1

The Financial Planning Process

Robert W. Cooper
C. Bruce Worsham

Overview and Learning Objectives

Chapter 1 explains what financial planning is—a six-step client-focused process for helping the client achieve his or her financial goals. **While a client's financial goals may involve business, as well as personal, objectives, this book focuses primarily on planning to meet the personal financial goals of individuals and families.** The chapter then describes three approaches for conducting financial planning. The chapter also discusses the key areas of specialization in which financial advisors concentrate their activities and summarizes the recommended content of a comprehensive financial plan. Next, it introduces the concepts of financial life cycle and life-cycle financial planning and then reviews one approach for organizing a comprehensive financial plan. The chapter then covers some of the key events in the historical development of financial planning as a profession during the past 30 to 35 years. Finally, the chapter discusses a number of trends that are creating opportunities for financial advisors to serve clients, and it identifies some of the obstacles that advisors must help clients overcome if financial goals are to be achieved. By reading this chapter and answering the questions, you should be able to

1-1. Explain the six steps in the financial planning process.

1-2. Describe three different approaches to financial planning, and identify several areas of specialization in which advisors concentrate their activities.

1-3. Identify the subjects that should be included in a comprehensive financial plan.

1-4. Describe what is meant by a person's financial life cycle, and explain how it relates to life-cycle financial planning.

1-5. Describe how a financial plan could be organized around the steps in the financial planning process.

1-6. Describe the evolution of financial planning as a profession.

1-7. Explain the trends that are creating opportunities in the financial planning marketplace.

1-8. Identify the principal financial goals/concerns of most consumers, and describe three major obstacles that prevent them from achieving these goals.

Chapter Outline

Emergence of a New Profession 1-3
What Is Financial Planning? 1-5
  Financial Planning Is a Process 1-5
  Steps in Financial Planning 1-6
How Is Financial Planning Conducted? 1-15
  Single-Purpose Approach 1-15
  Multiple-Purpose Approach 1-16
  Comprehensive Approach 1-17
Financial Planning Areas of Specialization 1-19
Content of a Comprehensive Financial Plan 1-21
  Life-Cycle Financial Planning 1-23
  Format of a Comprehensive Financial Plan 1-25
Evolution of Financial Planning As a Profession 1-29
Trends Creating Opportunities for Financial Planning Advisors 1-31
Consumer Needs for Financial Planning 1-35
  Obstacles Confronting Consumers 1-38
  Role of Financial Planning Advisors 1-39
Financial Planning Umbrella 1-41
Chapter One Review 1-43
Appendix 1A: Topic List for CFP® Certification Examinations 1-47
Appendix 1B: The Financial Planning Process as Viewed by the Certified Financial Planner Board of Standards, Inc. 1-49

* CFP®, Certified Financial Planner™, and CFP (with flame logo)® are certification marks owned by the Certified Financial Planner Board of Standards, Inc.

Emergence of a New Profession

Although providing financial planning advice and services to clients is a relatively new and still-emerging field of professional endeavor, very affluent individuals have had access to such help for many years. Moreover, some financial advisors **(see page xix for an explanation of the meaning of the term "financial advisor" or "advisor" as used in this book)**, such as accountants and life insurance agents, argue that they have been practicing financial planning all their professional lives. Perhaps they are correct. However, it is generally recognized that financial planning services that cover a spectrum of client concerns have become available to most Americans in the middle- and upper-middle-income brackets only in the past 30 to 35 years.

Financial advisors claiming to be practicing financial planning first appeared in numbers in the late 1960s, a period of rising inflation and interest rates. The financial planning movement grew rapidly during the 1970s as the general trend of prices continued upward. By the late 1970s and into the early 1980s, inflation and interest rates were virtually out of control. Confronted with very high income tax rates along with these inflation and interest rates, American consumers clamored for help. The growth of the financial planning movement was explosive. Often, however, what advisors labeled as financial planning consisted mostly of selling "get rich quick" products and elaborate income tax dodges, usually accompanied by an abundance of "hype." A few advisors, sometimes with near-messianic zeal, preached the message of comprehensive financial planning as the financial salvation of the American household.

By the mid-1980s, much of the turbulence in economic conditions began to settle down. In addition, when income tax reform eliminated the most extreme types of tax shelters from the marketplace, many so-called financial planning advisors disappeared from the scene. Many advocates of the comprehensive approach to financial planning came to realize that this type of financial planning is practical for only a small, affluent clientele, especially when provided solely on a fee-for-service basis. Also, with the oldest members of the "baby boom" generation entering their 40s, retirement planning became an increasingly important component of financial planning practices.

In the 1990s, the financial planning profession gained some stability and maturity. Now it is possible to describe more realistically what financial planning is and what client needs it can fulfill.

What Is Financial Planning?

One factor that has hampered the development of *financial planning* as a discipline and as a profession is the fact that there has been very little agreement among advisors as to what exactly financial planning is. Indeed, it sometimes seems that there are as many definitions of financial planning as there are people who believe they are engaged in financial planning. This debate, which continues among financial advisors even now,[1] is not merely an exercise in semantics. It becomes intensely practical when questions are raised about such issues as who shall regulate those advisors engaged in financial planning, who shall set standards for the financial planning profession, what sort of education should these advisors have, or which advisors may hold themselves out to the public as practicing financial planning.

Financial Planning Is a Process

Despite this ongoing controversy among advisors, financial planning can be defined conceptually as a process that accomplishes both of the following:

- ascertaining the client's financial goals
- providing a plan (not necessarily written) for achieving the client's goals

Whether used by advisors or self-planning individuals, the *financial planning process* has six steps: (1) establish financial goals, (2) gather relevant data, (3) analyze the data, (4) develop a plan for achieving goals, (5) implement the plan, and (6) monitor the plan. (Many advisors will reverse steps 1 and 2. The Certified Financial Planner Board of Standards essentially combines steps 1 and 2 into step 2 and adds a new step 1—establishing and defining the relationship with the client. (See appendix 1B.)

Steps in Financial Planning

For advisors, this process for helping clients achieve their financial goals can be applied to the full range of client goals on a comprehensive basis. The process can also be applied on a narrower basis to only a subset of those goals or even to only a single financial goal of a client. It is not the range of client goals addressed that determines whether an advisor is engaged in financial planning. Rather, it is the process used by the advisor in addressing client goals that is the determining factor. The following pages present a brief discussion of the six steps in the financial planning process.

Six Steps of Financial Planning
1. Establish financial goals. 2. Gather relevant data. 3. Analyze the data. 4. Develop a plan for achieving goals. 5. Implement the plan. 6. Monitor the plan.

Step 1: Establish Financial Goals

Few people begin a vacation without having a specific destination in mind. In contrast, millions of people make significant financial decisions without having a specific financial destination.

Goal setting is critical to creating a successful financial plan, but few people actually set clearly defined goals. By leading the client through the goal-setting exercise, the financial advisor not only helps establish reasonable, achievable goals, but also sets the tone for the entire financial planning process.

Clients typically express concern about such topics as retirement income, education funding, premature death, disability, taxation, qualified plan distribution, and a myriad of others. Sometimes clients enumerate specific, prioritized goals, but they are more likely to present a vague list of worries that suggest anxiety and frustration rather than direction. The advisor's responsibility is to help the client transform these feelings into goals.

Advisors should question clients to learn what they are trying to accomplish. Usually the response is couched in general terms, such as "Well, we want to have a comfortable standard of living when we retire." At first glance this seems to be a reasonable goal, but a closer evaluation reveals that this goal is far too vague. When do they want to retire? What is meant by "comfortable"? Do they want to consider inflation? Do they want to retire on "interest only" or draw down their accumulated portfolio over their expected lives?

Skillful questioning may reveal a more precise goal, such as "We want to retire in 20 years with an after-tax income of $60,000 per year in

current dollars, and we want the income to continue as long as we live without depleting the principal." Helping the client quantify goals is among the most valuable services a financial advisor can provide.

Another important service of the advisor is goal prioritization. Clients usually mention competing goals, such as saving for retirement and saving for education. Advisors help clients rank these competing goals.

Step 2: Gather Relevant Data

Because there are many client concerns that a financial advisor may need to address, the advisor will have to gather considerable information from the client. Defining the client's current situation, determining what the client's desired future situation is and when it is to be achieved, and establishing what the client is willing and able to do in order to get there require information. This information must be accurate, complete, up-to-date, relevant to the client's goals, and well organized. Otherwise, financial plans based on the information will be deficient—perhaps erroneous, inappropriate, inconsistent with the client's other goals, or dangerous to the client's financial well-being.

After a client expresses goals, objectives, and concerns, the advisor gathers all the information about the client that is relevant to the problem(s) to be solved and/or to the type of plan to be prepared. The more complex the client's situation and the more varied the number of his or her goals, the greater the information-gathering task.

Two broad types of information will need to be gathered: objective and subjective. A few examples of objective (factual) information that might be needed from the client include a list of securities holdings, inventory of assets and liabilities, a description of the present arrangement for distribution of the client's (and spouse's) assets at death, a list of annual income and expenditures, and a summary of present insurance coverages. Of at least equal importance is the subjective information about the client. The financial advisor often will need to gather information about the hopes, fears, values, preferences, attitudes, and nonfinancial goals of the client (and spouse).

One piece of information worthy of special attention is the client's *financial risk tolerance.* Advisors must determine the client's (and spouse's) attitude toward risk before making recommendations, preferably through use of a scientific, third-party evaluation. The American College's *Survey of Financial Risk Tolerance*[2] provides the type of analysis that helps the advisor suggest alternatives that are truly

appropriate for the client. Such information offers the additional benefit of helping avoid (or at least defend) lawsuits from a dissatisfied client.

Before the financial advisor begins the information-gathering process, he or she should give certain information to the client. First, the client should be made aware that he or she will have to invest time, perhaps a significant amount of time, in the information-gathering stage of financial planning. Even though part of the financial advisor's responsibility is to avoid consuming the client's time unnecessarily, this commitment of time by the client is essential. The magnitude of the needed time commitment will depend on the scope and complexity of the client's needs and circumstances, but the proper development of even a narrowly focused and fairly uncomplicated plan requires information that only the client can furnish.

Second, the client should be made aware that he or she probably will have to provide the advisor with some information that is highly confidential, perhaps even sensitive or painful, for the client to reveal. Again, the scope and complexity of the client's needs will influence this matter. The creation of even rather straightforward plans, however, may require clients to disclose such things as their income and spending patterns, their attitudes toward other family members, or their opinions as to the extent of their own financial responsibilities to others. Another prerequisite for the effective gathering of client information is a systematic approach to the task. Although there are many possible ways to systematize the gathering of information, one way that has been found useful by many financial advisors is to use a structured *fact-finder form.* Some fact finders are only a few pages long and ask for basic information, while others are thick booklets that seek very detailed data on each asset and amount. Most fact finders are designed for specific financial planning software to simplify data entry. For many client situations, a formal fact finder elicits considerably more information than needed. The sections that should be completed depend on the particular areas of concern to be addressed in each client's financial plan.

Obviously, information gathering is far more than asking the client a series of questions or filling out a form. Certainly that is required, but usually information gathering also requires examination and analysis of documents—such as wills, tax returns, employee benefit plan coverage, and insurance policies—supplied by the client or the client's other financial advisors. It also requires advising, counseling, and listening during face-to-face meetings with the client and spouse. These skills are especially important because the advisor needs to help the client and

spouse identify and articulate clearly what they really want to accomplish and what risks they are willing to take in order to do so.

Step 3: Analyze the Data

Once the relevant information about the client has been gathered, organized, and checked for accuracy, consistency, and completeness, the financial advisor's next task is to analyze the client's present financial condition. The objective here is to determine where the client is now in relationship to the goals that were established by the client in step one.

This analysis may reveal certain strengths in the client's present position relative to those goals. For example, the client may be living well within his or her means, and thus resources are available with which to meet some wealth accumulation goals within a reasonable time period. Maybe the client has a liberal set of health insurance coverages through his or her employer, thereby adequately covering the risks associated with serious disability. Perhaps the client's will has been reviewed recently by his or her attorney and brought up-to-date to reflect the client's desired estate plan.

More than likely, however, the financial advisor's analysis of the client's present financial position will disclose a number of weaknesses or conditions that are hindering achievement of the client's goals. For example, the client may be paying unnecessarily high federal income taxes or using debt unwisely. The client's portfolio of investments may be inconsistent with his or her financial risk tolerance. Maybe the client's business interest is not being used efficiently to achieve his or her personal insurance protection goals, or important loss-causing possibilities have been overlooked, such as the client's exposure to huge lawsuits arising out of the possible negligent use of an automobile by someone other than the client.

One conclusion from the advisor's analysis may be that the client cannot attain the goals established in step one. For example, the client's resources and investment returns may preclude reaching a specified retirement income goal. In this case, the advisor helps the client to lower the goal or shows what changes the client must make to achieve the goal. Postponing retirement, saving more money, seeking higher returns, and deciding to deplete principal during retirement are four ways to help achieve the goal. Presented with alternatives, the client can restate the original goal by either lowering it or revising restrictive criteria to make it achievable.

Step 4: Develop a Plan for Achieving Goals

After the information about the client has been analyzed and, if necessary, the goals to be achieved have been refined, the advisor's next job is to devise a realistic *financial plan* for bringing the client from his or her present financial position to the attainment of those goals. Since no two clients are alike, a well-drawn financial plan must be tailored to the individual, with all the advisor's recommended strategies designed for each particular client's needs, abilities, and goals. The plan must be the client's plan, not the advisor's plan.

It is unlikely that any individual advisor can maintain an up-to-date familiarity with all the strategies that might be appropriate for his or her clients. Based on his or her education and professional specialization, the advisor is likely to rely on a limited number of "tried and true" strategies for treating the most frequently encountered planning problems. When additional expertise is needed, the advisor should always consult with a specialist in the field in question to help him or her design the client's overall plan.

Also there is usually more than one way for a client's financial goals to be achieved. When this is the case, the advisor should present alternative strategies for the client to consider and should explain the advantages and disadvantages of each strategy. Strategies that will help achieve multiple goals should be highlighted.

The financial plan that is developed should be specific. It should detail who is to do what, when, and with what resources.

Implicit in plan development is the importance of obtaining client approval. It follows that the plan must not only be reasonable, it must also be acceptable to the client. Usually interaction between advisor and client continues during plan development, providing constant feedback to increase the likelihood that the client will approve the plan.

Normally, the report describing the plan should be in writing. Since the objective of the financial planning report is to communicate, its format should be such that the client can easily understand and evaluate what is being proposed. Some financial advisors take pride in the length of their reports, although lengthy reports are often made up primarily of standardized or "boilerplate" passages. In general, the simpler the report, the easier it will be for the client to understand and adopt. Careful use of graphs, diagrams, and other visual aids in the report can also help in this regard.

After the plan has been presented and reviewed with the client, the moment of truth arrives. At this time the advisor must ask the client to

approve the plan (or some variation thereof). As part of this request, the advisor must ask the client to allocate money for the plan's implementation. While there are those who frown at the mere mention of selling in connection with financial planning—financial planning does involve selling. Even financial advisors who are compensated entirely on a fee-for-service basis must sell the client on the need to work with the advisor to develop and implement a plan.

Step 5: Implement the Plan

The mere giving of financial advice, no matter how solid the foundation on which it is based, does not constitute financial planning. A financial plan is useful to the client only if it is put into action. Therefore, part of the advisor's responsibility is to see that plan implementation is carried out properly according to the schedule agreed upon with the client.

Financial plans that are of limited scope and limited complexity may be implemented for the client entirely by the advisor. For other plans, however, additional specialized professional expertise will be needed. For example, such legal instruments as wills and trust documents may have to be drawn up, insurance policies may have to be purchased, or investment securities may have to be acquired. Part of the advisor's responsibility is to motivate and assist the client in completing each of the steps necessary for full plan implementation.

Step 6: Monitor the Plan

The relationship between the financial advisor and the client should be an ongoing one. Therefore, the sixth and final step in the financial planning process is to monitor the client's plan. Normally the advisor meets with the client at least once each year to review the plan, or more frequently if changing circumstances warrant it. The first part of this review process should involve measuring the performance of the implementation vehicles. Second, updates should be obtained concerning changes in the client's personal and financial situation. Third, changes that have occurred in the economic, tax, or financial environment should be reviewed with the client.

If this periodic review of the plan indicates satisfactory performance in light of the client's current goals and circumstances, no action needs to be taken. However, if performance is not acceptable or if there is a significant change in the client's personal or financial circumstances or goals or in the economic, tax, or financial environment, the advisor and client should revise the plan to fit the new situation. This revision

process should follow the same six steps used to develop the original plan, though the time and effort needed will probably be less than in the original process.

Summary

The financial planning process described above is depicted schematically in figure 1-1. The blocks on the left represent the six steps

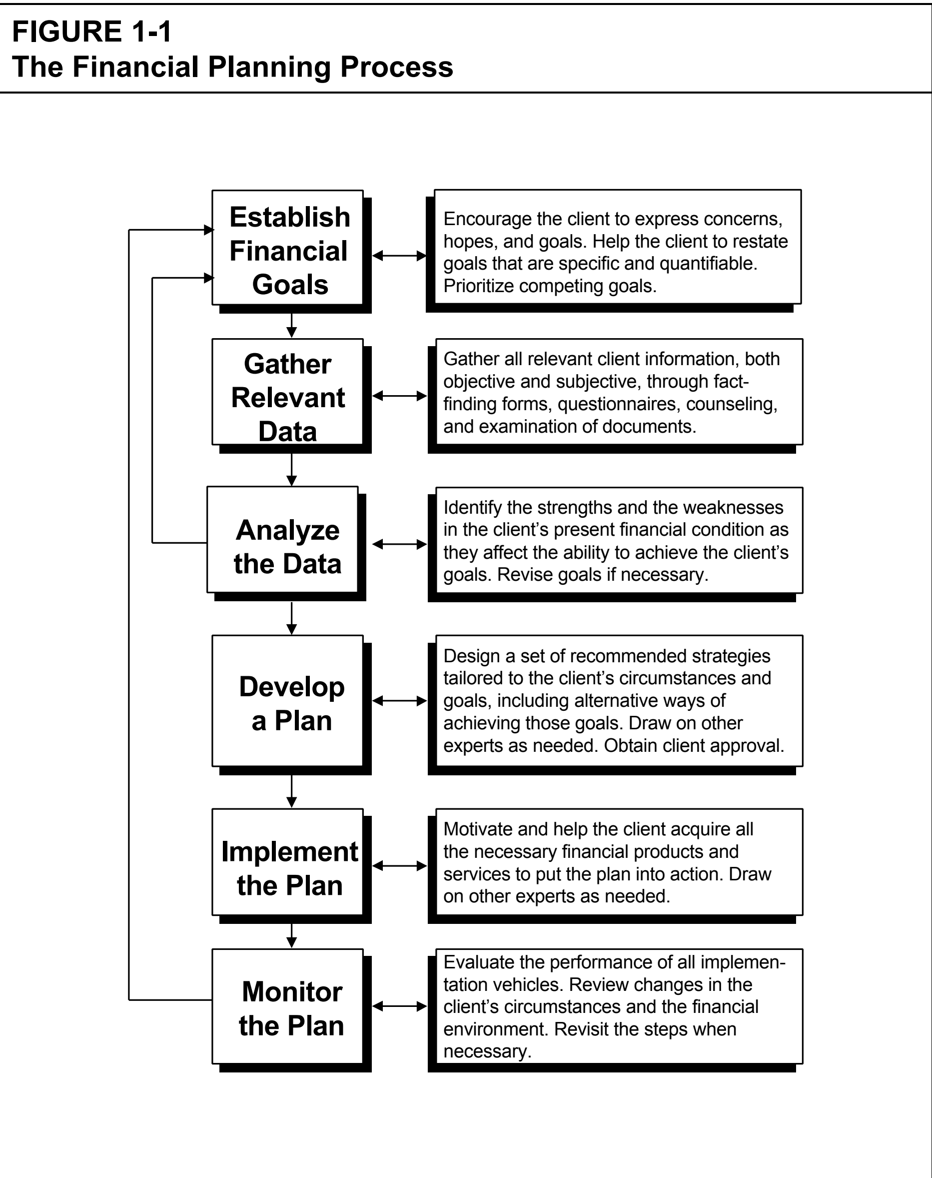

FIGURE 1-1
The Financial Planning Process

in the process, while the blocks on the right indicate the main substantive activities that should occur in each step.

Individuals who intend to take the Certified Financial Planner certification examination should review the steps in the financial planning process as listed in appendix 1B. The financial planning process in appendix 1B essentially combines steps 1 and 2 into step 2 and inserts a new step 1 called “Establishing and Defining the Relationship with the Client.”

How Is Financial Planning Conducted?

The ongoing debate over what financial planning is and, thus, who is engaged in financial planning has often centered on the breadth of services provided to clients. Some have contended that the financial advisor who focuses on solving a single type of financial problem with a single financial product or service is engaged in financial planning. Others have argued that true financial planning involves consideration of all of the client's financial goals and all the products and services available to achieve those goals. What if the advisor's focus is somewhere in between these two extremes?

Once financial planning is recognized as being a process, the traditional debate is relatively easy to resolve. Regardless of the breadth of services provided, an advisor is engaged in financial planning if he or she uses the six-step financial planning process in working with a client to develop a plan (not necessarily written) for achieving that client's financial goals. Thus, true financial planning can involve a single-purpose, multiple-purpose, or comprehensive approach to meeting a client's financial goals as long as the six-step financial planning process is utilized in doing so.

Single-Purpose Approach

Some advisors take the position that the simple selling of a single financial product or service to a client in order to solve a single financial problem constitutes financial planning. Clearly, these advisors would be incorrect if the financial planning process was not used to determine whether the problem their product solves is, in fact, the specific client's financial problem and if so, whether it is the most appropriate product or service for solving that client's problem. In this case, the advisor would be involved in product sales, not financial planning.

However, if an advisor sells a client a product to implement the recommendation of a plan developed according to the financial planning process and approved by the client, the service provided by the advisor

constitutes financial planning. According to this specialist or *single-purpose approach,* all the following individuals would be engaged in financial planning as long as they use the financial planning process in working with their clients:

- a stockbroker who advises a customer to buy shares of common stock of a particular company
- a salesperson who sells to a client shares in a real estate limited partnership
- a preparer of income tax returns who suggests that a client establish an IRA
- a banker who opens a trust account for the benefit of a customer's handicapped child
- a life insurance agent who sells key person life insurance to the owner of a small business
- a personal finance counselor who shows a client how to set up and live within a budget

Multiple-Purpose Approach

Client financial needs and financial products and services are often seen as falling into one of three basic categories: insurance planning, tax planning, and investment planning. Rather than taking a single-purpose approach of just solving a single financial problem with a single financial product or service, many financial advisors take a *multiple-purpose approach* by dealing with at least a large part of one of these categories, and perhaps some aspects of a second category. According to the multiple-purpose approach, the following individuals would be engaged in financial planning as long as they use the financial planning process in working with their clients:

- a multiline insurance agent who sells all lines of life, health, property, and liability insurance
- a tax attorney who assists clients with their income, estate, and gift tax planning
- an investment adviser who is registered as such with the Securities and Exchange Commission
- a life insurance agent who also sells a family of mutual funds to meet both the protection and wealth accumulation needs of clients

Comprehensive Approach

Still other advisors take a *comprehensive approach* to providing financial planning services, Comprehensive financial planning considers all aspects of a client's financial position, which includes all the client's financial needs and objectives, and utilizes several integrated and coordinated planning strategies for fulfilling those needs and objectives. The two key characteristics of comprehensive financial planning are

- that it encompasses all the personal and financial situations of clients to the extent that these can be uncovered, clarified, and addressed through information gathering and counseling
- that it integrates into its methodology all the techniques and expertise utilized in more narrowly focused approaches to solving client financial problems

Because of the wide range of expertise required to engage in comprehensive financial planning, effective performance commonly requires a team of specialists. The tasks of the advisor managing the team are to coordinate the efforts of the team and to contribute expertise in his or her own field of specialization.

In its purest form, comprehensive financial planning is a service provided by the managing advisor on a fee-only basis. No part of the managing advisor's compensation comes from the sale of financial products, thus helping to ensure complete objectivity in all aspects of the plan. Some team specialists also are compensated through fees, while others might receive commissions from the sale of products, while still others might receive both fees and commissions. In its less pure but often more practical form, comprehensive financial planning provides the managing advisor with compensation consisting of some combination of fees for service and commissions from the sale of some of the financial products. Again, other members of the team might receive fees, commissions, or both.

Furthermore, in its purest form, comprehensive financial planning is performed for a client all at once. A single planning engagement by the managing advisor and his or her team of specialists creates the one plan that addresses all the clients concerns and utilizes all the needed financial strategies. This plan is then updated with the client periodically and modified as appropriate. In its less pure form, comprehensive financial planning is performed incrementally during the course of

several engagements with the client. For example, the advisor in one year might prepare a plan to treat some of the client's tax concerns and insurance planning problems. In another year, the advisor might focus on the client's investment concerns and then dovetail the strategies for dealing with them with the previously developed tax and insurance strategies. In a third engagement the advisor might address the remaining issues in the tax, insurance, and investment planning areas and coordinate all the recommended strategies and previously developed plans. Again, each incremental part, as well as the overall plan, is reviewed periodically and revised as appropriate.

Financial Planning Areas of Specialization

Regardless of the breadth of the approach to financial planning—single-purpose, multiple-purpose, or comprehensive—employed by a particular advisor in working with clients, financial advisors tend to have areas of specialization in which they concentrate their activities. A survey conducted by the CFP Board of Standards in 1999 identified the following areas of specialization which, in turn, give an indication of the types of services provided by advisors to clients:[3]

- investment planning/advice—90 percent (of those surveyed)
- pension/retirement planning—87 percent
- comprehensive planning—73 percent
- estate planning—73 percent
- portfolio management—67 percent
- income tax planning—60 percent
- insurance planning—59 percent
- education planning—55 percent
- elder/long-term care planning—46 percent
- closely-held business planning—37 percent
- financial planning employee education—31 percent
- income tax preparation—25 percent
- divorce planning—19 percent

Content of a Comprehensive Financial Plan

As indicated in the previous section, many financial advisors see comprehensive financial planning as being one of their areas of specialization. In practice, however, it is the least frequently encountered type of financial planning engagement for most advisors for several reasons. First, not many clients are willing to invest as much of their own time in the undertaking as comprehensive financial planning requires. Second, usually only affluent clients are willing and able to pay for all the time of the advisor and his or her staff that is needed in developing a comprehensive financial plan. Third, not many clients can easily deal with the totality of their financial goals, capabilities, and difficulties all at one time. Instead, most prefer to concentrate on only one or a few related issues at a time. (As has been mentioned, however, even clients in the last group can have a comprehensive plan developed and implemented for them in incremental stages.)

For those cases in which the advisor is called upon to prepare a comprehensive financial plan for a client, whether entirely in one engagement or incrementally over a period of time, what should the plan contain? Clearly, comprehensive financial planning is such an ambitious and complex undertaking that it must cover numerous subjects. At a minimum, these subjects should include the major planning areas identified by the Certified Financial Planner Board of Standards in its

FOCUS ON ETHICS
Beginning a Dialogue on Ethics

Every chapter contains an ethics dialogue box similar to this one. Ethics is a topic that should be implicit in any discussion of financial planning and the role of the financial advisor. This first box addresses a question that many advisors have asked: “Is the highly ethical advisor financially rewarded for being ethical.” The answer is that he or she may be, but there is no guarantee. There are certainly some illustrations of the shady advisor reaping significant financial gains. Disciplined ethical conduct, by itself, does not guarantee financial success.

Perhaps the question should be addressed from a different perspective. Do clients want to do business with someone who really understands financial planning but who has questionable morals? Do clients want to do business with someone whose integrity is unassailable but whose financial planning skills are marginal? The answer to both questions is no.

The skilled financial advisor who is client centered and ethically well disciplined clearly has the attributes that clients desire and deserve. Again, ethical practice provides no guarantees of financial success. It is clear, however, that clients want to do business with financial advisors who have earned their trust and are technically competent.

Topic List for CFP Certification Examinations (see appendix 1A). These areas are

- general principles of financial planning (for example, personal financial statements, client attitudes and behavioral characteristics, and so forth)
- insurance planning and risk management
- employee benefits planning
- investment planning
- income tax planning
- retirement planning
- estate planning

A comprehensive financial plan should address all of these major planning areas as they relate to the client. If the financial advisor does not have the expertise to personally address each of the major planning areas in the development of the plan, he or she should form a team of specialists and serve as its manager. The advisor's role would then be to coordinate the efforts of the team and to contribute expertise in his or her own field of specialization. If, for some reason, one of the major planning areas does not apply to the client, the plan should spell out this fact. This will indicate that an important planning area was not overlooked in the development of the plan but was investigated and found not to apply to the client at this time.

In addition to the major planning areas that pertain to almost every client, there are a number of more specialized areas that are relevant to many, but not all, clients. These specialized areas are, for the most part, subsets of, and typically involve several of, the major planning areas. However, because all of these specialized areas are unique, they merit separate treatment. They should be made part of a client's comprehensive financial plan only if he or she is affected by them. Typically, a single-purpose or multiple-purpose financial plan that is focused on the particular planning need deals with these specialized areas.

The most important of these specialized areas in terms of the number of people it affects is educational funding. Most clients understand the need to save for college and are aware that college costs have risen at a faster pace than the *Consumer Price Index (CPI)*. Still, the vast majority of families accumulate far too little money for college by the matriculation date. They usually have to cut back on living expenses, borrow money, tap into retirement assets, or seek additional employment

to meet the funding need. Often, they lower their sights and target a school that is less expensive, rather than the one best suited to their needs. Consequently, planning to meet the costs of higher education has become a necessity for most people who have children.

The other specialized areas worthy of mention are those that can be categorized as financial planning for special circumstances. These areas typically include planning for

- divorce
- terminal illness
- nontraditional families
- job change and job loss, including severance packages
- dependents with special needs

As previously mentioned, all of these specialized planning areas are subsets of one or more of the major planning areas. For example, divorce planning could affect every single one of the major planning areas but, nevertheless, should not be part of a comprehensive financial plan unless the client is contemplating divorce. Even then, divorce planning would be better handled under a single-purpose or multiple-purpose financial plan because of its unique aspects and shorter planning horizon than the major planning areas.

Life-Cycle Financial Planning

There are five distinct phases in an individual's *financial life cycle*. Starting at a relatively young age (that is, age 25 or younger), a career-minded person typically will pass through four phases en route to phase 5 and his or her retirement. These five phases and their corresponding age ranges are

1. early career (age 25 or younger to age 35)
2. career development (age 35 to age 50)
3. peak accumulation (age 50 to ages 58–62)
4. preretirement (3 to 6 years prior to planned retirement)
5. retirement (ages 62–66 and older)

Together, these five phases span a person's entire financial life. Although some people will not experience all of the phases or will spend more or less time in any one phase, the vast majority of career-minded people will go through all five phases.

The first step in creating a comprehensive financial plan is for the advisor to lead the client through the goal-setting process. Goal setting requires clients to recognize that there are several phases in their financial life; for young clients, the early career phase is the beginning of that life. The goals that young clients who are in this phase typically set reflect this fact. For example, a client who is in the early career phase often is newly married and has young children, and the client and/or his or her spouse are establishing employment patterns. The client probably is concerned about accumulating funds for a home purchase if he or she has not already done so. As the children grow older, the client begins to think about saving for college. Protecting his or her family from a potential financial disaster due to death or disability is also important, as is building a cash reserve or emergency fund to meet unexpected contingencies. However, the client's goals that pertain to retirement and estate planning generally will not have a very high priority in the first few years of the early career phase, but they still need to be considered if the financial plan is to be a truly comprehensive one.

Once the client has a comprehensive financial plan, it is incumbent on the advisor to monitor the plan. As the client moves into the career development phase of his or her financial life cycle, some goals may need revision. This phase is often a time of career enhancement, upward mobility, and rapid growth in income. The phase usually includes additional accumulation and then expenditure of funds for children's college educations. Moreover, the advisor should recommend coordinating the employee benefits of the client and his or her spouse and integrating them with insurance and investment planning goals.

As the client moves into the peak accumulation phase, the ever-vigilant advisor should be monitoring the plan for any needed changes. In this phase, the client is usually moving toward maximum earnings and has the greatest opportunity for wealth accumulation. The phase may include accumulating funds for special purposes, but it is usually a continuation of trying to meet the goals set for the major planning areas.

The preretirement phase often involves winding down both the career and income potential, restructuring investment assets to reduce risk and enhance income, and a further emphasis on tax planning and evaluating retirement plan distribution options relative to income needs and tax consequences. Throughout this phase, the financial advisor should be actively involved in keeping his or her client's financial plan on target to meet all the client's goals.

The final phase in the client's financial life cycle is retirement. If the advisor has kept the client's financial plan fine-tuned, then this phase should be a time of enjoyment with a comfortable retirement income and sufficient assets to preserve purchasing power. While all of the major planning areas should have been receiving attention throughout the client's financial life cycle, now is the time for the advisor to make certain that his or her client's estate plan is in order.

The advisor who monitors a client's financial plan throughout the client's financial life cycle is practicing *life-cycle financial planning.* A comprehensive financial plan that is developed for a relatively young client needs to be reviewed and revised fairly frequently as the client ages and passes through the phases of his or her financial life cycle. Many of the client's financial goals will need adjusting as life's circumstances change; having the right goals is critical to creating a successful financial plan. The advisor's role in setting goals is to help the client establish reasonable, achievable goals and to set a positive tone for the entire financial planning process. The entire process encompasses not only the development of the client's first financial plan but also any future revisions and/or modifications to that plan.

The content of a comprehensive financial plan should, as already mentioned, include a discussion of each of the major planning areas. Which phase of the financial life cycle that the client is currently in strongly influences the priority given to the goals for each of the planning areas. Financial planning is a process that should be ongoing throughout the client's financial life. That is why financial planning over the client's financial life is called life-cycle financial planning.

Format of a Comprehensive Financial Plan

A financial plan, whether comprehensive or not, is essentially a report to the client regarding the advisor's findings and recommendations. This report results from the application of the financial planning process to the client's present situation in an effort to assist the client in meeting his or her financial goals. Although there are as many different formats for a comprehensive financial plan as there are financial advisors, it is easy to agree that every comprehensive financial plan should include certain types of information. For example, every comprehensive plan should cover all of the major planning areas. Every plan should be based

on reasonable, achievable goals set by the client. And every plan should be structured around strategies for achieving the client's goals. In addition, in the process of formulating strategies, assumptions have to be made and should be spelled out in the plan documents. Typical assumptions include the interest rate, the rate of inflation, and the client's financial risk tolerance, to name but a few. Finally, every plan is developed around information gathered during a fact-finding process. Much of this information, such as financial statements, should also be included in the plan. Recognizing that there are many possible variations for organizing all of this information into a cohesive plan, one possible approach is to structure the plan to parallel the steps in the financial planning process as described below.

First (paralleling step 1, establishing financial goals), a comprehensive financial plan should specify the client's stated goals, indicating the priority of each one and the time frame for achieving it. Each goal, as indicated earlier in this chapter, should be stated as specifically as possible. Because there are likely to be a number of goals included in a comprehensive financial plan, it may be helpful for the client to list them in relevant categories, such as protection, accumulation, liquidation, and so forth. Keep in mind that the best solution for a specific goal may involve a combination of the major planning areas; whatever approach is adopted for categorizing the goals, the plan should be designed to avoid confusing the client.

Second (paralleling step 2, gathering relevant data), a comprehensive plan should describe the client's present situation based on both the personal and financial data gathered from the client. In terms of the personal situation, this should include not only basic information about the client and his or her family, such as names, addresses, phone numbers, dates of birth, Social Security numbers, and so on, but also other relevant personal information that helps define the client's present situation and, thus, will affect the financial plan. This other relevant information could include such topics as one of the children's serious health problem, a feeling of personal obligation to support aging parents, a desire to treat adopted or stepchildren differently from natural children, previous marriages and alimony or child-support obligations, and gifts or inheritances pending or anticipated.

In addition to defining the client's present personal situation, the plan should include a description of the client's present financial situation. This is most commonly done by including a copy of the client's balance sheet, listing his or her assets and liabilities and showing

net worth; a cash-flow statement that identifies all the client's sources and uses of cash and indicates his or her net cash flows; and a federal income tax statement and an analysis thereof. The information presented should include not only a current balance sheet, cash-flow statement, and income tax statement, but also projections relevant to understanding the client's current position. The client's current investment portfolio should also be presented with an indication of, among other things, its liquidity, diversification, and risk characteristics. As noted earlier in this chapter, many advisors reverse steps 1 and 2 of the financial planning process. If an advisor is organizing a financial plan around the steps of the process and has reversed steps 1 and 2, he or she will want to organize the plan accordingly.

Next, for each goal, at least three critical areas of information should be presented:

- (paralleling step 3, analyzing the data) the problem(s) the advisor has identified that the client would encounter in attempting to accomplish the goal
- (paralleling step 4, developing a plan) the recommended financial and tax services, products, and strategies for overcoming the identified problem(s) (including any underlying assumptions the advisor made in formulating the recommendation) so that the client can achieve the goal
- (paralleling step 5, implementing the plan) recommendations for implementing the proposed solution for achieving the goal

Regardless of the format a financial advisor adopts to organize a comprehensive financial plan, the important point to remember is that the plan should be communicated to the client in the form of a written report. The format of this financial planning report should make it easy for the client to understand and evaluate what is being proposed. In general, the simpler the report, the easier it will be for the client to understand and adopt. Careful organization, as well as the use of graphs, diagrams, and other visual aids, can help in this regard.

Evolution of Financial Planning As a Profession

It was noted at the beginning of this chapter that financial planning is, in general, still a new and emerging profession. Its development as such has been facilitated by a number of organizations during the past 30 or so years.

Perhaps the earliest landmark event in the development of financial planning as a profession occurred in 1969 with the formation of the International Association of Financial Planners, later renamed the International Association for Financial Planning (IAFP). The IAFP was a trade association that, among other things, promoted financial planning, conducted educational and training programs for members, sponsored market research about financial planning, and promoted ethical conduct among those engaged in financial planning.

Several colleges and universities have played an important role in the development of the financial planning profession. In 1972 the College for Financial Planning, which is the educational institution that originally awarded the Certified Financial Planner™ (CFP®) professional designation, was formed. (This function was later transferred to another organization, now called the Certified Financial Planner Board of Standards.) In 1973 holders of the CFP® designation formed the Institute of Certified Financial Planners (ICFP), a membership organization to help build professionalism in the field. The IAFP and ICFP were unified recently to form the Financial Planning Association (FPA).

A number of important developments occurred in the mid-1970s and thereafter at what was originally called The American College of Life Underwriters, further contributing to the financial planning movement. The name of the institution was changed to The American College to reflect a broadened educational mission within the financial services field. The College created a graduate-degree program, Master of Science in Financial Services, that originally included a full six-credit graduate course in financial counseling. Discussions by the College's Board of Trustees with various constituencies of the institution led eventually to a broadened array of designation-level courses. This broadening in the

curriculum culminated with the creation of a new professional designation in the early 1980s—Chartered Financial Consultant (ChFC). Meanwhile the College's sister organization, the American Society of Chartered Life Underwriters, also broadened its mission, membership, and programs, accepting the new categories of graduates of the College into the Society and changing its name to the American Society of CLU & ChFC. Further emphasizing this direction, the Society changed its name again in 1998 to the Society of Financial Service Professionals.

Traditional colleges and universities also contributed to the emerging financial planning profession during the 1970s and 1980s, though on a much smaller scale than the College for Financial Planning and The American College, both of which serve a national student body. A number of schools developed curricula in financial planning at the undergraduate or master's level and began offering courses to help prepare people for the CFP and ChFC examinations. Now several states allow attainment of either the ChFC or CFP designations to satisfy the education requirement for registration as an investment adviser.

Two other forces that have spurred the growth and professionalization of financial planning have been the American Institute of CPAs (AICPA) and the National Association of Personal Financial Advisors (NAPFA). In 1987 the AICPA developed for its members an educational program leading to the designation that is now called Personal Financial Specialist. Formed in 1983, NAPFA is an organization committed to comprehensive fee-only financial planning. In 2002, NAPFA created the NAPFA-Registered Financial Advisor, a membership category with educational, experience, and ethical requirements.

Trends Creating Opportunities for Financial Planning Advisors

A number of trends having important implications for advisors engaged in financial planning have emerged in the United States in recent years. They all point to enormous opportunities for these advisors to render valuable service to clients.

One of the most important trends is that the population is growing older. The median age of Americans has risen more than 7 years in the past 3 decades, meaning that a larger proportion of the population has moved into the period of highest earnings. Also, as people get older, they tend to devote a smaller share of their income to current consumption and a larger share to saving and investing.

One of the causes of the rising median age of Americans is that the members of the *baby boom generation* are no longer babies. The children born from 1946 to 1964 now range in age from their late 30s and early 40s to their late 50s and constitute about 30 percent of the U.S. population. Another cause of the rising average age is that Americans are living longer. Approximately 12.4 percent of them are now age 65 or over as compared to 9.2 percent in 1960, and this percentage will continue to rise. Government statistics indicate that the average life expectancy for 65-year-old males is now over 16 years and for 65-year-old females is now over 19 years.

The aging of the American population means that more and more consumers need retirement planning help during both their remaining years of active work and their retirement years. Also, an increasing proportion of the population needs assistance in planning for the cost of their children's college educations.

A second important trend in the financial planning marketplace is that dual-income families are increasingly common. This trend results from an increasing percentage of women entering (and reentering) the labor force, even during the years when they have young children. Dual-income families typically have higher total incomes, pay higher income and social security taxes, and have less time

Trends Creating Opportunities for Financial Planning Advisors

1. Rising median age
2. Increased impact of dual-income families
3. Volatility of financial conditions
4. Technological change

to manage their finances. The opportunities for the advisors engaged in financial planning to assist are obvious.

A third broad trend is the increasing volatility of financial conditions in the American economy. Three indicators of this volatility confronting and confusing American households in the past 40 years are the changes that have occurred in inflation rates, in the level of interest rates, and in common stock prices. For example, during the first half of the 1960s, annual increases in the CPI averaged only 1.3 percent; the *prime interest rate* charged by banks on short-term business loans averaged only about 4.68 percent, and the *Standard & Poor's 500 Index* of common stock prices averaged around 72.0. Consider the dynamic patterns of these indicators since then, as shown in table 1-1.

Inflation and interest rates rose steadily in the late 1960s, and they were undoubtedly a motivating factor behind the growth in the number of advisors engaged in financial planning. Inflation and interest rates then cooled but bounced up again sharply in the mid-1970s. After a 3-year respite, they rose very sharply in the late 1970s and into the 1980s. Throughout this entire period, stock prices rose only modestly.

Inflation rates slowed again during the mid-1980s, as did the prime interest rate. Meanwhile the stock market rose dramatically but erratically. As the 1980s came to a close, inflation and interest rates were creeping up again and average common stock prices were gyrating sharply from day to day. Then in the early 1990s, inflation started cooling again, stock prices rose dramatically, and interest rates plummeted. The mid-1990s saw continued moderation of inflation, yet interest rates crept upward while the stock market set record highs. Inflation in 1998 dropped to 1.6 percent, its lowest level in 3 decades. From 1997 to 1999 the stock market soared to unprecedented highs, but also displayed unsettling volatility. In 2000, the stock market turned downward and continued to drop in 2001 and 2002. From a high near 1500 in the middle of 2000, the S & P 500 Index fell below 900 by the end of 2002, quite close to where it was in the middle of 1997 near the beginning of the bull market. Meanwhile, in response to actions of the Federal Reserve, interest rates dropped to their lowest levels in decades, declining from 9.50 percent during December 2000 to 4.00 percent in July 2003, where it remains as of November 2003.

In addition to the volatility of inflation rates, interest rates, and stock market prices, another destabilizing factor faced by American consumers has been important U.S. income tax law changes that affect all aspects of financial planning. Still another element of instability in the financial

TABLE 1-1
Consumer Price Index Changes (Urban Consumers), the Prime Rate, and the Standard & Poor's 500 Stock Index: 1965–2001

Year	Percentage Change in CPI	Average Prime Rate %	Average S & P 500 Index
1965	1.6%	4.54%	88.2
1970	5.7	7.91	83.2
1971	4.4	5.72	98.3
1972	3.2	5.25	109.2
1973	6.2	8.03	107.4
1974	11.0	10.81	82.8
1975	9.1	7.86	87.1
1976	5.8	6.84	102.0
1977	6.5	6.82	98.2
1978	7.6	9.06	96.0
1979	11.3	12.67	102.8
1980	13.5	15.27	118.7
1981	10.3	18.87	128.0
1982	6.2	14.86	119.7
1983	3.2	10.79	160.4
1984	4.3	12.04	180.5
1985	3.6	9.93	186.8
1986	1.9	8.33	236.3
1987	3.6	8.21	268.8
1988	4.1	9.32	265.9
1989	4.8	10.87	323.1
1990	5.4	10.01	335.01
1991	4.2	8.46	376.20
1992	3.0	6.25	415.75
1993	3.0	6.00	451.63
1994	2.6	7.15	460.42
1995	2.8	8.83	541.72
1996	3.0	8.27	670.49
1997	2.3	8.44	873.43
1998	1.6	8.35	1085.50
1999	2.2	8.00	1327.33
2000	3.4	9.23	1427.22
2001	2.8	6.91	1194.18

Source: *Statistical Abstract of the United States*; "Selected Interest Rates: Historical Data," *Statistics: Releases and Historical Data,* The Federal Reserve Board, updated weekly, available at *http://www.federalreserve.gov/releases/;* and *Federal Reserve Bulletin*, various issues.

environment has been the failure rate among financial institutions, including some very large ones. In the 1980s and early 1990s failure rates among savings and loan associations, banks, and insurance companies were higher than they had been in many years.

With the possible exception of the bull market of the late 1990s where many investors felt they could "do it themselves" without either

professional advice or paying much attention to risk,[4] volatile economic conditions generally create greater demand for financial planning services. They also emphasize the need for financial advisors to continuously monitor their clients' financial circumstances and to adjust the plans as circumstances dictate. These volatile financial conditions make it doubly important that advisors thoroughly understand and abide by their clients' risk tolerances. With the three year decline in the stock market that began in 2000 and its major impact on the value of invested assets, investors are again recognizing the value of financial planning services and the need to consider risk as well as return in attempting to achieve their financial goals.

A fourth major trend in the financial planning market is the technological revolution that has occurred in the financial services industry. This revolution has made possible the creation of many new financial products and has made it easier to tailor these products to individual client needs. Also the technology has made possible improved analysis of the performance of these products by advisors with the skills to do so.

Consumer Needs for Financial Planning

A basic and inescapable principle of economics is the law of scarcity—in every society, human wants are unlimited whereas the resources available to fill those wants are limited. The available resources must be somehow rationed among the wants. This rationing problem creates the need for financial planning even in affluent societies, such as the United States, and even among the most affluent members of such societies. To put it colloquially, there is just never enough money to go around.

What are the main financial concerns of American consumers? Are they able to handle those concerns on their own or do they need professional help? In short, do U.S. consumers have a significant need and effective demand for professional financial planning services in the early years of the new millennium?

A national consumer survey conducted by the CFP Board of Standards in 2002 identified the following top-10 reasons people begin financial planning:[5]

- building a retirement fund (83 percent of those surveyed)
- building an "emergency fund" (38 percent)
- home purchase/renovation (35 percent)
- managing/reducing current debt (34 percent)
- vacation/travel (32 percent)
- building a college fund (32 percent)
- accumulating capital (31 percent)
- providing insurance protection (30 percent)
- sheltering income from taxes (28 percent)
- generating current income (23 percent)

In reporting the results of its 2002 Consumer Survey, the CFP Board of Standards also broke the findings down according to three key groups of respondents—"up and coming," "mid-life," and "retirement cusp." Table 1-2 shows the financial planning focus of each of the groups and highlights the relative importance of retirement planning to all three

TABLE 1-2
Financial Planning Needs

Consumer Group	Who Are They?	Financial Planning Focus
Up and Coming	• Ages: 20-39 • 28% have a written financial plan • 59% completed plan within the last 3 years • Most tolerant of risk • More likely to use the Internet for financial purposes • Most likely to have financial software	• Prepare for retirement • Manage/reduce debt • Build an emergency fund • Build a college fund • Save for a home purchase/renovation
Mid-Life	• Ages: 40-54 • 37% have a written financial plan • 61% completed plan at least 5 years ago • More likely to use a financial professional to develop a plan • Highest amount of household income • Have low to moderate risk tolerance	• Prepare for retirement (strongest focus of all three consumer groups) • Build an emergency fund • Finance college education • Provide insurance protection • Home purchase/renovation • Vacation/travel
Retirement Cusp	• Ages: 55-69 • 52% have a written financial plan • 65% completed plan at least 5 years ago • Higher net worth and lower risk tolerance • Most likely to have a financial professional as a primary advisor • Lower risk tolerance than younger groups	• Prepare for retirement • Accumulate capital • Shelter income from taxes • Generate income • Build an emergency fund • Vacation/travel • Provide insurance protection

Source: *2002 Consumer Survey*, Certified Financial Planner Board of Standards, Denver, CO.

consumer groups. The quite similar findings of two independent studies conducted in 2002, one by the National Retirement Planning Coalition (NRPC)[6] and the other by the Employee Benefits Research Institute

(EBRI),[7] emphasize that in many cases, there is a strong need for professional help in planning effectively for one's retirement:

- Long retirements are expected.
  - NRPC survey: The average respondent expects to spend at least 19 years in retirement.
  - EBRI survey: The majority of working respondents expect to spend at least 20 years in retirement.
- Retirement income needs are underestimated (retirement planning professionals typically recommend 75–90 percent of preretirement income to live comfortably in retirement).
  - NRPC survey: Respondents indicate they expect to need 60 percent of preretirement income to live comfortably.
  - EBRI survey: Seventeen percent of working respondents expect to need less than 50 percent of their preretirement income in retirement, 25 percent indicated 50-59 percent and 14 percent indicated 60-69 percent; only 25 percent indicated 70-89 percent.
- Retirement savings are insufficient.
  - NRPC survey: Only one-third of the respondents are very confident that they will be able to maintain the lifestyle they want through their retirement years.
  - EBRI survey: With 23 percent of the nonretired workers indicating that they are very confident in having enough money to live comfortably throughout their retirement years and 47 percent indicating that they are somewhat confident, almost half have saved less than $50,000 and only 17 percent have saved $100,000 or more.
- Inadequate planning has been conducted.
  - NRPC survey: Forty-one percent of the respondents have not attempted to determine how much retirement savings they will need to live comfortably and another 41 percent who did attempt to calculate their required retirement savings could not complete the calculation or could not determine the income they need to retire.
  - EBRI survey: One-third of the nonretired respondents indicated that they have tried to calculate how much money they will need to have saved by the time they retire so that they can live comfortably in retirement.

Baby boomers, Americans born between 1946 and 1964, are now in midlife. A study conducted by the American Association of Retired Persons (AARP) in 1999 found that while baby boomers appear to be quite optimistic about their retirement years, their optimism is moderated somewhat by concerns about finances.[8] Another study conducted by AARP in 2002 found that personal finances are among the areas of their lives with which baby boomers are least satisfied.[9] About one-third of the survey respondents indicated that they are worse off financially than they thought they would be at this point in their lives. Many baby boomers feel financially strapped, especially when it comes time to pay college tuition. While 29 percent of those surveyed have made "improving their personal finances" their top goal over the next five years, nearly half do not believe they are likely to achieve their goal due, among other things, to their own inability to handle credit cards and debt, the volatile stock market, the cost of living, and economic uncertainty in the workplace.

Another study of baby boomers conducted by The Allstate Corporation in 2001 suggests that many baby boomers are likely to encounter a retirement that is quite different in financial terms from the past.[10] Among other things, the survey revealed that during retirement, more than one in three baby boomers will be financially responsible for parents or children, 7 percent will be financially responsible for both parents and children, one in five will pay college tuition for one or more children, and more than 70 percent will continue to work. The survey also suggests that baby boomers appear to be poorly prepared for this financially burdensome retirement with survey respondents having saved only an average of 12 percent of the total they will need to meet even basic living expenses in retirement and having far underestimated the predicted increase in the cost of living over the next 20 years.

The baby boom generation has also become known as the *sandwiched generation* because many of its members are already faced with helping finance their children's education and aiding their aging parents at the same time that they themselves should be saving for their own retirement. Retirement, college funding, and long-term care are important to everyone, but especially to sandwiched boomers.

Obstacles Confronting Consumers

The results of the surveys discussed above and similar studies make it clear that many American households still have not gained control of their financial destinies. Certainly, there are many reasons why they

have not developed financial plans that will enable them to do so. Three of the most important obstacles they face are the following:

- the natural human tendency to procrastinate—Among the reasons for putting off the task of establishing a financial plan may be a lack of time due to a hectic lifestyle, the seeming enormity of the task of getting one's finances under control, and the belief that there is still plenty of time to prepare for achieving financial goals.
- the very common tendency for Americans to live up to or beyond their current income—The pressure in households to overspend for current consumption is enormous, and many families have no funds left with which to implement plans for the achievement of future goals.
- the lack of financial knowledge among consumers—Although in recent years there has undoubtedly been some growth in the financial sophistication of Americans, there is still widespread ignorance about how to formulate financial objectives and how to identify and properly evaluate all the strategies that might be used to achieve them.

Role of Financial Planning Advisors

A basic inference that can be drawn from the results of consumer surveys is that Americans need help in managing their personal finances to achieve their financial goals. Moreover, many Americans seem to realize that they would benefit from professional help, and with better education, most others would reach the same conclusion. A major part of the challenge facing advisors who are doing financial planning is to help clients overcome obstacles by educating them and motivating them to gain control of their own finances.

Financial Planning Umbrella

The major planning areas that follow the General Principles of Financial Planning (see appendix 1A) are discussed in chapters 2 through 7. The order, as well as the corresponding chapter in which these planning areas are discussed, is as follows:

- chapter 2: Insurance Planning and Risk Management
- chapter 3: Employee Benefits Planning
- chapter 4: Investment Planning
- chapter 5: Income Tax Planning
- chapter 6: Retirement Planning
- chapter 7: Estate Planning

These areas are viewed as the major planning areas that fall under the financial planning umbrella. Even though each one of these planning areas is a specialty unto itself, together they make up the totality of what is known as comprehensive financial planning. The order in which these planning areas are covered in this book is identical to the order that they appear on the Topic List for CFP® Certification Examinations (see appendix 1A).

Chapter 8 is devoted exclusively to Social Security, Medicare, and Medicare supplements. Even though the government and quasi-government programs stemming from these three areas could just as easily be discussed under insurance planning, employee benefits planning, and retirement planning, they are dealt with separately in this book because of their importance in providing a minimum floor of protection. They are viewed by advisors as the foundation upon which comprehensive financial planning builds.

NOTES

1. Shelley A. Lee, "What is Financial Planning, Anyway," *Journal of Financial Planning*, December 2001, pp. 36-46.
2. *Survey of Financial Risk Tolerance,* The American College, Bryn Mawr, PA, 1992.

3. *First Annual CFP Practitioner Survey: Executive Summary of Findings*, Certified Financial Planner Board of Standards, Denver, CO, Summer 1999, p. 7. The telephone survey of 661 CFP practitioners was conducted by Market Facts, Inc.
4. Nancy Opiela, "The State of Financial Planning: A Grassroots Perspective," *Journal of Financial Planning*, December 2002, pp. 8-16.
5. *2002 Consumer Survey*, Certified Financial Planner Board of Standards, Denver, CO. This was a survey of 996 upper-quartile households of all ages (income ranged from $60,000+ to $85,000+ depending on the householders' ages).
6. *Retirement Readiness*, National Retirement Planning Coalition, August 2002. A telephone survey was conducted by Mathew Greenwald & Associates, Inc., which polled 500 total respondents among Americans between the ages of 40 and 65. The respondents surveyed were financial decision makers for their households with annual incomes of at least $50,000 and who had not purchased an annuity.
7. *The 2002 Retirement Confidence Survey*, Employee Benefit Research Institute, Washington, DC, January 2002. A telephone survey was conducted of 1,000 individuals (771 workers and 229 retirees) age 25 or older in the United States.
8. *Baby Boomers Envision Their Retirement: An AARP Segmentation Analysis*, AARP, Washington, DC, February 1999. A telephone survey of 2,001 Americans aged 33-52 was conducted by Roper Starch Worldwide, Inc.
9. *Boomers at Midlife: The AARP Life Stage Study*, AARP, Washington, DC, July 2002. A telephone survey of 3,666 adults 18 and older (including 2,127 boomers) was conducted by Princeton Survey Research Associates.
10. *Retirement Reality Check*, The Allstate Corporation, Northbrook, IL, December 2001. Harris Interactive polled 1,004 people born between 1946 and 1961, with household incomes ranging from $35,000 to $100,000.

Chapter One Review

Key Terms and Concepts are explained in the Glossary. Answers to the Review Questions and Self-Test Questions are found in the back of the book in the Answers to Questions section.

Key Terms and Concepts

financial planning
financial planning process
financial risk tolerance
fact-finder form
financial plan
single-purpose approach
multiple-purpose approach
comprehensive approach
Consumer Price Index (CPI)
financial life cycle
life-cycle financial planning
baby boom generation
prime interest rate
Standard & Poor's 500 Index
sandwiched generation

Review Questions

1-1. Identify the six steps in the financial planning process and briefly indicate the kinds of activities involved in each step.

1-2. Describe each of the following approaches to financial planning:
   a. single-purpose approach
   b. multiple-purpose approach
   c. comprehensive approach

1-3. At a minimum, what subjects should be included in a comprehensive financial plan?

1-4. Explain what is meant by life-cycle financial planning.

1-5. Summarize the major events occurring from the late 1960s to the present in the evolution of financial planning as a profession.

1-6. Describe the opportunities in the financial planning marketplace resulting from each of the following trends:
   a. rising median age
   b. increasing number of dual-income families
   c. volatility of financial conditions
   d. increasing use of sophisticated technology by the financial services industry

1-7. What are the top-10 reasons why people begin financial planning?

1-8. Describe three important obstacles preventing households from gaining control of their own financial destinies.

Self-Test Questions

Instructions: Read chapter 1 first, then answer the following questions to test your knowledge. There are 10 questions. For questions 1 through 4, match the statement with the step in the 6-step financial planning process to which it relates; for questions 5 through 10, circle the correct answer. When finished with the test, check your answers with the answer key in the back of the book.

Match each statement below with the step in the 6-step financial planning process to which it relates.

1-1. This step in where the advisor does fact-finding. ________

1-2. This step is where the advisor reviews changes in the client's circumstances and the financial environment. ________

1-3. This step is where the advisor identifies the strengths and weaknesses in the client's present financial condition. ________

1-4. This step is where the advisor motivates and helps the client acquire all the necessary financial products and services. ________

(A) Establish financial goals.
(B) Gather relevant data.
(C) Analyze the data.
(D) Develop a plan.
(E) Implement the plan.
(F) Monitor the plan.

1-5. According to a 2002 consumer survey conducted by the CFP Board of Standards, the top reason why people begin financial planning is to

(A) accumulate capital
(B) purchase or renovate a home
(C) build a retirement fund
(D) generate current income

1-6. Which of the following financial advisors using the financial planning process would be considered to be practicing multiple-purpose financial planning?

(A) A multiline insurance agent who sells life, health, property, and liability insurance to a client
(B) A personal finance counselor who shows a client how to set up and live within a budget
(C) A stockbroker who advises a customer to buy shares of common stock in the "XYZ" Company
(D) A banker who opens a trust account for the benefit of a customer's handicapped child

1-7. Trends creating opportunities for advisors engaged in financial planning include which of the following?

I. Longevity among Americans is increasing.
II. The financial environment is becoming more stable.

(A) I only
(B) II only
(C) Both I and II
(D) Neither I nor II

1-8. Which of the following statements correctly describe(s) a characteristic of comprehensive financial planning in its purest form?

I. The managing advisor's compensation is usually a combination of fees and commissions.
II. The plan is created by the managing advisor and his or her team of specialists in a single planning engagement.

(A) I only
(B) II only
(C) Both I and II
(D) Neither I nor II

1-9. Financial advisor activities considered to be part of the plan development phase in the financial planning process include all of the following EXCEPT

(A) obtaining the client’s approval of the plan
(B) presenting alternative plan strategies to the client
(C) writing a report for the client that describes the plan
(D) reviewing the plan to see that it is performing satisfactorily

1-10. According to two independent studies conducted in 2002, all of the following statements regarding retirement or retirement planning are correct EXCEPT:

(A) Long retirements are expected.
(B) Inadequate planning has been conducted.
(C) Retirement income needs are overestimated.
(D) Retirement savings are insufficient.