment menu, strong underlying managers, and attractive fees."

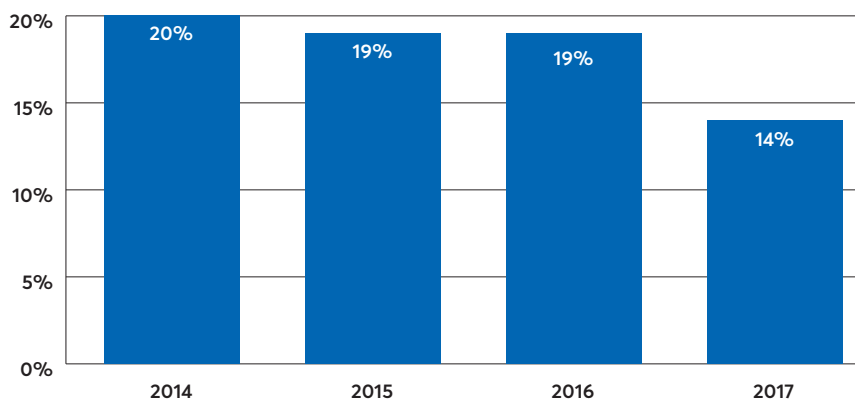
But it also recommended Optum Bank, the HSA Authority and Bank of America. All four plans had at least two of the three key features.

Only the HSA Authority was recommended by Morningstar as both a spending and saving vehicle.

Devenir offers a search tool that allows people to search through 519

Share of Dollars Placed in Individual HSAs

Employee accounts dominate the sector



Source: Devenir Research

Client

plan providers by a wide range of criteria.

Funding the HSA

If a client's employer is not associated with the HSA, they may need to ask HR if it is possible to have a portion of their pay or bonuses directed to it. If they can't do that or are self-employed, they will need to take a more active role in funding the account.

For 2018, those with individual coverage can save a maximum of \$3,450 in their HSA. For those with family coverage, the contribution limit jumps to \$6,900. Clients who are 55 or older by the end of the year can sock away an additional \$1,000.

If your client joined a high-deductible plan during the year, they can still contribute the maximum as long as they had coverage by Dec. 1, under what's known as the last-month rule.

When taking advantage of that rule, clients must remain on a high-deductible plan for all of the following year. Failing to do so may mean they'll have to claim "excess" contributions as part of their taxable income and pay a 10% penalty tax on that sum.

Remember that all funding limits are related to tax filing status too, meaning

that while spouses can each have their own HSA, the maximum remains unchanged if they file a joint tax return. For instance, a husband can put \$4,000 into his HSA this year, but that means his wife can contribute only \$2,900 to hers, so as a family, they still remain under the \$6,900 limit.

All contributions made to an independent HSA are still deductible from taxable income, even if a client doesn't itemize.

For families with adult children still on the family health plan who file their own independent tax returns, this presents a chance to fully fund two HSAs connected to the same insurance coverage, Ramthun says. A client and adult child can each open an HSA and each stash the full \$6,900 in it this year. Happy news for broke children: the funding can come from someone beside the account owner. Bad news: parents can't use their HSA to cover an independent child's medical costs.

"Contributions can be put in as a lump sum or be spread out over the course of the year," Ramthun says. "But if they want the tax deduction, they need to make sure the money is in the account before the April tax deadline,

though I urge people not to wait that long. If they want to wait to see how much medical expenses they actually incurred and use it as a cash account, they should still put the funds in by the end of the year."

All contributions made to an independently opened HSA are still deductible from taxable income, even if a client doesn't itemize. The tax break just won't be realized until a client completes their tax return and files IRS Form 8889. That said, workers will typically lose out on FICA tax benefits on their contributions, Fronstin adds.

If Clients Already Have HSAs

Clients who have HSAs but then join an employer that offers different ones have two options. They can keep both accounts or close the one they opened independently and move the funds to the work-related HSA.

They should not, however, opt out of the work-related account, Ramthun advises. They'll need to leave it open to receive employer HSA contributions.

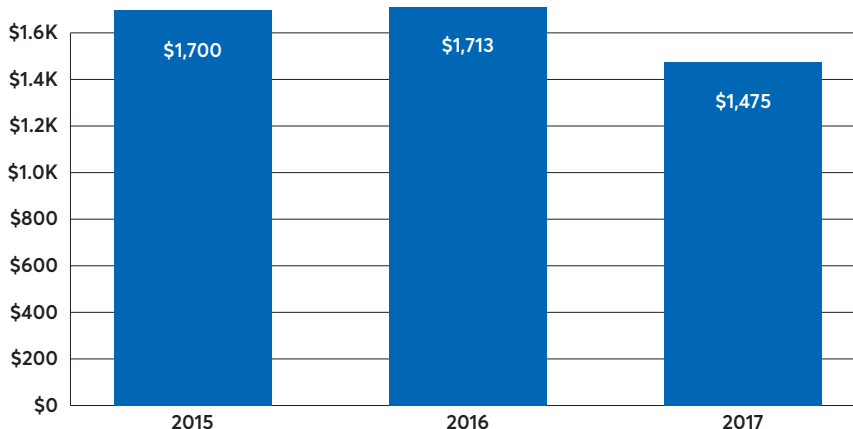
Rather, if a client wants to keep the original HSA, they should opt to do a trustee-to-trustee transfer once or twice a year, Ramthun says. "You can move the money between HSAs as often as you want, but I would limit it as there can be fees involved."

Also, be careful not to roll the money over. Taking money out of an account and into your possession only to deposit it in another account must be done in 60 days and can be done only once a year, as with an IRA. **FP**

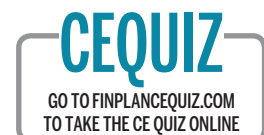
Kerri Anne Renzulli is a senior editor of Financial Planning. Follow her on Twitter at @kerrenzulli.

Dip in Contributions

Average amount saved annually in an independent HSA



Source: Devenir Research



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A retirement portfolio that is built for growth during both the accumulation years and the distribution years can distribute far more to a retiree than its starting balance at the beginning of retirement.

Ease Clients' Concerns

If history is a guide, your clients can stop freaking out about running out of money during their post-work life.

By Craig L. Israelsen

I am about to provide you with a historical analysis that will help your clients breathe an enormous sigh of relief about their retirement portfolios.

Since 1926, there have been 33 distinct "client lifetimes," as I call them. By following a simple investing strategy, all 33 would have been left with millions of dollars if they lived to age 95.

Consider a client lifetime as a 60-year window, starting at age 35 when the person seriously begins to invest for retirement. The client retires at age 70, and then lives to age 95. Thus, this 60-year lifetime includes a

35-year period of accumulation, followed by a 25-year period of distributions.

Ideally, some people will begin investing even earlier, and of course, some will live beyond age 95, but for the purposes of this analysis, we assume the above parameters are true. I also base my calculations for the retiree's distributions on the RMD guidelines, assuming the retiree only withdraws the RMD amount each year and nothing more, and that each year's RMD withdrawal is adequate for their needs.

The starting income at age 35 is assumed to be a modest \$50,000, with an increase of

1.5% annually through age 70. In the accumulation phase, the client saves 8% of their annual income every year and invests it in a 60% equity, 40% fixed-income portfolio. More specifically, the portfolio — which is rebalanced annually — includes the following:

- 40% large U.S. stocks represented by the S&P 500.
- 20% small U.S. stocks represented by the Ibbotson Small Companies Index from 1926 to 1978 and the Russell 2000 from 1979 to 2017.
- 30% U.S. bonds represented by the Ibbotson Intermediate Term Bond Index from 1926 to 1975 and the Barclays Capital Aggregate Bond Index from 1976 to 2017.
- 10% cash represented by 3-month Treasury bills.

Here's the tricky part. A client who began their investing life in 1926 at age 35 had a far different experience than one who, at age 35, began their investing life in 1940. Why? Because the sequence of returns experienced in each client's portfolio will be different based on the historical moment. Thus, we need to analyze each rolling 60-year period from 1926 through 2017 to account for each cohort of clients. In fact, I've analyzed 33 distinct rolling 60-year periods over the

Portfolio

92-year period from 1926 to 2017.

"The Big View" chart uses a red dotted line to show the retirement portfolio balance at age 70 for each of the 33 different clients. The solid blue line represents the total dollar amount of RMDs withdrawn over the 25 years from age 70 to 95, and the lighter blue bars represent the ending portfolio balance at age 95.

In our analysis, the average 25-year total RMD withdrawal between ages 70 to 95 was \$4.8 million.

Using the assumptions outlined above, over the entire 1926 to 2017 time period, the average 35-year rolling return for this four-asset, annually-rebalanced portfolio was 9.97%.

But of course, there's variation in people's experiences. A client who began their investing life at age 35 in 1926 accumulated \$1.18 million in their retirement portfolio by the end of 1960 at age 70. Meanwhile, their portfolio had an average annualized return of

8.31% using the actual returns of the four indexes used in this analysis.

This same client began their retirement in 1961 and after withdrawing the RMD each year for the next 25 years, had withdrawn a total of \$3.16 million by the end of 1985. At the start of 1986, as a 95-year-old, they still had a balance of \$3.1 million in their retirement account. We need to remember that they maintained a 60/40 portfolio not only through the accumulation phase, but also through retirement.

Impressive Outcomes

As the graph shows, each of the 33 different clients (the first one turned 35 in 1926, the last one turned 35 in 1958) accumulated an average of \$1.3 million in their retirement portfolios by age 70. The largest balance at age 70 was \$1.76 million over the 35-year period from 1958-1992, while the smallest balance was roughly \$860,000 over the period from 1940-1974. So, our 33 clients had impressive outcomes by age 70.

The average 25-year total RMD

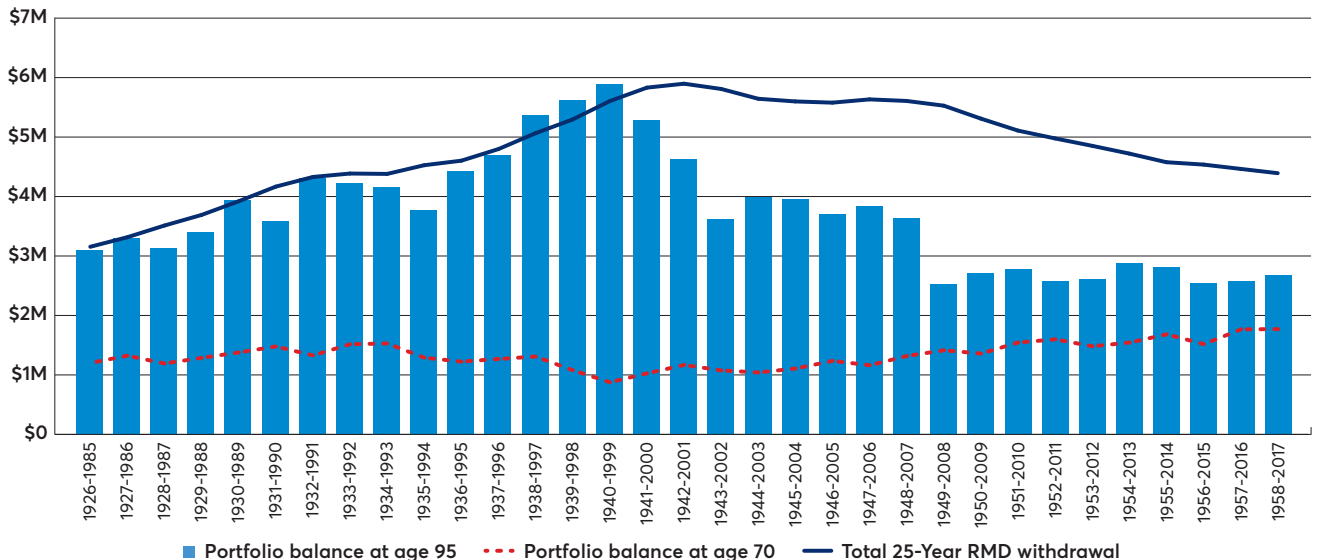
withdrawal between ages 70 to 95 was \$4.8 million, or roughly 3.7 times more than the average starting balance of the retirement portfolio at age 70. The average annual RMD-based withdrawal over all the rolling 25-year periods was \$193,014. Of course, there is variation around that average. You will recall that the RMD fluctuates based on the portfolio's performance in the prior year, combined with the escalating mandated withdrawals as the client ages.

For example, during one particular 25-year period from January 1961 to December 1985, the average annual RMD withdrawal was \$126,244 — the lowest average over all the rolling periods. In contrast, during the 25-year period from 1977 to 2001 the average annual RMD was \$236,843 — the highest average due to a favorable sequence of returns in the portfolio.

This particular 25-year distribution period from 1977 to 2001 came after a 35-year accumulation period that started in January 1942 and ended in December 1976, when the client turned

The Big View

There have been 33 client lifetimes since 1926.



Source: Steele Mutual Fund Expert, calculations by author

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Portfolio

70. The starting balance for this client in January 1977 was \$1.15 million.

Over the next 25 years, a total of \$5.9 million was withdrawn based on RMD guidelines (which averages out to \$236,843). At age 95, this particular client had a portfolio balance of \$4.6 million. Do you think they will run out of money? I certainly don't. Of course, every story won't have such a happy ending, but the RMD methodology guarantees a portfolio will not be liquidated prior to age 116 if only the RMD is withdrawn each year — and no more.

The Big Picture

Simply put, a retirement portfolio that is built for growth during both the accumulation years and the distribution years can distribute far more to the retiree than its starting balance at the beginning of retirement.

This big picture is important for retirees to understand so they don't fret over what they feel is too small a

retirement portfolio. A portfolio that has a material equity allocation can grow to meet withdrawal demands over time.

Finally, the average portfolio balance at age 95, for all 33 clients, after enduring 25 years of RMD-based withdrawals, was \$3.7 million. The maximum figure was \$5.89 million and the minimum figure was \$2.53 million.

This is incredibly comforting if the stipulated RMD each year is adequate to meet your client's needs during their retirement years.

We also must consider the costs associated with the portfolio. Thus far in the analysis, we have been using performance data based on four indexes, and indexes don't have annual expense ratios or advisory fees. "The Staggering Impact of Portfolio Costs" summarizes the impact portfolio costs have on the outcomes for these 33 different investors.

As shown in the table, the baseline figures do not account for any portfolio

costs. If we assume a total portfolio cost of 50 bps, the average portfolio balance at age 70 falls by nearly \$142,000 from \$1.32 million to \$1.18 million. At 50 bps, the average total RMD withdrawal from age 70 to 95 drops from \$4.82 million to \$3.98 million.

Finally, the average portfolio balance at age 95 declines from \$3.7 million to \$2.93 million. Obviously, the impact to the investor is more pronounced if the portfolio cost escalates to 100 bps or 150 bps.

A retirement portfolio built for growth can distribute far more to a retiree than its starting balance at retirement.

In summary, a growth-oriented portfolio combined with an adequate savings rate during the working years produces a retirement nest egg at age 70 that simply cannot be liquidated prior to age 95 if the client withdraws only the amount stipulated by the RMD. Moreover, it is imperative to keep portfolio costs and advisory fees as low as possible.

Note that this analysis did not rely upon a Monte Carlo simulation. Rather, it was based on actual historical performance over rolling 60-year periods. The variability in the sequence of returns was fully accounted for. Unless you believe the future will be radically different from the past, this analysis should be reassuring to your clients. Share it with them. **FP**

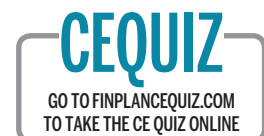
Craig L. Israelsen, Ph.D., a Financial Planning contributing writer in Springville, Utah, is an executive in residence in the personal financial planning program at the Woodbury School of Business at Utah Valley University. He is also the developer of the 7Twelve portfolio.

The Staggering Impact of Portfolio Costs

The effect on investors can be quite significant.

Total Portfolio Expenses	0 bps	50 bps	100 bps	150 bps
Average Portfolio Balance at Age 70	1,322,564	1,180,728	1,055,264	944,238
Average Total RMD Withdrawal Over 25 years	4,827,592	3,988,878	3,301,455	2,737,413
Average Portfolio Balance at Age 95	3,705,899	2,930,070	2,317,789	1,834,470

Source: Steele Mutual Fund Expert, analysis by author



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From: Avoiding a Medicare Hit

1. What is the current basic premium for Medicare Part B?

1. \$150 per month
2. \$75 per month
3. \$200 per month
4. \$134 per month

2. What is the maximum modified adjusted gross income a married couple filing jointly can have before they will be subject to a Medicare surcharge for an income related monthly adjustment?

1. \$85,000
2. \$200,000
3. \$170,000
4. \$100,000

From: Ease Clients' Concerns

3. What was the average 60% equity/40% bond portfolio balance, at age 95, for 33 different clients (in time periods ranging from 1926 to 2017) who began investing at age 35, saving 8% annually of a salary starting at \$50,000 and increasing 1.5% each year until age 70?

1. \$5.89 million
2. \$3.7 million
3. \$2.53 million
4. \$800,000

From: How to Help With HSAs

4. To qualify as a high-deductible plan that can be used with an HSA, the plan must offer a minimum deductible of how much for individuals?

1. \$2,700
2. \$1,350
3. \$2,000
4. \$1,500

5. What is the maximum annual deductible for a family in order for a plan to qualify as one that can be used with an HSA?

1. \$10,200
2. \$15,100
3. \$13,300
4. \$9,700

From: Warning: Be Careful When Clients Hire Family Caregivers (online only)

6. How much, on average, do family caregivers helping a relative with dementia spend on annual out-of-pocket expenses?

1. \$10,697
2. \$8,765
3. \$11,289
4. \$7,522

From: Rates Are Rising. Are Unconstrained Bond Funds Still Worth the Risk? (online only)

7. As of the end of second quarter 2018, what was the five-year annualized return of PIMCO's Unconstrained Institutional Class Bond Fund?

1. 5.21%
2. 2.57%
3. 1.18%
4. 3.31%

From: How Sending Out Promotional Materials Can Affect Suitability (online only)

8. Which FINRA notice addresses examples of electronic communications considered to be either within, or outside, the definition of "recommendation" for advisors?

1. Notice to Members 01-45
2. Notice to Members 01-23
3. Notice to Members 01-55
4. Notice to Members 01-75

From: Help Clients Boost Savings

9. At what income level is a couple filing jointly disqualified from contributing directly to a Roth IRA?

1. \$150,000
2. \$225,000
3. \$199,000
4. \$300,000

10. What is the current annual maximum allowed for all employee contributions, employer contributions and non-Roth after-tax contributions?

1. \$25,000
2. \$75,000
3. \$35,000
4. \$55,000

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My Worst Advice

Sometimes a planner's guidance to a client can go seriously awry. Why? Reality doesn't always match the dream.

By Ben Taatjes

Five years ago, I made the biggest mistake of my career.

I gave some untimely advice to a new client and soon realized the full impact that our work can have on our clients' lives — not just on their wallets.

When Jim (I'm withholding his last name for privacy reasons) first visited my office, he was 62 years old and simply gathering information to see if he could retire at 65.

I saw he had built up a sizable nest egg in a 401(k) and was debt free. He was a diligent saver over his entire career and was in an excellent financial position, so I gave him the most surprising news of his life. I told him, "Jim, I have great news for you. If you want to, you can retire right now."

He replied, "You mean I don't have to wait until I'm 65? Will I have enough money?"

"That's right," I told him. "We've calculated for risks and inflation, and with your planned spending, you will have plenty of income to retire today."

About a week later, Jim visited our office and was very excited. He said, "Guess what, Ben? I took your advice and put in my two-week notice."

With that, Jim said goodbye and left happy as can be.

Now, you may be wondering why this was such bad advice. After all, the plan was financially sound, and he was certainly ready to retire — on paper, that is.

Three months later, Jim and his wife came into our office for a review. Even though only a few months had passed, he looked as if he had aged three years. I could immediately tell something was wrong.

As we talked, I learned that all of Jim's friends were his former co-workers. Now that he had retired, he was spending most of his time alone, watching television while his wife was at work. Besides

having a small amount of yard work, he was bored and had no plan.

Additionally, because he had a physically demanding career, his new sedentary lifestyle was negatively affecting him. He was

inactive, sleeping later and moving visibly slower.

Mentally, he was already slower and seemed disengaged from life. He certainly wasn't the same upbeat person who had strutted into my office celebrating his retirement. Instead, he seemed like a man disconnected from his purpose.

Without realizing it, Jim had left his purpose at work and didn't have a new one to take its place

In essence, it was as if he had moved into an empty house that he expected to be furnished. Reality did not match the dream.

What I finally understood was that Jim hadn't initially come in to retire. He had been planning to retire at 65. Those three years would have given him more time to process, to say goodbye to his friends and to prepare mentally for his retirement.

Jim helped me to see that preparing well for retirement means far more than financial planning.

To truly serve clients holistically, advisors should work with them to create plans that address their purpose, relationships, health and legacy.

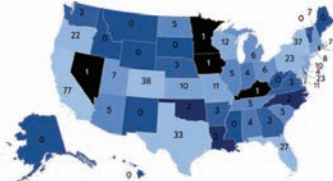
Simply put, if you don't address the nonfinancial issues, the financial ones will not matter. **FP**



Ben Taatjes, is CEO and founder of Taatjes Financial Group in Willmar, Minnesota.

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2014 through Feb 2017



Source: SourceMedia research

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