

Financial Advisor Series

Foundations of Retirement Planning
Second Edition

Kirk S. Okumura



This publication is designed to provide accurate and authoritative information about the subject covered. While every precaution has been taken in the preparation of this material, the authors, and The American College assume no liability for damages resulting from the use of the information contained in this publication. The American College is not engaged in rendering legal, accounting, or other professional advice. If legal or other expert advice is required, the services of an appropriate professional should be sought.

© 2010 The American College
270 S. Bryn Mawr Avenue
Bryn Mawr, PA 19010
(888) AMERCOL (263-7265)
theamericancollege.edu
All rights reserved
ISBN-10: 1-932819-88-6
ISBN-13: 978-1-932819-88-5
Library of Congress Control Number 2009908144
Printed in the United States of America

Financial Advisor Series

Sales Skills Techniques

Techniques for Exploring Personal Markets

Techniques for Meeting Client Needs

Techniques for Prospecting: Prospect or Perish

Women and Money: Matters of Trust

Product Essentials

Essentials of Annuities

Essentials of Business Insurance

Essentials of Disability Income Insurance

Essentials of Life Insurance Products

Essentials of Long-Term Care Insurance

Essentials of Multiline Insurance Products

Planning Foundations

Foundations of Estate Planning

Foundations of Retirement Planning

Foundations of Financial Planning: An Overview

Foundations of Financial Planning: The Process

Foundations of Investment Planning

The American College

The American College® is an independent, nonprofit, accredited institution founded in 1927 that offers professional certification and graduate-degree distance education to men and women seeking career growth in financial services.

The Center for Financial Advisor Education at The American College offers both the LUTCF and the Financial Services Specialist (FSS) professional designations to introduce students in a classroom environment to the technical side of financial services, while at the same time providing them with the requisite sales-training skills.

The Solomon S. Huebner School® of The American College administers the Chartered Life Underwriter (CLU®); the Chartered Financial Consultant (ChFC®); the Chartered Advisor for Senior Living (CASL®); the Registered Health Underwriter (RHU®); the Registered Employee Benefits Consultant (REBC®); and the Chartered Leadership Fellow® (CLF®) professional designation programs. In addition, the Huebner School also administers The College's CFP Board—registered education program for those individuals interested in pursuing CFP® certification, the CFP® Certification Curriculum.¹

The Richard D. Irwin Graduate School® of The American College offers the master of science in financial services (MSFS) degree, the Graduate Financial Planning Track (another CFP Board-registered education program), and several graduate-level certificates that concentrate on specific subject areas. It also offers the Chartered Advisor in Philanthropy (CAP)® and the master of science in management (MSM), a one-year program with an emphasis in leadership. The National Association of Estate Planners & Councils has named The College as the provider of the education required to earn its prestigious AEP designation.

The American College is accredited by:

The Middle States Commission on Higher Education
3624 Market Street
Philadelphia, PA 19104
267.284.5000

The Middle States Commission on Higher Education is a regional accrediting agency recognized by the U.S. Secretary of Education and the Commission on Recognition of Postsecondary Accreditation. Middle States accreditation is an expression of confidence in an institution's mission and goals, performance, and resources. It attests that in the judgment of the Commission on Higher Education,

1. Certified Financial Planner Board of Standards, Inc., owns the certification marks CFP®, CERTIFIED FINANCIAL PLANNER™, and CFP (with flame logo)®, which it awards to individuals who successfully complete initial and ongoing certification requirements.

based on the results of an internal institutional self-study and an evaluation by a team of outside peer observers assigned by the Commission, an institution is guided by well-defined and appropriate goals; that it has established conditions and procedures under which its goals can be realized; that it is accomplishing them substantially; that it is so organized, staffed, and supported that it can be expected to continue to do so; and that it meets the standards of the Middle States Association. The American College has been accredited since 1978.

The American College does not discriminate on the basis of race, religion, sex, handicap, or national and ethnic origin in its admissions policies, educational programs and activities, or employment policies.

The American College is located at 270 S. Bryn Mawr Avenue, Bryn Mawr, PA 19010. The toll-free number of the Office of Professional Education is (888) AMERCOL (263-7265); the fax number is (610) 526-1465; and the home page address is theamericancollege.edu.

Contents

Financial Advisor Series	iii
The American College	iv
Table of Contents	vi
Preface.....	xiii
Acknowledgments.....	xv
About the Financial Advisor Series.....	xvi
Overview of the Book.....	xvii
1 Introduction to Retirement Planning.....	1.1
Introduction	1.1
Retirement Planning Discipline	1.2
Selling/Planning Process.....	1.2
Retirement Planning Process: The Advisor’s Perspective.....	1.2
Five Phases of Retirement Planning: The Client’s Perspective.....	1.5
Questions That Define the Retirement Planning Discipline	1.8
Critical Issues that Affect Retirement Planning.....	1.8
Issue One: Retirement Age	1.9
Issue Two: Life Expectancy	1.9
Issue Three: Financial Preparedness	1.10
Issue Four: Need for Education and Advisors.....	1.10
Issue Five: Government Concern	1.11
Issue Six: Changing Face of Retirement	1.12
Issue Seven: The Three-Legged Stool.....	1.13
Issue Eight: Baby Boomers and Retirement—Demographics Worth Considering.....	1.13
Issue Nine: Roadblocks to Retirement Saving	1.14

Issue Ten: Retirement Planning Objectives	1.17
Role of the Advisor in Retirement Planning	1.18
Responsibilities of the Financial Advisor	1.19
Motivating Your Clients to Begin Planning for Retirement	1.20
Assessing the Market.....	1.21
Retirement Planning Environment.....	1.21
Market Demographics	1.23
Locating Prospects for Retirement Planning.....	1.26
Market Identification Techniques.....	1.28
Prospecting Sources	1.33
Conclusion.....	1.38
Chapter One Review.....	1.39
Review Questions	1.39
Self-Test Questions.....	1.39

2 Retirement Income Sources and Calculations 2.1

Sources of Retirement Income.....	2.1
Social Security	2.3
Pensions	2.5
Savings.....	2.6
Earnings	2.8
The Advisor’s Role	2.9
Social Security: An Overview	2.10
History of Social Security	2.10
Common Misconception about Social Security.....	2.11
Who Is Covered?.....	2.11
Social Security Benefits	2.12
Eligibility for Benefits	2.12
Survivor Benefits.....	2.14
Disability Benefits.....	2.16
Retirement Benefits	2.18
Impact of Social Security on Retirement Planning	2.20
Other Sources of Retirement Income	2.21
Capitalizing Home Equity in the Retiree’s Principal Residence	2.22
Liquidating a Business Ownership Interest.....	2.23
Inheritances	2.23
Other Forms of Support	2.24
The Advisor’s Role	2.25
Time Value of Money Basics.....	2.25
Compound Interest.....	2.26
Estimating the Future Value of Investments.....	2.26
Present Value	2.31
Personal Financial Statements	2.34

Financial Position Statement	2.35
Preparing a Financial Position Statement	2.38
Cash Flow Statement	2.39
Chapter Two Review	2.45
Review Questions	2.45
Self-Test Questions.....	2.46

3 Fact Finding and Goal Setting.....3.1

Setting Retirement Goals	3.1
Importance of Goal Setting in Retirement Planning	3.1
The Advisor’s Role in the Goal-Setting Process	3.2
Retirement Expectations	3.3
Assumptions Required in the Retirement Planning Process	3.4
Retirement Income Needs	3.4
Inflation Assumption	3.5
Retirement Age Assumption	3.7
Longevity Assumption.....	3.7
Income Requirement Assumption.....	3.9
Marginal Income Tax Rates.....	3.15
Interest Earnings on Savings, Investments, and Assets Earmarked for Retirement.....	3.16
Other Assumptions.....	3.16
Summary	3.18
Meeting with the Prospect.....	3.18
Preparing for the Interview	3.19
Initial Interview.....	3.19
Interviewing the Prospect.....	3.23
Establishing an Agenda	3.24
Explaining the Need for Retirement Planning.....	3.25
Clarifying Motives and Goals.....	3.26
Methods	3.26
The Problem: Ensuring Adequate Retirement Income.....	3.27
Sources of Retirement Income.....	3.28
Qualifying the Prospect	3.28
Personal Retirement Planning Review	3.30
Preliminary Discovery Agreement.....	3.32
Dominant Need Situation.....	3.32
Direct Transition	3.33
Summary	3.34
The Fact Finding Process.....	3.34
Total Financial Needs Analysis to the Dominant or Single Need—the Deductive Approach	3.35
Dominant or Single Need to Total Financial Needs Analysis—the Inductive Approach	3.35

Fact Finders	3.35
Mutual Agreement to Work Together.....	3.52
Discovery Agreement.....	3.52
Chapter Three Review	3.52
Review Questions	3.53
Self-Test Questions.....	3.53
4 Financial Obstacles to Successful Retirement Planning.....	4.1
Specialized Planning Needs	4.1
Education Funding	4.3
Remember Insurance Protection and Risk Management	
Needs	4.11
Health Care Costs During Retirement.....	4.11
Medical Expense Insurance.....	4.13
Overview of the Medicare System.....	4.14
Long-Term Care.....	4.21
The Solution: Long-Term Care Insurance	4.22
Other Insurable Financial Risks.....	4.32
Insurance Planning and Risk Management	4.32
Medical Care Expenses.....	4.34
Premature Death Losses.....	4.36
Disability Income (DI) Losses.....	4.39
Property and Liability Losses	4.41
Unemployment	4.43
Impact of Income Taxes on Retirement Planning	4.44
Income Tax Rates.....	4.44
State Income Taxes.....	4.45
Tax Reduction Strategies	4.46
Alternative Minimum Tax (AMT)	4.49
Using Form 1040 to Find Selling/Planning	
Opportunities	4.49
Special Income Tax Rules for Qualified Plans	4.50
Important Income Tax Planning Concepts	4.51
Inflation.....	4.52
Causes of Inflation.....	4.52
What Inflation Means	4.52
Inflation and Financial Decision Making.....	4.55
Danger of Procrastination	4.57
Cost of Waiting.....	4.57
The Advisor's Role	4.60
Chapter Four Review.....	4.61
Review Questions	4.61
Self-Test Questions.....	4.62
5 Investments and Financial Products.....	5.1

Saving and Investing	5.1
Risk.....	5.2
Time Horizon.....	5.2
Liquidity.....	5.2
Transaction Costs	5.2
Tax Consequences.....	5.2
Competing Investment Opportunities.....	5.3
Summary	5.4
Approaches to Saving and Investing	5.4
Pretax	5.4
Tax-Free	5.6
Tax-Deferred.....	5.7
After-Tax	5.9
The Advisor’s Role	5.9
Suitability and Risk Tolerance.....	5.9
Suitability	5.9
Risk Tolerance	5.10
The Advisor’s Role	5.12
Managing Risk.....	5.12
Understanding Risk	5.12
Risk-Return Trade-off.....	5.14
Investment Risk Management	5.15
Managing Investments.....	5.16
Investment Strategies.....	5.16
Dealing with Sudden Wealth	5.23
Overview of Investment and Financial Products	5.26
Mutual Funds.....	5.26
How Mutual Funds Work.....	5.27
Taxation of Distributions	5.31
A Word of Caution	5.32
Mutual Funds and Retirement Planning	5.32
Annuities	5.32
Variable Life Insurance Products	5.40
Stocks and Bonds.....	5.42
Barriers to Investing.....	5.46
The Advisor’s Role	5.47
Chapter Five Review	5.48
Review Questions	5.48
Self-Test Questions.....	5.49

6 Tax-Advantaged Retirement Plans 6.1

Qualified Plans.....	6.1
Concept of Qualified Plans.....	6.2
The Qualified Plan Advantage.....	6.3
Categories of Qualified Plans	6.4

Types of Qualified Plans	6.8
Legal Requirements.....	6.13
Tax Aspects	6.17
Other Tax-Advantaged Retirement Plans.....	6.18
SEP	6.19
SIMPLE	6.20
403(b) Plan	6.23
Selling/Planning Opportunities.....	6.26
Non Qualified Retirement Plans	6.27
Nonqualified Deferred-Compensation Plans.....	6.28
Stock Option Plans	6.30
Sec. 457 Plans	6.32
Planning with IRAs and IRA Rollovers.....	6.34
Traditional IRA	6.34
Roth IRA	6.39
Traditional IRA versus Roth IRA	6.42
Rollovers and Direct Transfers	6.44
Conclusion.....	6.46
Chapter Six Review.....	6.46
Review Questions	6.47
Self-Test Questions.....	6.48

7 Wealth Management and Distribution Strategies for Retirees 7.1

Planning Considerations at Early Retirement.....	7.1
The Early Retirement Trend.....	7.1
Factors That Affect the Early Retirement Decision	7.2
Considering an Early Retirement Offer	7.5
IRA Withdrawals in Early Retirement.....	7.12
Selling/Planning Opportunities.....	7.12
Summary	7.14
Lifetime Asset Distribution Planning	7.15
Social Security	7.15
Distributions from Qualified Retirement Plans	7.19
Working with Retiring Employees	7.26
Retirement—When Work Ends	7.26
Employer’s Perspective	7.29
Worker’s Perspective	7.29
Working during Retirement.....	7.29
The Advisor’s Role	7.30
Postretirement Saving and Investing Strategies.....	7.31
Preretirement Mentality	7.32
Postretirement Financial Concerns.....	7.33
Planning Considerations and Strategies.....	7.33
Retirement Planning Process Revisited	7.40
Preparing for Your Presentation.....	7.40

Delivering Your Presentation	7.42
Periodic Review	7.43
Chapter Seven Review	7.44
Review Questions	7.44
Self-Test Questions.....	7.45
8 Wealth Transfer Planning and Professionalism	8.1
Life Insurance Proceeds	8.1
Beneficiary Designations	8.2
Limitations on the Policyowner's Rights	8.3
Naming a Beneficiary	8.4
Life Insurance Proceeds	8.5
Estate Planning Considerations	8.5
How Property Passes at Death	8.6
Basic Estate Tax Calculation	8.12
Estate Planning Techniques	8.15
Trusts	8.22
Income in Respect of a Decedent.....	8.24
Ethics and Professionalism for the Financial Advisor.....	8.27
State Regulation	8.28
Federal Regulation	8.31
Company Rules and Procedures	8.33
Being a Professional	8.36
A Concluding Thought	8.39
Chapter Eight Review	8.39
Review Questions	8.39
Self-Test Questions.....	8.40
Appendix A Time-Value-of-Money Tables.....	A.1
Appendix B Household Budget Summary	B.1
Appendix C Retirement Planning Fact Finder	C.1
Appendix D Answers to Questions	D.1
Glossary.....	G.1
Index.....	I.1

Preface

The mission of this book is to develop your professionalism as a financial advisor who counsels prospects and clients about the need for retirement planning. We intend to do this by teaching you important aspects of the retirement planning process as it is adapted from the eight-step selling/planning process. Each chapter covers one or more concepts relevant to successful retirement planning and/or the skills, techniques, or knowledge that facilitate their use. To gain an understanding of the retirement planning process, you need to read the entire book.

Although much of the text material will be new to you, some will, no doubt, refresh knowledge you acquired in the past. In either case, all of the text material is both valuable and necessary if you aspire to be a successful financial advisor. The benefits you gain from studying the text will be directly proportional to the effort you expend. Read each chapter carefully and answer the essay and multiple-choice review questions for the chapter (preferably before looking in the back of the book for the answers); to do less would be to deprive yourself of the unique opportunity to become familiar with the selling/planning process and all that it entails.

The book includes educational features designed to help you focus your study of the selling/planning process. Among the features found in each chapter are

- learning objectives
- a chapter outline, examples, figures, and lists
- key terms and concepts
- review questions (essay format)
- self-test questions (multiple-choice format)

Features located in the back of the book are a(n)

- glossary
- answers to questions section
- index

Finally, all of the individuals noted on the acknowledgments page made this a better book, and we are grateful. In spite of the help of all these fine folks, however, some errors have undoubtedly eluded our eyes. For these we are solely responsible. At the same time, we accept full credit for giving those of you who find these errors the exhilarating intellectual experience produced by such discovery. Nevertheless, the author acknowledges that any errors discovered are solely his fault.

Acknowledgments

This book was written by Richard A. Dulisse, CFP, former assistant professor of financial planning at The American College, and updated by Kirk S. Okumura of The American College faculty.

About the Financial Advisor Series

The mission of The American College is to raise the level of professionalism of its students and, by extension, the financial services industry as a whole. As an educational product of The College, the Financial Advisor Series shares in this mission. Because knowledge is the key to professionalism, a thorough and comprehensive reading of each book in the series will help the practitioner-advisor to better service his or her clients—a task made all the more difficult because the typical client is becoming more financially sophisticated every day and demands that his or her financial advisor be knowledgeable about the latest products and planning methodologies. By providing practitioner-advisors in the financial services industry with up-to-date, authoritative information about various marketing and sales techniques, product knowledge, and planning considerations, the books of the Financial Advisor Series will enable many practitioner-advisors to continue their studies so as to develop and maintain a high level of professional competence.

When all books in the Financial Advisor Series are completed, the series will encompass 16 titles spread across three separate subseries, each with a special focus. The first subseries, *Sales Skills Techniques*, will focus on enhancing the practitioner-advisor's marketing and sales skills but will also cover some product knowledge and planning considerations. The second subseries, *Product Essentials*, will focus on product knowledge but will also delve into marketing and sales skills, as well as planning considerations in many of its books. The third subseries, *Planning Foundations*, will focus on various planning considerations and processes that form the foundation for a successful career as a financial services professional. When appropriate, many of its books will also touch upon product knowledge and sales and marketing skills. Current and forthcoming titles are listed earlier in this book.

Overview of the Book

Foundations of Retirement Planning guides the financial advisor through the retirement planning process, explaining the use of fact finders, methods of analyzing facts, presentation of solutions, and calculation of clients' retirement income needs.

Chapter 1 examines 10 critical issues that affect retirement planning today, with an emphasis on the roadblocks to retirement saving. In addition, it discusses the roles and responsibilities of the financial advisor in the retirement planning process. The chapter introduces the eight-step selling/planning process (or sales cycle), including the adaptation of this process to retirement planning. Furthermore, it discusses the five stages of retirement planning from the client's perspective. Finally, the chapter examines prospecting, retirement planning demographics, and the various age-based market segments for retirement planning.

Chapter 2 identifies the main sources of retirement income, with a special focus on Social Security and the role Social Security benefits play in retirement planning. Next, the chapter considers time-value-of-money concepts and reviews future value and present value calculations. The chapter concludes with a discussion of personal financial statements, including the financial position and cash flow statements. It explores cash flow analysis, planning, and management, with an emphasis on household budgeting techniques.

Chapter 3 begins with a discussion of goal setting and examines the quantitative assumptions that are required in the retirement planning process, concentrating particularly on the two basic methods for calculating a prospect's retirement income need. The purpose and goals of the initial retirement planning interview are explored, along with three methods to qualify prospects for retirement planning. The chapter also includes a step-by-step explanation of how to use the retirement planning fact finder.

Chapter 4 examines the financial obstacles to successful retirement planning. It discusses the impact of special planning needs—especially college education funding—on retirement planning. It also discusses how Social Security, Medicare, Medicaid, and medical expense and long-term care insurance, as well as other insurance products and risk management techniques, affect planning. The chapter then assesses the impact of income taxation, inflation, and the procrastination of saving on retirement planning.

Chapter 5 focuses on investments and financial products. It considers the four basic approaches to investing, along with the concepts of suitability and risk tolerance, and it identifies the basic types of risk associated with investing. Risk management and investment management techniques, such as diversification, asset allocation, and dollar cost averaging, are examined, as well as financial products

used in retirement planning such as mutual funds, annuities, life insurance, stocks, and bonds.

Chapter 6 discusses tax-advantaged retirement plans, examining the basic types of qualified and nonqualified plans in detail. It also addresses the effect of salary reduction on income taxes and the impact of tax deferral on the accumulation of money. There is an in-depth discussion of the traditional IRA, Roth IRA, IRA rollovers, and the rules for the taxation of distributions from IRAs.

Chapter 7 explores wealth management and distribution strategies for retirees. It looks at reasons for and against taking early retirement, along with its effect on Social Security benefits and company-sponsored retirement plans. The chapter explores the roles of Social Security retirement benefits, life insurance, and qualified plan and IRA required minimum distribution rules in retirees' asset distribution planning. Pre- and postretirement investment strategies are covered, as well as the development of effective retirement planning solutions.

Chapter 8, which is devoted to wealth transfer planning and professionalism, opens with a discussion of life insurance beneficiary designations and the five ways that property transfers from owners to survivors at death. The chapter explores the use of basic estate planning techniques and the impact of income in respect of a decedent, and it reviews state regulation of insurance products and federal regulation of securities products. The book concludes with an evaluation of the critical role of ethics and professionalism in the financial advisor's selling/planning activities.