

Center for Financial Advisor Education

FA 262 Workbook

Foundations of Financial Planning: An Overview



THE AMERICAN COLLEGE

The American College® is an independent, nonprofit, accredited institution founded in 1927 that offers continuing education (CE), professional certification and graduate-degree education to men and women seeking career growth in financial services. The College's programs are primarily on a distance basis, but two programs rely heavily on classroom instruction.

The Center for Financial Advisor Education at The American College offers the LUTCF and Financial Services Specialist (FSS®) professional designations. Both curriculums are designed to introduce students in a classroom environment to the technical side of financial services while at the same time providing them with the requisite selling skills. Both LUTC and FSS courses prepare students to undertake more advanced College programs.

The Solomon S. Huebner School® of The American College administers the Chartered Life Underwriter (CLU®), the Chartered Financial Consultant (ChFC®), the Registered Health Underwriter (RHU®), the Registered Employee Benefits Consultant (REBC®), the Chartered Advisor for Senior Living (CASL™), 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.

Finally, 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. The National Association of Estate Planners & Councils (NAEPC) has named The College as the provider of the education required to earn its prestigious AEP designation.

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The American College is located at 270 S. Bryn Mawr Avenue, Bryn Mawr, PA 19010. The toll-free telephone number of the Office of Student Services is (888) AMERCOL (263-7265), the fax number is (610) 526-1465, and <http://www.theamericancollege.edu> is the home page address. The College welcomes visitors to its 35-acre campus during regular business hours, 8:00 a.m. to 5:30 p.m., Monday through Friday.

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Foundations of Financial Planning: An Overview Assignment Schedule

This workbook contains quizzes, exercises, projects, and case studies that are intended to supplement the material in Chapters 1 through 8 of the FA 262 textbook, *Foundations of Financial Planning: An Overview*.

Class	Assignments	Page in Text	Page in Workbook
1 ____ Date	<p>The Financial Planning Process Readings:</p> <ul style="list-style-type: none"> Overview and Learning Objectives Emergence of a New Profession What Is Financial Planning? How Is Financial Planning Conducted? Financial Planning Areas of Specialization Content of a Comprehensive Financial Plan Evolution of Financial Planning as a Profession Trends Creating Opportunities for Financial Planning Advisors Consumer Needs for Financial Planning Financial Planning Umbrella Chapter One Review <p>Course Overview and Expectations (Read before class 2) Acknowledgment of Course Requirements (Due class 2) Supplemental Reading 1 (Due today) Breakout—Class 1 (Due today) Foundations of Financial Planning: An Overview Pre-Test Sales Planning Project 1—Identifying Financial Goals and Obstacles (Begin, due class 3) Most Valuable Concepts</p>	<p>1-1 1-3 1-5 1-15 1-19 1-21 1-29 1-31 1-35 1-41 1-43</p>	<p>W-9 W-15 W-17 W-23 W-25 W-29 W-165</p>
2 ____ Date	<p>Insurance Planning and Risk Management Readings:</p> <ul style="list-style-type: none"> Overview and Learning Objectives Importance of Protection Objectives Risk Types of Pure Risks Planning for Pure Risks: Insurance and Other Techniques A Survey of Personal Insurance Coverages A Concluding Comment Chapter Two Review Appendix 2: Risk Identification Questionnaire <p>Acknowledgment of Course Requirements (Due today) Supplemental Reading 2 (Due today) Breakout—Class 2 (Due today) Quiz—Classes 1 and 2 (Due today) Sales Planning Project 2—Interview with an Experienced Advisor (Begin, due class 4) Most Valuable Concepts</p>	<p>2-1 2-3 2-5 2-9 2-11 2-37 2-73 2-75 2-81</p>	<p>W-15 W-35 W-43 W-45 W-49 W-165</p>

3	Employee Benefits Planning Readings: Overview and Learning Objectives Scope and Significance of Employee Benefits Importance of Benefit Planning Eligibility for Benefits Types of Employee Benefits Cafeteria Plans Chapter Three Review Sales Planning Project 1—Identifying Financial Goals and Obstacles (Due today) Supplemental Reading 3 (Due today) Breakout—Class 3 (Due today) Quiz—Class 3 (Due today) Sales Planning Project 3—Medical Expense Coverage Checkup (Begin, due class 5) Action Project 1—Discovering a Client’s Goals and Obstacles (Begin, due class 5) Most Valuable Concepts	3-1 3-3 3-9 3-13 3-17 3-61 3-67 	 W-29 W-55 W-63 W-65 W-69 W-75 W-165
4	Investment Planning Readings: Overview and Learning Objectives The Meaning of Investment Service to the Client Categories of Investment Assets Sources of Investment Risk Special Portfolio Considerations Investment Returns Investment Principles, Strategies, and Techniques Investment Markets and Regulation A Final Word Chapter Four Review Sales Planning Project 2—Interview with an Experienced Advisor (Due today) Supplemental Reading 4 (Due today) Breakout—Class 4 (Due today) Quiz—Class 4 (Due today) Sales Planning Project 4—Financing Your Goals (Begin, Due class 6) Most Valuable Concepts	4-1 4-5 4-11 4-15 4-27 4-33 4-39 4-45 4-51 4-57 4-59 	 W-49 W-81 W-89 W-91 W-95 W-165

7 _____ Date	<p>Estate Planning</p> <p>Readings:</p> <ul style="list-style-type: none"> Overview and Learning Objectives The Goals of Estate Planning Starting the Process Types of Property Interest Estate Planning Documents Transfers at Death Taxes Imposed on Transfers of Wealth Preserving the Client's Wealth Conclusion Chapter Seven Review <p>Action Project 2—Life Cycle or Market Survey (Due today)</p> <p>Supplemental Reading 7</p> <p>Breakout—Class 7 (Due today)</p> <p>Quiz—Class 7 (Due today)</p> <p>Most Valuable Concepts</p>	<p>7-1</p> <p>7-3</p> <p>7-5</p> <p>7-7</p> <p>7-13</p> <p>7-21</p> <p>7-25</p> <p>7-39</p> <p>7-55</p> <p>7-57</p>	<p>W-111</p> <p>W-141</p> <p>W-147</p> <p>W-149</p> <p>W-165</p>
8 _____ Date	<p>Social Security, Medicare, and Medicare Supplements</p> <p>Readings:</p> <ul style="list-style-type: none"> Overview and Learning Objectives Social Security and Medicare Coverage to Supplement Medicare Postscript Chapter Eight Review <p>Sales Planning Project 5—Retirement Planning (Due today)</p> <p>Action Project 3—Retirement and the Early Career Segment (Due today)</p> <p>Supplemental Reading 8</p> <p>Breakout—Class 8 (Due today)</p> <p>Quiz—Class 8 (Due today)</p> <p>Most Valuable Concepts</p>	<p>8-1</p> <p>8-3</p> <p>8-25</p> <p>8-31</p> <p>8-33</p>	<p>W-127</p> <p>W-133</p> <p>W-153</p> <p>W-159</p> <p>W-161</p> <p>W-165</p>
_____ Date	Review Session for the Final Examination		
_____ Date	<p>Final Examination</p> <p>This is a closed-book exam. You cannot refer to your textbook or any other materials during the exam. The exam will consist of 50 multiple-choice questions.</p>		

Special Notes to Advisors

Workbook Materials Disclaimer

While every precaution has been taken in the preparation of this material to insure that it is both accurate and up-to-date, it is still possible that some errors eluded detection. The authors and The American College assume no liability for damages resulting from the use of the information contained in this Workbook. 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.

Caution Regarding Use of Illustrations

The illustrations, sales ideas, and approaches in this workbook are not to be used with the public unless you have obtained approval from your company. Your company's general support of The American College's programs for training and educational purposes does not constitute blanket approval of the sales ideas and approaches presented in this workbook, unless so communicated in writing by your company.

Use of the Term Financial Advisor or Advisor

Use of the term "Financial Advisor" as it appears in this workbook is intended as the generic reference to professional members of our reading audience. It is used interchangeably with the term "Advisor" to avoid redundancy. Financial Advisor takes the place of the following terms:

Account Executive	Life Insurance Agent
Agent	Life Underwriter
Associate	Planner
Broker (stock or insurance)	Practitioner
Financial Consultant	Producer
Financial Planner	Property & Casualty Agent
Financial Planning Professional	Registered Investment Advisor
Financial Services Professional	Registered Representative
Health Underwriter	Senior Advisor
Insurance Professional	

Course Overview and Expectations

Welcome to FA 262, *Foundations of Financial Planning: An Overview*. This introductory section begins with an overview of the course objectives. Then it discusses the components of the course, and reviews the various assignments and activities that will help you apply what you learn. Finally, it closes with a discussion of what is expected from you.

Overall Course Objectives

The Financial Services Specialist (FSS) is a new designation offered by The American College. The FSS builds on the enormously successful and quality training courses associated with the LUTCF designation. The American College and National Association of Insurance and Financial Advisors (NAIFA) have partnered to offer these courses which enable students to gain the necessary skills associated with being a competent and ethical financial advisor (**see page W-7 for an explanation of the meaning of the term “financial advisor” or “advisor” as used throughout the materials of this course**).

The goal of this course is to introduce you to the financial planning process and the major planning areas that define the profession. The finer points of each financial planning area go well beyond the scope of this course. However, the readings and activities in this course will enable you to understand your own practice in the larger context of the financial planning profession. By the end of the course you should be able to

- describe to a client the main planning areas in general and broad terms
- discuss financial goals and obstacles with clients and prospects
- identify possible needs in each major planning area
- make some general recommendations to clients in regard to actionable items in major planning areas

Achieving these objectives depends on the time and energy you invest in completing the assignments of the various components of this course. The next section provides an overview of the course components and the assignments related to them.

Course Components and Assignments

The American College's LUTC and FSS courses offer practical on-the-job training. Therefore, they require students to take action and participate fully. Except for the final examination, each component of the course is designed to facilitate action and participation, which can translate into more new clients and better client relationships. The course components include

- the classroom
- the text
- the workbook
- the final examination

The Classroom

The classroom is where the idea-sharing that gives FSS and LUTC courses their unique value takes place. Of course, the value you receive in the classroom depends on your preparation and participation.

The students in an FSS and LUTC classroom represent various levels of knowledge and experience in the financial services industry. Sharing with one another provides everyone an opportunity to grow in proficiency, professionalism, and productivity. In fact, the classroom's "magic" only happens if everyone is prepared and participates.

The Text

The discussions in the classroom focus on the application of the concepts discussed in the textbook. Thus, you are expected to have completed the reading assignment before class. In addition to the regular textbook information, chapters also contain a chapter review and some may have a case history to read.

Chapter Review—In order to reinforce what you learn, each chapter in the text includes a chapter review that consists of short-answer, multiple-choice, and matching questions. You are *not required* to complete these before class. Many students use these questions to review for the final examination. The answers are provided in the back of the text.

Case History—A chapter may contain a case history, which can be an actual sales situation or a description of how a successful advisor markets, prospects, interviews, services, and so forth. It is designed to stimulate thinking and discussion about selling and planning ideas and activities. As you read a case history, think about how you would handle a similar situation. Does it suggest a method you want to adopt or avoid? Why? The case history will be discussed in class at your moderator's discretion.

The Workbook

The workbook contains an assignment schedule and all of the mandatory assignments that must be completed for each class. The assignments are primarily breakouts, case studies, quizzes, sales planning projects, and action projects.

Assignment Schedule—The assignment schedule lists your assignments for the entire course and is located in the front of the workbook. There is a space on the assignment schedule to write the date for each class session, which your moderator will announce at the first class. By following the schedule, you can readily determine the material that is to be covered in every class and the work that is expected of you.

Except for the assigned readings in the textbook and assignments your moderator gives to you, all other activities can be found in the workbook. Let's take a look at them.

Breakouts—For each class there is a breakout, a set of questions and/or exercises designed to focus your attention on the topics your moderator will most likely cover in class. The breakouts ask you to apply what you learn. For example, many of them ask you to explain a concept as you would to a client or prospect. You may then be asked to participate in a role-playing exercise based on your answer to the breakout. You are expected to have breakouts completed for each class.

Case Studies—Some classes may use case studies. A case study provides a specific set of facts and circumstances about a sales situation. You are then asked to come up with specific recommendations and to support your rationale for them. The case studies are a part of the class discussion at the moderator's discretion. You are expected to have them completed for any class for which they are assigned.

Quizzes—There is a quiz that must be completed for each class, except Class 1. The question type may be true/false, multiple choice, fill-in-the-blank, matching, and so forth. Quizzes are due at the beginning of each class.

Sales Planning Projects—Sales planning projects focus on the behind-the-scenes activities that support and enable successful interaction with prospects. They explore the planning involved with marketing, prospecting, interviewing, and servicing financial services products. In addition, a sales planning project can also provide learning experiences that sharpen your ability to advise prospects and design appropriate plans for them. Thus, possible activities could include market research, record keeping, interviews of other financial advisors and professionals, and so forth.

Forms are provided for each project. You will be given one week or more to complete each assignment. Begin working on the project the day it is assigned. If you wait until the last minute, you can miss the purpose and lose a real benefit.

Action Projects—Action projects focus on the skills and techniques to use when working directly with a prospect. They explore the areas of contacting the prospect for an appointment, working with a prospect during an interview, and asking for referrals. In every action project, there is a specific, brief assignment that calls for personal contact with a number of prospects for a definite purpose. Sometimes an approach is suggested.

Action projects typically fit into a financial advisor's daily routine. Very little preparation or extra research is involved. Sales are inevitable, but they are *not required* for completion of the action project.

Supplemental Readings—This workbook contains supplemental reading material for each class, reviewing the fundamental points of the selling/planning process and the key skills you must

master to meet your prospects' financial needs. **This supplemental reading material is part of the course curriculum and will be included in the final exam.**

Project Assignment Summary

Sales Planning Project	Title	Assigned Class	Due in Class	Page
1	Identifying Financial Goals and Obstacles	1	3	W-24
2	Interview with an Experienced Advisor	2	4	W-49
3	Medical Expense Coverage Checkup	3	5	W-69
4	Financing Your Goals	4	6	W-95
5	Retirement Planning	6	8	W-127

Action Project	Title	Assigned Class	Due in Class	Page
1	Discovering a Client's Goals and Obstacles	3	5	W-75
2	Life-Cycle or Market Survey	5	7	W-111
3	Retirement and Early Career Segment	6	8	W-133

The Final Examination

At the end of the course, you will take a 50-question multiple-choice examination that consists of the three multiple-choice formats (straight answer, Roman numeral choice, and EXCEPT) used in the workbook quizzes and chapter reviews found in the text. All answers are based on the material in the text. The final examination will not be difficult if you have read the text and completed all of the quizzes and chapter reviews. In order to pass the course, you must pass the final examination with a score of at least 70 percent.

Passing Requirements

Attendance—Your participation in the classroom discussion is crucial to the effectiveness of an FSS or LUTC class. Therefore, your attendance is also vital. To successfully complete the course, you must attend at least six of the eight regular classes. Lateness of more than 20 minutes is half an absence, so is leaving early. Missing more than 40 minutes is a full absence. Two absences are permitted. If you end the course with two and one-half absences, you have exceeded the allowable limit.

Moderator's Grade—The moderator records grades for quizzes, projects, and participation in class sessions. These grades are combined to obtain the average grade for all classroom-related work. This average grade is called the Moderator's Grade.

Examination Grade—There is a 50-question final examination at the end of the course. The questions are multiple choice. A grade of 70 percent or higher is necessary to pass the exam.

Term Grade—The average of the Moderator's Grade and the final examination score must be no less than 70 percent to obtain credit. This average is called the Term Grade.

Three Requirements—In summary, to qualify for successful completion of the course, you must meet each of the following three requirements:

1. Satisfy the attendance requirement for your course.
2. Score 70 percent or more on the final examination.
3. Receive a Term Grade of at least 70 percent.

Expectations

Before Class

Complete all assignments before the class meets. The average amount of time you should plan to spend on completing these activities is *at least* two and one-half hours per class—about the same amount of time spent in classroom discussion. Some classes will require more time, others less.

Activities include the following:

- Read and study the assigned pages in the text.
- Complete any breakouts and case studies.
- Complete the class quizzes.
- Complete any sales planning project assigned.
- Complete any action project assigned.
- Complete all other assignments required by the moderator.

During Class

Assignments—Turn in your assignments at the beginning of class. The moderator has been directed to penalize late assignments by 50 percent. If more than a week late, papers receive a zero.

Moderator—The moderator is an individual nominated by the local NAIFA association and appointed by The American College. He or she is not a teacher by profession, but a full-time financial advisor or management person. The moderator shares with you the demands of self-discipline and the constant pressure of time. Consequently, the moderator cannot afford the luxury of catering to anyone who is negligent about completing work on time, maintaining reasonable order, or respecting the rights of others. The moderator needs and deserves the full cooperation of every student.

Performance of Action Projects by Non-Sales Students and Managers

All students are expected to do the action projects. This applies to students who are nonproducers and to those in management. It includes, for example, students such as office staff, home office executives, state insurance commissioners, a finance officer on a military base, and others who may not be licensed to sell insurance.

If you cannot do the projects yourself, you are expected to handle them in one of the following ways (listed in order of preference):

1. Select an FSS or LUTC student who is with your company or in your community to work with on the project. Base your reports on your joint work.
2. If there is no local FSS or LUTC student from your company to work with, do joint work with one of your company's advisors who is not taking the course. This can be a former FSS or LUTC student or someone without any FSS or LUTC experience.
3. If you are in management and it is not possible to work with an advisor/student, assign the project(s) to one or more of the advisors under your supervision, and report these results.
4. If you have no advisors to work with and none under your supervision, arrange to interview one or more advisors each week, and use the interview as the basis of the project report. Write what the advisor did on the project reporting form.
5. If the four preceding options are unworkable for you, it is up to you to suggest alternative solutions on which you and your moderator can agree. For example, you may develop two presentations to write out or present to the class during the course. These may be on special topics, or you may research a particular insurance sales topic, to write about and give photocopies to all class members. Topics can include state laws, statistical information about insurance, actuarial studies, articles in insurance magazines, self-improvement topics, relationship insights, or a question that came up in class that needed research.

Keep in mind that these five alternatives are special options for isolated instances. Almost every student in the class will be licensed to sell insurance and is expected to complete the action projects as assigned for a passing grade. You are expected to do the prospecting activity and make the follow-up approaches yourself.

If you need to do the projects in one of the ways suggested above, discuss it in advance with the moderator and reach agreement on how to proceed. As a safeguard, put your agreement in writing, include both of your signatures, and file the agreement.

Note to FSS and LUTC Students

Please read this page carefully, sign at the bottom, and return it to your moderator. Occasionally there are misunderstandings concerning the requirements for the successful completion of the course. The purpose of this memorandum is to insure that the requirements and the ground rules laid down by the moderator are clearly understood. Failure to sign this form does not relieve you from these requirements.

Acknowledgment of Course Requirements

–To be signed by student–

It is my understanding, from the explanation received in the first class session and outlined in the Course Overview and Guidelines section of the workbook, that successful completion of this course requires meeting the attendance requirements, achieving a passing examination score (70 percent), and earning an overall average (term grade) of 70 percent on all work for the course. Specifically, I understand that

1. Credit for the course will not be given to any student who fails to attend at least six of eight class sessions. The maximum number of absences is two. Missing more than 20 minutes of class is a half-absence. Missing more than 40 minutes of class is a full absence. It does not matter whether absences are due to illness, injury, business appointments, company or agency meetings, vacations, or conflicts in personal schedules. No attendance credit is given for attendance at an exam review session. I further understand that neither the local NAIFA officers or the moderator has authority to excuse absences, because the requirement applies impartially to all students.
2. Grades are assigned during the course by the moderator. Grades for participation in class discussions (and preparation for them), and scores made on action projects, sales planning projects, and quizzes are averaged. That number is then averaged with the final examination to arrive at the Term Grade.
3. Written assignments are to be handed in at the beginning of the class session in which they are due. Papers up to one week late are automatically reduced by 50 percent and to zero after that.
4. To receive credit for the course, I must sit for and receive a passing grade on a final examination acceptable for any course offered by The American College. The correct answers to the final examination questions are based solely on the information found in the text. The American College reserves the right to set aside the final examination of any class and require another examination.
5. Course results will be mailed out within 4 weeks after the final exam date, assuming all course requirements have been met, including payment of tuition. These reports will indicate a “passing” or “not passing” status only. No numerical grade is assigned.

I have read the course requirements and understand them.

I further understand that recruiting or attempted recruiting of personnel of another company is not permitted in any American College course or in connection therewith.

Finally, I understand that any student whose behavior adversely affects reasonable order and harmony in the classroom will not be allowed to continue with the course. There will be no tuition refund, and the student may be barred from future participation in FSS and LUTC courses.

Print your name _____ Date _____

Student's signature _____

Supplemental Reading 1

Overview of the Selling/Planning Process

For many advisors, financial planning (whether single-purpose, multiple-purpose, or comprehensive) is a process they use to help prospective clients (prospects for short) and clients appropriately purchase products that the advisor sells. For other advisors, financial planning is not only a process but also their main, and in many instances, only product. Either way, the advisor is selling a product and engaging in financial planning. Thus, it is important for the advisor to excel in both selling and planning. For this reason, The American College has adopted an 8-step selling/planning process, which culminates in the satisfaction of the prospect's needs and wants, and the conversion of a prospect into a loyal client.

Understanding and applying the selling/planning process will help you build a successful practice with satisfied clients. The 8-step process gives you a basic framework on which to build your strategies for carrying out marketing, prospecting, planning, and servicing activities. It also acts as a reference tool to analyze your interaction with prospects and clients so you can identify your strengths and weaknesses.

Undergirding the 8-step selling/ planning process is a client-focused communication philosophy, which recognizes that the objective of a long-term client-advisor relationship ought to be in the forefront of the advisor's mind. The relationship ought to be professional, ethical, and mutually beneficial. Therefore, while the prospect's or client's needs and wants should be the primary basis for any recommendations the advisor makes, there are other balancing factors that can, and in some cases, should, be weighed.

The Eight Steps of the Selling/Planning Process

The 6-step financial planning process described in the textbook does not fully reflect the process implemented by the broader range of advisors who practice single-purpose, multiple-purpose, and/or comprehensive financial planning. For instance, the 6-step financial planning process ignores the need for advisors to identify prospects. In addition, using the phrase "monitoring the plan" for the last step of the financial planning process ignores the servicing aspect with which many commission-based advisors must reckon. Below, you will find a chart



comparing the 8-step selling/planning process with the 6-step financial planning process espoused by The American College and with the one promulgated by the CFP® Board of Standards.

TAC 8-Step Selling/Planning Process	TAC 6-Step Financial Planning Process	CFP® 6-Step Financial Planning Process
Identify the Prospect		
Approach the Prospect		
Meet the Prospect	Establish Financial Goals	Establishing and Defining the Relationship with the Client
Gather Information and Establish Goals	Gather Relevant Data	Gathering Client Data Including Goals
Analyze the Information	Analyze the Data	Analyzing and Evaluating the Client's Financial Status
Develop and Present the Plan	Develop a Plan for Achieving Goals	Developing and Presenting Financial Planning Recommendations and/or Alternatives
Implement the Plan	Implement the Plan	Implementing the Financial Planning Recommendations
Service the Plan	Monitor the Plan	Monitoring the Financial Planning Recommendations

1. Identify the Prospect. Identify whom you are going to approach and why. Long-term, mutually beneficial relationships begin with getting in front of the prospects that have a probable need for your products and can afford them. They appreciate you and your services and can be a source for repeat business and referrals. You need a system to consistently find potential clients in target markets. The secret to a successful practice is prospecting and marketing.

2. Approach the Prospect. Contact the prospect by telephone, mail, e-mail, or face-to-face, and ask for the appointment, stating the reason why you are interested in meeting. As telemarketing and direct mail become less effective, client recommendations (referred leads) and other alternatives, such as seminars, become more critical than ever.

3. Meet the Prospect. In the initial interview you establish rapport and explain your business purpose. Make brief, positive statements about yourself, your company, and the services you offer. Ask thought-provoking and challenging questions and encourage agreement to proceed with the gathering of relevant information about the prospect. Impress upon the prospect what makes you different from other advisors and what you offer that is of added value. The prospect must show interest in pursuing solutions to uncovered needs for the selling/planning process to proceed further.

4. Gather Information and Establish Goals. Using a fact-finder, ask questions that will uncover the prospect's goals, attitudes, and priorities, in addition to facts about the prospect's personal and financial lives. This will help you identify needs and recommend appropriate ways to meet them.

Information is required to define the prospect's current situation, determine what his or her desired future situation is and when it is to be achieved, and establish what the prospect is willing and able to do to achieve those goals. This information must be accurate, complete, up-to-date, relevant to the prospect's goals, and well organized. Financial plans based on erroneous or

incomplete information will be deficient, inappropriate, and inconsistent with the prospect's other goals, or even dangerous to his or her well-being.

Goal setting is important to creating a successful financial plan. By guiding the prospect through the goal-setting part of the process, the advisor not only helps to establish reasonable, achievable goals, but also sets the tone for the entire selling/planning process and the overall client-advisor relationship.

5. Analyze the Information. Once the relevant information about the prospect has been gathered, organized, and checked for accuracy, consistency and completeness, you need to analyze the prospect's present financial situation. The objective is to identify where the prospect is now in relationship to the goals that were established in the previous step. You must identify real problems and needs to which your products and services will provide real solutions.

Although the prospect's situation may reveal a number of strengths, more than likely your analysis will reveal a number of weaknesses, or conditions that are preventing achievement of his or her goals. The prospect may have excellent fringe benefits at work, including good life, medical, and disability insurance benefits. The prospect may have just recently updated his or her will and installed a living will that included provisions to legally carry out his or her wishes in the case of death or catastrophic illness. On the other hand, the prospect may be using debt unwisely, amassing credit card and other debt, paying unnecessarily high federal income taxes, or be inadequately insured. Or, a prospect's investment portfolio may be inconsistent with his or her investment objectives or risk tolerance.

It may be that the prospect cannot realistically attain the goals stated, and they need to be revised. For example, the prospect's income and resources may prevent reaching a specified retirement income goal or retirement starting age. In this case, the advisor should help the prospect revisit the goal and revise it, or discuss what needs to be done to achieve that goal. Postponing retirement, saving more money, seeking higher returns, or deciding to deplete principal during retirement may be four ways to help the prospect achieve his or her retirement income goal. Presented as alternatives, the advisor can help the prospect restate the original goal in terms that will more likely make it achievable.

6. Develop and Present the Plan. After the information has been analyzed and the objectives to be achieved confirmed, and if necessary revised, the next step is to devise a realistic plan for bringing the prospect from his or her present financial position to the attainment of those objectives. A good plan must reflect the prospect's needs, attitudes, and goals. Remember, the plan must be the prospect's plan, not yours.

Many times there is more than one way to achieve a prospect's financial goals. When this is the case, the advisor should present alternate strategies and explain the advantages and disadvantages of each one. It is not likely that any individual advisor can maintain an up-to-date familiarity with all the strategies that may be available and appropriate for a given prospect's situation. Based on his or her education, experience, training, and specialization, the advisor is likely to rely on a given number of proven strategies and products that typically work when encountering similar prospect circumstances. When additional expertise is needed, the advisor should always consult with another advisor who specializes in the field in question to help design that aspect of the prospect's plan.

In addition, the advisor should identify some of the prospect's possible concerns, and seek to address them proactively. For example, presenting a large number of recommendations could

overwhelm a prospect and sabotage the implementation of the plan. The advisor can avoid this paralysis by identifying the recommendations that should be pursued first, and when necessary, breaking the most important recommendations down into smaller and more manageable steps.

7. Implement the Plan. After the plan is presented and reviewed with the prospect, the advisor must ask the prospect to implement the plan or parts of the plan and commit to purchasing the appropriate financial products and services. It is the advisor's responsibility to motivate the prospect to act and help him or her acquire the financial products and services required to put the plan into action. Therefore, be prepared to address concerns and obstacles that may prevent the prospect from implementing the plan.

For advisors who conduct financial planning in the context of a product sale, implementing the plan will also mean completing any necessary paperwork, explaining the purchasing process to the prospect, and verifying that the prospect understands the product and process. If the plan is limited in scope or complexity, it may be within the advisor's ability to implement the plan entirely. Otherwise, it may be necessary to call upon additional specialized professional expertise where needed. For example, legal instruments, such as wills and trusts, may need to be drawn up and executed, requiring the services of a licensed practicing attorney.

8. Service the Plan. This may be the most important step in preserving your hard work and expanding on it. For advisors who sell insurance products, servicing the plan starts with delivering a policy. At policy delivery, advisors should reaffirm the client's purchasing decision by reviewing the problems solved by owning the product. In addition, the advisor should review the service he or she will provide the client, including a periodic (typically annual) review. Finally, the advisor should take advantage of any opportunity to obtain referrals.

For all advisors, it is important to communicate to the client which services and products are provided and their additional costs. The advisor should communicate the service standards that the client can expect the advisor to meet. How long will it take the advisor to return a phone call or e-mail? How long will it take to process various types of requested changes?

In addition, all advisors should review the plan periodically. The review should check the client's progress in implementing the plan. It should review the plan's performance in meeting the client's goals and objectives. Furthermore, it should be a time for the advisor to examine any changes to the client's personal situation, financial situation, and the world around him or her (economic, tax, or financial environment) that would warrant making any changes to the plan.

Note: For some financial advisors, a prospect becomes a client after step 3, meet the prospect. For others, the prospect becomes a client after step 7, implement the plan. For simplicity, from this point forward, this course will use the term client unless discussing marketing or prospecting.

Client-Focused Communication Philosophy

The *client-focused approach* is a communication philosophy that rejects high-pressure, hard-sell methods and supports the counselor model of an advisor. The client-focused model contrasts with a *transactional approach*, which focuses on the results of the transaction—the collection of the commission for a policy and/or the fee for a plan—and moves on to the next transaction, rather than focusing on the client.

The client-focused approach emphasizes helping clients by providing solutions to their insurance and financial needs and helping them achieve their objectives. The key difference between this method and a transactional one is that a client-focused advisor approaches the client with a genuine agenda of helping in an open, honest, and forthright manner. The client's satisfaction with the process and the results is essential. The process focuses on the advisor's role in helping people recognize and understand their financial needs, providing needed information, removing obstacles to financial success, and assisting in taking positive action to achieve their goals. The objective of the process is to develop a long-term mutually beneficial relationship between the advisor and the client.

Client-focused communication requires that the advisor thoroughly understand what clients want to accomplish and the resources available to them. This approach involves asking clients many questions: about what they want to accomplish financially, what their attitudes are toward a vast array of financial products, and what opportunities are available to them. Active listening and good communication skills on the advisor's part are indispensable to the process. The advisor must comprehend how clients view their current situation and future possibilities regarding personal assets and liabilities. Only after understanding the client's life circumstances, attitudes, values, and objectives can recommendations be made.

The following chart highlights the differences between these two views of the selling process.

Transactional Approach	Client-Focused Approach
Advisor oriented	Client oriented
Creates needs	Discovers needs
Talks at the client	Discusses with the client
Acquires sales	Acquires clients
Increases fear and distrust	Increases trust and understanding
Persuasion model	Discovering and helping model
Presentation	Fact-finding
Salesperson talks	Client talks
Telling	Listening
Discovery occurs through objections	Discovery occurs through fact-finding
Closing techniques	Relationship building

A Second Approach for a Comprehensive Financial Plan

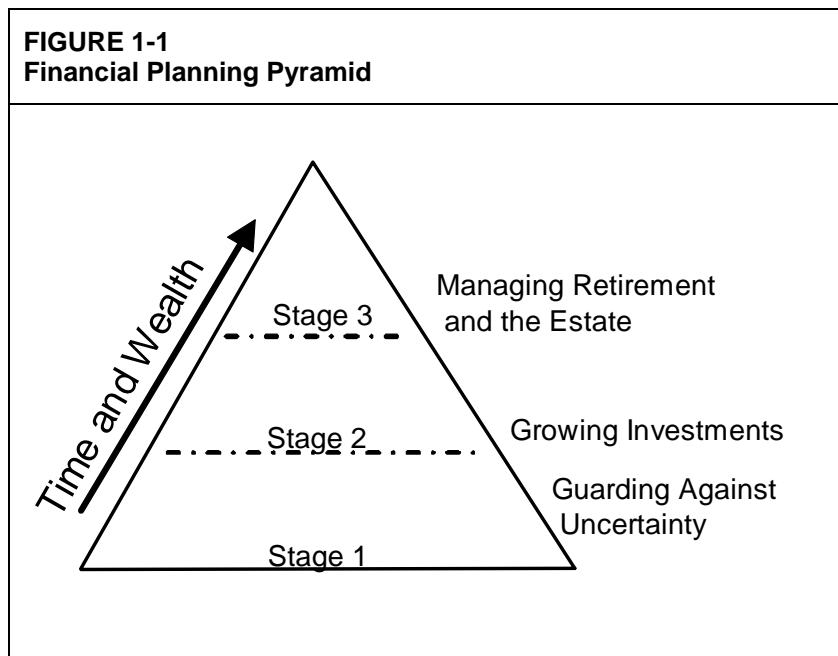
The textbook described one approach for structuring a comprehensive financial plan. A second possible approach is to build the plan from the ground up in three stages. This type of plan typically requires several meetings with the client over a period of years. At the first stage of plan development, the advisor should concentrate his or her efforts on protecting the client against unexpected occurrences that could cause financial hardship. At the second stage, the advisor should focus on the client's wealth-accumulation objectives. At the third and final stage, the advisor should address retirement and estate concerns. To help in understanding how these stages fit together in a comprehensive plan, one needs to look at the *financial planning pyramid* in figure 1-2.

The financial planning pyramid is a widely accepted approach for developing a comprehensive financial plan over a period of time. The pyramid illustrates how developing a

plan begins with a sound foundation and proceeds in an orderly fashion. In its simplest form, stage 1, the foundation of the pyramid, protects the client against life's financial uncertainties. It is built with emergency savings, insurance coverages, and a properly drawn will.

Stage 2, the middle part of the pyramid, is the wealth-accumulation component of the financial plan. As the client moves up the pyramid (that is, as the client's financial well-being improves), the focus of the plan shifts from income-protection needs to wealth-accumulation goals. This typically involves growing money through various types of investments.

Stage 3, the top part of the pyramid, becomes important once the client has achieved most of his or her accumulation goals. This last component of the financial plan addresses both the management of retirement assets and the conservation and distribution of the estate. This part of the financial plan typically is carried out by an estate plan and other advanced planning strategies including trusts and an updated will.





Breakout—Class 1

1-1 Why are you taking this course? What do you hope to gain?

1-2 Think about your current approach to selling and/or planning in terms of the selling/planning process. Describe what you do to accomplish each step.

Identify the Prospect

Approach the Prospect

Meet the Prospect

Gather Information and Establish Goals

Analyze the Information

Develop and Present the Plan

Implement the Plan

Service the Plan

1-3 How will an understanding of the financial planning environment benefit your practice?

Name _____ Date _____

Foundations of Financial Planning: An Overview Pre-Test

(5 points each; maximum score = 100)

1. What are the six steps of the financial planning process and the eight steps of the selling/planning process?

2. What are the primary objectives of the client-focused sales approach?

3. What are the three approaches or views of financial planning?

4. What are the three types of pure risks facing individuals that insurance treats?

5. Briefly describe the major differences between whole and universal life insurance.

6. What is the least-restrictive (most-favorable) definition of disability found in a disability income policy?

7. What is the purpose of a coordination-of-benefits provision in a medical-expense policy?

8. Under Section 79 of the Internal Revenue Code (IRC), how much employer-provided group life insurance is not taxed to the employee?

9. How does “fully insured” status relate to the amount in dollars of Social Security benefits paid to a deceased worker’s survivors?

10. Name three types of investments called cash equivalents that are readily accessible in an emergency.

11. Name several sources of risks in investing.

12. Briefly describe the major types of investment markets.

13. What is the difference between tax exclusions and tax deductions?

14. Name the three basic categories of deductions available to individual taxpayers.

15. Briefly describe the three tax doctrines that determine what, to whom, and when something is taxable.

16. Name the major types of tax-qualified and tax-advantaged plans.

17. Describe several different types of property interests.

18. Explain the difference between a state inheritance tax and federal estate tax.

19. Explain the difference between a conventional power of attorney and a durable power of attorney.

20. Briefly describe the types of benefits of Parts A and B of Medicare.

Sales Planning Project 1

Identifying Financial Goals and Obstacles

(Assigned Class 1—Due Class 3)

Purpose

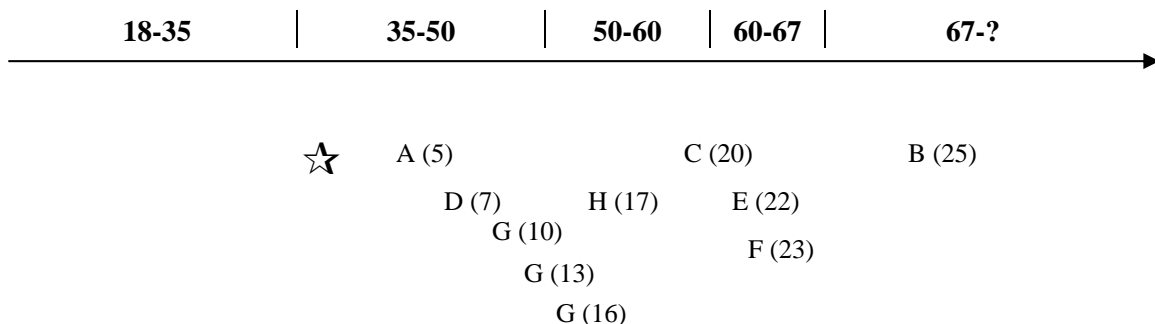
Understanding a prospect’s financial planning needs requires understanding the prospect’s financial goals and dreams. It is also important to understand the obstacles to achieving these goals. This project is designed to help you practice exploring a prospect’s financial goals and obstacles by analyzing your own situation.

Assignment

Complete the following activity and answer the related questions.

Procedure

1. Make a list of your top five to 10 goals (buying a home, retirement, a vacation trip, purchasing a vacation home, and so forth) and anticipated events (such as marriage, birth of a child, post-secondary education for child or self, child’s marriage, beginning a second career, buying a car, and so forth).
2. Prioritize your goals. Number them in order of importance. For example, retirement may be number 1, buying a home number 2, and so forth.
3. Circle the goals that have financial impact. Place a checkmark next to the ones for which you have identified the amount needed to fund the goal and have begun funding.
4. Indicate your current age on the timeline with a star. The timeline will help you see how much time you have to achieve your goals.
5. Plot where you foresee achieving your goals or the anticipated events occurring (using an appropriate abbreviation or the corresponding letter, whichever you prefer). Next to each point, write the number of years from today in parentheses. Some goals may occur multiple times. For example, you have three children and expect all three to pursue post-secondary education (represented below by goal “G”). In this case, treat education as one goal but indicate it multiple times. See example below.



6. Answer the questions that will help you identify obstacles to achieving your financial goals.
7. Answer the summary questions.

Name _____ Date _____

Sales Planning Project 1

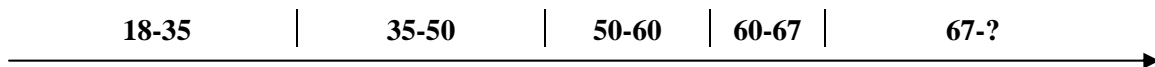
Identifying Financial Goals and Obstacles

Report Form (1 of 3)

1. Identify five to 10 goals (or anticipated events). Prioritize them. Then, circle those goals that require money. Finally, place a checkmark next to those goals for which you have calculated the amount needed and which you have started funding.

	Goal/Event	Priority		Goal/Event	Priority
A			F		
B			G		
C			H		
D			I		
E			J		

2. Draw a star for your current age on the timeline below. Plot the goals and events from above along with the estimated number of years before they are to be achieved or occur.



Sales Planning Project 1

Identifying Financial Goals and Obstacles

Report Form (2 of 3)

3. Which of these goals would you want to achieve if one of the following events happened to you or your partner (if applicable)? List the letters of these goals.

	You	Partner
Died tomorrow		
Disabled tomorrow		
Hospitalized tomorrow		
Needed LTC at age 65		
Parents needed LTC tomorrow		

4. Describe the financial impact each of the following situations would have on you and/or your family. Also indicate your level of concern that such an event may occur. Use a scale of 1 to 5 with 1 indicating no concern and 5 indicating great concern.

Event	Concern	Financial Impact/Strategy
Your premature death		
Your disability		
Your need for LTC		
Losing your job		
Totaling your car		
Your house burning down		
Getting sued		

Name _____

Sales Planning Project 1

Identifying Financial Goals and Obstacles

Report Form (3 of 3)

5. List other potential and plausible obstacles that could inhibit your achieving these goals. Focus on obstacles that are real and preventable, such as credit card debt, out-of-control spending, and so forth. Describe your strategy for avoiding these obstacles.

Potential Obstacle	Strategy

Summary Questions

1. Do you have a comprehensive financial plan? If yes, what planning areas does it cover? If not, why not?

2. How feasible is it for you to fully fund all of the finances needed to achieve all of your goals? What solution(s) do you see to this problem?

3. What action is required in light of your assessment of potential obstacles?

4. What two things did you learn about your own financial plan through this exercise?

Supplemental Reading 2

Importance of Risk Management

As important as it is to accumulate funds for future financial goals and dreams, a client must also consider protecting those funds from the unexpected and financially intrusive possibilities of life. For example, a client's premature death could place intense financial strain on the client's surviving family. Monies that would otherwise have gone to funding a child's education could be diverted to meet current living expenses. Or worse, the family's income could be affected so severely that the family dives deep into debt and must file for bankruptcy. Thus, the role the financial advisor plays in helping clients define exposure to possible risks and take appropriate action cannot be overstated.

Beginning your counseling sessions with an exploration of your client's goals, dreams, and values is an excellent way to assist in identifying what accumulation needs they have and which ones they would feel strongly about protecting from the risks of everyday life. For example, a client may feel strongly about sending her children to college. In fact, she may have started accumulating funds for that purpose. But is she aware of the possible financial risk to those funds that she faces from having inadequate liability limits in her auto or homeowners insurance? What are her wishes if she were to die prematurely?

The rest of this reading will discuss some of the planning factors to consider as you work with your clients to help them achieve financial security. In most states, it is illegal for an unlicensed person to provide advice regarding insurance. Thus, your role may be to help clients define their need for various protection products and then help them find a qualified and competent expert to receive specific advice and purchase needed products.

Caution!

In most states, it is illegal for an unlicensed person to provide advice regarding insurance.

Planning Considerations

Life Insurance

Determining the Client's Need—In general, consider the effect of death on an accumulation goal that requires a substantial sum of money or a perpetual stream of payments. The need for life insurance is especially acute for clients who have dependents, whether children or adults. For example, some clients may be funding an elderly parent's long-term care and would like to ensure such care continues in the event of the former's premature death. Life insurance is commonly used to fund the following needs for survivors. For example, life insurance can provide monies to

- replace a portion or all of the deceased's income based on living expenses of survivors
- create emergency and adjustment funds

- provide funds for dependent care
- set up funds for children's education
- repay outstanding debts (mortgage or consumer debt)
- settle all expenses associated with burial, estate taxes, probate costs, and unpaid medical care

For some clients, life insurance is a creative way to leave money to a charitable cause. A \$500,000 gift could become \$1.5 million through life insurance.

Also, consider the life insurance needs of a business owner. These include the following:

- to protect the business from the loss of a key employee whose absence would impact the bottom line
- to reward and retain key employees through an executive-bonus plan
- to effect a business continuation plan at the death of an owner

Furthermore, life insurance can also be used as an accumulation vehicle. In some instances, it may be appropriate for accumulating supplemental retirement income or funds for children's education. For businesses, it may be appropriate for funding nonqualified deferred-compensation plans or even qualified retirement plans.

Selecting the Type of Policy—When selecting the type of policy, begin by looking at the nature of the needs. Are they temporary and short-term in nature? For these needs, term insurance is most appropriate. Are they temporary but long-term in nature? For these needs, either term or permanent insurance may be appropriate. Are they permanent? Permanent needs require permanent life insurance.

In addition, the client's overall risk exposure plays a role since many clients will be financially unable to fully insure all of their risks. In these situations term insurance or a combination of term and permanent life insurance may be more appropriate.

Furthermore, if the client has a cash accumulation need, permanent life insurance products may be appropriate depending on the relative value of the tax-deferred growth of the cash value and the client's preference for life insurance products with cash values.

If permanent insurance is required, then you will need to choose between the various types of products available. Your major concern will be the appropriateness of the product. For example, if the client has no experience in mutual funds or stocks and is extremely conservative, a variable insurance product would probably be inappropriate.

Structuring Ownership—If the amount of a client's life insurance along with his or her projected net worth puts him or her near the estate tax exclusion amount, it will be very important to ensure the client does not own any new policies. An irrevocable life insurance trust may be an appropriate strategy.

Disability Income Insurance

Determining the Amount of Coverage—The key to determining the amount of any additional coverage is knowing what existing disability coverage the client already has. If a policy covers up to 70 percent of a client's earned income, and he or she has other disability coverage through an employer's plan, the individual policy will only be underwritten for the amount needed to bring

the total of all benefits to 70 percent of the client's earned income. It's important to coordinate any additional coverage with existing coverage, especially in terms of the following:

- the amount of coverage
- the elimination period
- the length of the benefit period
- the definition of disability

Selecting a Policy—If the client can afford it, the best type of policy is a noncancelable one because the insurer cannot raise the premium. The next best choice is the guaranteed renewable, which allows insurers to raise the premium for a particular group of policies.

Clients should consider a guaranteed insurability rider, which allows them to increase the coverage without underwriting. In addition, the cost-of-living rider should be considered to help benefits keep pace with inflation.

Long-Term Care Insurance (LTCI)

Motivating the Client—In your discussions about retirement, an important issue is how the client will handle his or her need for long-term care. You can motivate the client to address his or her need for LTCI by asking questions that explore the client's feelings about

- maintaining independence and dignity
- choosing care providers and settings
- preserving assets and wealth
- avoiding burdening family and/or friends

Assessing the Client's Suitability—Premium affordability is one of the most important factors for assessing the client's suitability. Thus, knowing a client's anticipated retirement income is very important (unless his or her children will be paying the premium). Buying the product at younger ages (under age 60) will help make the premiums affordable. In measuring affordability, it is advisable for the client to take into account possible premium increases. Can the client afford the premium if it were 20 percent more?

Assets are also important. However, the client's reason for wanting the coverage may be to avoid Medicaid—not to preserve assets. The National Council on Aging (formerly the United States Senior Health Cooperative) suggested the following minimum guidelines in its book *Planning for Long-Term Care*:

- annual (retirement) income of at least \$25,000 for a single person and \$35,000 for a couple
- assets of at least \$75,000, excluding the client's home and car¹

Structuring a Plan—The structure of the plan will depend on the client's assets and retirement income not only as a limiting factor for the premium but to determine the maximum daily benefit amount and the elimination period. The client's retirement income and assets can be used to pay a

¹ *Planning for Long-Term Care*. New York, NY: United Seniors Health Cooperative, 2002, p. 86.

portion of the cost of care if care is needed and will be necessary to pay for care during the elimination period.

A good objective to keep in mind is that insurance should cover the period when the need will most likely arise. In other words, money is generally best spent in obtaining shorter elimination periods and greater maximum daily benefits than in buying longer periods of coverage.

Simple versus Compound Inflator (based on policy with 5-year MDB and 5% inflation factor)					
		Simple		Compound	
Age	Policy Year	Daily	Lifetime	Daily	Lifetime
45	1	\$150	\$273,750	\$150	\$273,750
57	12	\$240	\$438,000	\$271	\$494,575
72	27	\$337	\$615,025	\$564	\$1,029,300
87	42	\$465	\$848,625	\$1,174	\$2,142,550

In addition, inflation protection is a necessity. Compounding inflators are essential for any client under 75. Simple inflators or higher maximum daily benefit amounts may be appropriate for older clients.

Annuity

The Client’s Time Horizon—Consider the client’s time horizon—when he or she will need this money. Nonqualified deferred annuities are designed for those who will not touch their money for several years. Keep in mind two constraints.

The first is the 10-percent penalty tax that the IRS imposes on withdrawals up to the investment gain in the contract that are made before age 59 ½. Note that for withdrawals that are made not as a result of annuitization, the taxable investment gain is considered to come out first. There are a few exceptions to the penalty tax, for example, death, disability, and instances where withdrawals are substantially equal periodic payments made at least annually for the life or life expectancy of the annuitant.

The second constraint is the surrender charges that the insurance company typically imposes on withdrawals that exceed a certain percentage of the policy’s value (usually about 10 percent). Surrender charges typically last between 5 to 10 years. They can last for longer periods of time. However, some policies do not assess them at all.

Comparison with Tax-Advantaged Retirement Plans—If the client is eligible for, yet not maximizing, his or her contributions to a 401(k) plan, 403(b) plan, SEP, SIMPLE, deductible IRA, or Roth IRA, the advisor should compare the applicable plan and the nonqualified deferred-annuity.

Comparison with Municipal Bonds—For clients with high income, compare the annuity with municipal bonds and municipal bond funds. The advantage for municipal bonds is that the client can generally withdraw money without incurring federal income taxes and penalties.

Comparison with Mutual Funds—There is one very important difference between variable annuities and taxable mutual funds. Because the variable annuity is tax-deferred, heirs do not receive a step up in basis.

EXAMPLE: Anne is 55-years-old and has \$100,000 she wants to invest. She does not anticipate needing the money but would like to have it available if she needs it. Her hope is to leave it to her son. She is considering investing in mutual funds or a variable annuity. Assume she dies at age 80 and the funds are worth \$500,000. The chart below compares the tax impact on her son.

Mutual Fund	Variable Annuity
<ul style="list-style-type: none"> • Her son receives the \$500,000 with a step up in basis. • His cost basis would be \$500,000. • If he sold them at her death, there would be no taxable gain (\$500,000 – \$500,000 = \$0). 	<ul style="list-style-type: none"> • Her son receives the \$500,000 without a step up in basis. • His cost basis would be \$100,000. • If he sold them at her death, the taxable gain would be \$400,000 (\$500,000 – \$100,000 = \$400,000).

Product Selection—As always, suitability is important. When a deferred annuity looks like a good fit, the preferred type will depend on the client’s risk tolerance.

For clients looking for a guaranteed rate of return, the fixed-interest deferred annuity may be suitable. Many companies offer a guaranteed minimum interest rate, usually 3 percent. The fixed-interest deferred annuity is worth investigating for clients who have monies locked in low-earning certificates of deposit (CDs). One tradeoff is that CDs are FDIC insured and annuities are not.

The equity-indexed annuity (EIA) enables clients to take advantage of some of the upside of the stock market. In exchange for a guaranteed minimum interest rate, the client’s upside is limited and often capped. But for many risk-averse clients, that will be quite acceptable. Note that the EIAs tend to have higher expenses associated with them than their regular fixed-annuity counterparts.

Advising clients to purchase products they do not understand is fraught with many pitfalls. Thus, variable deferred annuities are typically appropriate for clients who have experience with mutual funds or individual stocks and bonds. Also, when comparing with mutual fund options that do not offer tax-deferral, it could take some time before the tax-deferral advantage overcomes the negative impact on the fees and expenses associated with variable deferred annuities. That means that the longer the holding period, the better the chance for the client to reap the benefits of the tax-deferred growth within the variable deferred annuity.

Homeowners Insurance

Choosing a Policy Form—Recommend the best coverage for which the client can qualify and can afford (remember, the client has other insurance needs and investment goals to fund). For structural coverage, extended replacement cost coverage, which covers costs up to a certain percentage over the selected coverage amount (usually 20 percent), is the best. For coverage on personal belongings, replacement cost coverage is the best coverage. Actual cash value coverage, which factors in depreciation, provides less coverage for both structure and personal belongings.

Also, the client should check the value of rising local building costs each year to ensure his or her home is insured to its proper value. Inflation protection is a good idea but does not replace an annual checkup.

In addition, recommend that the client look into his or her possible need to protect against floods and earthquakes, two perils usually excluded from standard homeowners coverage. Earthquake coverage can typically be added on as an endorsement (in California, most coverage is insured through a state agency but sold by insurers). Flood insurance can be purchased from the National Flood Insurance Program (NFIP) or private insurance companies (subsidized by NFIP) so long as the client's property is eligible for flood insurance. In general, flood coverage does not take effect until 30 days after the insured purchases it. See www.floodsmart.gov for more information on flood insurance, including a page that allows a person to assess the flood risk of his or her home.

Selecting a Coverage Amount—Unless you are a property and casualty insurance agent, you will not determine the coverage amount. The client's property and casualty insurance agent will help determine that. Your objective here is to advise the client to purchase 100 percent of the replacement cost and to check his or her coverage each year to keep the coverage amount adequate. Carefully explain the problems that will arise if the client chooses an amount that at some point is less than 80 percent of the replacement cost.

Make an Inventory of Personal Belongings—Recommend that the client identify and record the major items he or she owns. Tell the client to record any information that would help in establishing each item's value, for example, make, model, and serial numbers. In addition, the client should record the purchase prices, present value, date of purchase, and attach any applicable receipts he or she may have. The client should document his or her inventory using a video and/or still photos and store this information away from his or her home. A safe deposit box is an appropriate place.

Endorsements and Personal-Articles Floaters—Review the internal limits of coverage on various items. The client may have a need for a greater amount of coverage for which he or she could purchase an endorsement to increase the coverage or a personal-articles floater policy. Either coverage can be used for property such as furs, jewelry, fine arts, antiques, and computer equipment. The client's homeowners insurance agent can help him or her choose the most appropriate form of coverage. It is important that in either case, as with the overall replacement coverage, the client review the coverage periodically to ensure the item or items are insured for the proper amount.

Other Coverage—If the client runs a business from the home, he or she should be aware that a separate policy to cover office equipment and business liability will be necessary.

Auto Insurance

Selecting Limits—When it comes to selecting bodily-injury liability and property-damage limits, consider what is at stake by selecting the state-required minimum limits. One lawsuit could drain all of a client's savings and investments. In general, the more assets a client has, the higher his or her limits should be. A good starting point for most clients is a bodily-injury liability limit of \$100,000 for a single injury and \$300,000 for all injuries in one accident, and property-damage

coverage of \$50,000. For those with high assets and income, the minimum recommended coverage is that which is required to purchase an umbrella liability policy.

Selecting Deductibles—The amount of the client’s deductibles for collision and other-than-collision coverages will depend on the amount he or she can afford and wants to self-insure. Higher deductibles will save money, provided the client does not get into a few accidents in a short period of time.

Removing Collision and Other-than-Collision—For older cars, it may not be cost-effective to keep collision and other-than-collision coverages. Experts say that if a car is worth less than 10 times the annual premium for these coverages, then these two coverages may not be a wise use of money. Your clients can obtain the value of their cars from auto dealers, banks, and online pricing services such as Kelley Blue Book, National Automotive Dealers Association, and so forth.

Cost-Savings Advice—In addition, advisors can give their clients some important advice for reducing their outlay for auto insurance. Here are a few to consider:

- Insure all cars with one company. Insurers give discounts for multiple cars.
- Obey traffic laws and drive defensively. Moving violations and accidents will drive up your insurance rates.
- Inquire and act on any discounts for driver safety, low annual mileage, good grades (for students), college students away from home, anti-theft devices, and so forth.
- Look for discounts for placing your homeowners and auto insurance with the same company.
- Factor in the cost of auto insurance on different cars when you are looking to buy a new one. Cars that are stolen more frequently, easier to damage, harder to repair, and so forth have higher premiums.

2-2 What are the possible personal, property, and liability risks associated with each of the following situations?

A. Saving for retirement

B. Saving for a child's education

C. Desiring to leave behind a legacy to children or a cause

D. Owning a home

E. Providing for everyday expenses (food, clothing, gas, and so forth)

2-3 What is your strategy for dealing with someone who needs more insurance (pick a line of insurance if your approach would vary based on the line of insurance that is needed) and says, "I can't afford it?"

Name _____ Date _____

Quiz—Classes 1 and 2

(Due Class 2)

Instructions: This quiz covers the reading material found in both Class 1 and Class 2. Study the reading assignments, then circle the correct answer for each of the following questions. Each question is worth 7 points (105 points total).

1. Which of the following would an advisor do in the “implement the plan” step of the selling/planning process?
 - (A) Review the changes in the client’s circumstances and the financial environment.
 - (B) Identify the strengths and weaknesses in the client’s present financial condition.
 - (C) Gather considerable information from the client via a fact finder.
 - (D) Motivate and help the client acquire all necessary financial products and services.

2. Which of the following statements regarding the findings of independent studies conducted on retirement planning is correct?
 - (A) An overwhelming number of pre-retirees currently consult with a financial advisor.
 - (B) There is a strong need for professional help when it comes to retirement planning.
 - (C) Most people have planned well without the help of a financial advisor.
 - (D) Social Security is positioned well to provide people with a comfortable retirement.

3. Which of the following situations represents a speculative risk?
 - (A) the possibility of a new car getting into an accident
 - (B) the possibility of a person needing medical care at a hospital
 - (C) the possibility of losing a wage-earner’s income due to his or her death
 - (D) the possibility of a house appreciating or depreciating in market value

4. Ted is moving into an unfurnished apartment that he just rented. He wants a homeowners policy to protect his personal property. As Ted’s financial advisor, which of the following homeowners forms would you recommend that he buy?
 - (A) HO-2
 - (B) HO-4
 - (C) HO-6
 - (D) HO-8

5. Which of the following types of total-disability definitions contained in disability income policies is most beneficial for an insured?
- (A) own occupation definition
 - (B) own occupation for 2 years, then any suitable occupation
 - (C) own occupation for 5 years, then any suitable occupation
 - (D) any occupation for the insured's reasonably suited definition
6. Trends creating opportunities for advisors engaged in financial planning include which of the following?
- I. impact of technology in the financial services industry
 - II. enduring stability of financial conditions in the economy
- (A) I only
 - (B) II only
 - (C) Both I and II
 - (D) Neither I nor II
7. Which of the following is (are) reasons people begin financial planning?
- I. building a retirement fund
 - II. home purchase/renovation
- (A) I only
 - (B) II only
 - (C) Both I and II
 - (D) Neither I nor II
8. Which of the following statements regarding whole life insurance is (are) correct?
- I. The cost per thousand for any given issue age is cheaper for whole life than for term policies.
 - II. Whole life insurance is appropriate when there is a permanent need for coverage.
- (A) I only
 - (B) II only
 - (C) Both I and II
 - (D) Neither I nor II

9. Which of the following statements regarding Part D (coverage for damage to your auto) of an auto insurance policy is (are) correct?
- I. The two primary coverages are “collision” and “other-than-collision.”
 - II. “Other-than-collision” coverage used to be called “comprehensive.”
- (A) I only
(B) II only
(C) Both I and II
(D) Neither I nor II
10. Which of the following statements regarding homeowners insurance is (are) correct?
- I. The client should buy flood insurance 24 hours before a possible flood.
 - II. Earthquake coverage is generally included in the basic coverage of any policy.
- (A) I only
(B) II only
(C) Both I and II
(D) Neither I nor II
11. All of the following are obstacles that prevent consumers from gaining control of their financial destinies EXCEPT
- (A) the lack of financial knowledge among consumers
 - (B) the tendency for consumers to spend beyond their incomes
 - (C) the absence of tax incentives to save rather than spend disposable income
 - (D) the natural human tendency to procrastinate
12. All of the following are stages of the financial planning pyramid approach for developing a comprehensive financial plan over a period of time EXCEPT
- (A) allocating and diversifying investments
 - (B) managing retirement and the estate
 - (C) growing investments
 - (D) guarding against uncertainty
13. All of the following advisors are engaged in financial planning EXCEPT
- (A) an income-tax preparer who suggests that a client establish an IRA
 - (B) a real estate agent who refers a client to a life insurance agent
 - (C) a multiline insurance agent who sells life and health insurance and mutual funds
 - (D) a financial planner who charges a fee for his or her services

14. All of the following statements regarding annuities are correct EXCEPT
- (A) Life annuities guarantee a lifetime income for the annuitant.
 - (B) Annuities can be purchased on a qualified or nonqualified basis.
 - (C) The variable annuity's underlying investment portfolio is typically common stocks.
 - (D) Immediate annuities can be used to accumulate a retirement nest egg.
15. Life insurance can be used to fund all of the following needs EXCEPT
- (A) to accumulate funds for children's education
 - (B) to repay debts
 - (C) to replace income lost due to a disability
 - (D) to settle expenses associated with burial

Sales Planning Project 2

Interview with an Experienced Advisor

(Assigned Class 2—Due Class 4)

Purpose

The purpose of this sales planning project is for you to see the financial planning discipline and/or profession from a different perspective. The specific nature of the project will depend on the nature of your practice:

<u>If you are...</u>	<u>Then the purpose of this project is to learn...</u>
a commission-based specialist	how your specialty fits into the larger financial planning discipline
a fee-based planner	how a specialist approaches the financial planning discipline

Assignment

The assignment is to identify and interview (either face-to-face or over the telephone) an experienced advisor. Then, you will record and report your results in the form provided in this assignment.

Procedure

To complete this assignment, do the following:

1. Find an experienced advisor. If you are a commission-based specialist, identify a fee-based planner and vice-versa. If you need assistance, ask your moderator for suggestions.
2. Prepare for the interview by reading and understanding the following questions that you will ask. In italics is an explanation of the information the question should provide. If the advisor does not give you that information, rephrase the question.
 - How did you find prospects when you first started? How do you find prospects today? *Many experienced advisors work from referrals. Find out the other ways they prospect and how they prospected before they were able to work strictly on a referral basis.*
 - How do you approach prospects for an interview? What do you do? What do you say? *Regardless of the type of practice, advisors must see people to make a living. Find out what the advisor says to obtain appointments.*
 - What common financial and related topics do you cover most often in your interaction with clients? *Here you are trying to find out what topics the advisor discusses most often with his or her clients. Dig beyond very broad topic areas like tax planning, risk management, estate planning, retirement planning, investment planning, and so forth. Find out some of the actual tax planning topics the advisor covers. If possible, obtain a copy of a fact finder the advisor uses.*
 - How do you prioritize between the various protection and accumulation needs in the likely event that the client cannot afford to purchase all of the products he or she needs?

Many clients will not be able to fund every financial need. Determine the advisor's philosophy on funding. Which protection and accumulation needs (life insurance, disability insurance, health insurance, retirement, children's education, emergency fund, and so on) are most important? Would the advisor recommend funding as many of the high-priority needs as fully as possible or funding several higher-priority needs partially?

- *How do you motivate the client to take action on the recommendations you make? This question explores how the advisor responds to a client's concerns, resistance, and objections that prevent him or her from taking action.*
 - *What recommendations do you make that do not coincide directly with the product you sell? This question is geared more for commission-based specialists. It is intended to determine to what extent this particular specialist helps the client see the related aspects of the solution for which he or she does not have a product to sell.*
 - *Do you meet with a client on a regular basis once a plan is implemented? How often? What do your follow-up meetings look like? The objective of this question is to determine what the monitoring process looks like, if it exists.*
 - *How are you compensated? Are there initial fees? Ongoing fees? How do you determine the fees that are charged? You are not looking for specific fee amounts. You simply want to find out when and how the client pays. Is it a one-time fee? Is it ongoing? Is it both?*
 - *What credentials and education do you have? Which do you recommend? Find out what designations the advisor has and what education he or she feels is important and helpful.*
3. Contact the advisor and tell the advisor that you are interested in learning about his or her practice. Ask if he or she would be willing to share thoughts and discuss experiences on his or her practice. Arrange a time when you can conduct a 30-minute interview either over the phone or face-to-face.
 5. Consider taping the interview to review later while you are completing your report form. Remember to obtain the interviewee's permission if you decide to tape the interview.

Name _____ Date _____

Sales Planning Project 2

Interview with an Experienced Advisor

Report Form (1 of 3)

Advisor Interview

1. How did you find prospects when you first started? How do you find prospects today?

2. How do you approach prospects for an interview? What do you do? What do you say?

3. What common financial and related topics do you cover most often in your interaction with clients?

4. How do you prioritize between the various protection and accumulation needs in the likely event that the client cannot afford to purchase all of the products he or she needs?

Sales Planning Project 2

Interview with an Experienced Advisor

Report Form (2 of 3)

5. How do you motivate the client to take action on the recommendations you make?

6. What recommendations do you make that do not coincide directly with the product you sell?

7. Do you meet with a client on a regular basis once a plan is implemented? How often? What do your follow-up meetings look like?

8. How are you compensated? Are there initial fees? Ongoing fees? How do you determine the fees that are charged?

9. What credentials and education do you have? Which do you recommend?

Name _____ Date _____

Sales Planning Project 2

Interview with an Experienced Advisor

Report Form (3 of 3)

Summary Questions

1. Name three ways in which the advisor's practice differs from yours (other than how he or she is compensated).

2. Name two ways in which the advisor's practice is similar to yours.

3. What did you learn from this project that you can apply to your current practice? Name two and describe how you can use them in your practice.

Supplemental Reading 3

Inflation-Adjusted Items

This chapter makes reference to several inflation-adjusted items. The updated numbers are as follows.

<u>Inflation-Adjusted Item</u>	<u>2005 Amount</u>	<u>Page Ref</u>
adoption tax credit	\$10,630.....	3-55
adoption tax credit phase out begins at.....	\$159,450.....	3-56
adoption tax credit is phased out at	\$199,450.....	3-56

Medical Expense Insurance

Health Savings Account (HSA)

One of the newest additions to the defined-contribution medical expense plans is the health savings account (HSA), which effectively replaced the Archer Medical Savings Account (MSA) in 2004. The HSA was created by the Medicare Prescription Drug and Modernization Act of 2003, and expanded the availability of pretax or tax-deductible savings accounts used to pay for deductibles and other unreimbursed medical expenses associated with high-deductible health plans (HDHPs) to include anyone covered by an HDHP.

Eligibility—An HSA can only be set up in conjunction with the purchase of an HDHP or coverage by an HDHP through an employer. The individual covered by an HSA cannot be claimed as a dependent on another person's federal income tax return and cannot be entitled to Medicare benefits because of attaining age 65 or disability. In addition, an individual cannot be covered by a non-HDHP that duplicates benefits provided by the HDHP. For the purposes of HSAs, an HDHP is defined as having the following deductibles and annual out-of-pocket limitations (which are subject to annual indexing for inflation):

- In the case of individual coverage, the deductible must be at least \$1,000, and annual out-of-pocket expenses cannot exceed \$5,000 (in 2005).
- In the case of family coverage, the deductible must be at least \$2,000, and annual out-of-pocket expenses cannot exceed \$10,000 (in 2005).

Contributions—For employer-sponsored plans, contributions can be made by the employer, the employee via salary reduction, or both. In either case, the contributions are excluded from taxable income and not subject to federal income tax, FICA, or FUTA. In addition, employer contributions are tax-deductible to the employer. If an employee makes contributions separate

from salary reductions, such contributions are made after-tax and are also subject to FICA and FUTA. However, the employee may deduct them on his or her federal income tax return as an above-the-line tax deduction. Thus, they are not subject to any limitations due to income or representing a minimum percentage of adjusted gross income.

Likewise, for plans not sponsored by an employer, the contributions are made after tax but are tax deductible as an above-the-line tax deduction. They, too, have already been subject to FICA and FUTA taxes.

Contributions cannot exceed the lesser of the annual deductible of the HDHP or \$2,650 for an individual and \$5,250 for family coverage (both numbers are for 2005 and are subject to annual indexing for inflation). Individuals aged 55 or older can make additional contribution amounts of \$600 in 2005, increasing in \$100 increments through 2009 when the amount will be \$1,000.

Distributions—Distributions from HSAs are tax-free as long as they are used to pay for qualified medical expenses. For the most part, the eligible medical expenses are the same ones that would be deductible if the client itemized his or her tax-deductible unreimbursed medical expenses. However, tax-free withdrawals are not permitted for the purchase of insurance other than long-term care insurance, COBRA continuation coverages, or health coverage while an individual receives unemployment compensation. Any unused funds accrue and can be used for medical expenses in future years. Nonqualified distributions are includible in gross income and a 10-percent penalty applies unless the account holder is age 65 or older or the distribution is a result of the client’s death or disability.

Estate Tax Implications—Upon death, the remaining balance in an HSA is includible in the account holder’s gross estate for estate tax purposes. If the beneficiary is the surviving spouse, the HSA belongs to the spouse and he or she can deduct the account balance in determining the account holder’s gross estate. The surviving spouse can then use the HSA for his or her medical expenses. If the beneficiary is anyone else, the beneficiary must include the fair market value of the account in his or her gross income for tax purposes.

Planning Considerations—Anyone who is covered by an HDHP and has the money adequately to fund an HSA should consider one. Even if the client exhausts the HSA each year, the tax savings may make the HSA worth it. For clients who cannot adequately fund the account, associated fees could potentially make the HSA not worth it.

Sample Fees for an HSA	
Account Set Up Fee:	\$25.00
Monthly Fee (if average daily balance falls below \$2,500.00):	\$2.50
Account Closing Fee:	\$20.00

Determining the Best Medical Expense Coverage

When a client can choose between various plans either through an employer or on the individual market, remember that the lowest premium is guaranteed to be the least-expensive plan only if those insured by the plan never use it. The plan with the lowest premium is often not the plan that

costs the least. Pay close attention to which coverages are included and excluded. Also, pay attention to coinsurance, deductibles, and copayments.

If the plan or plans cover prescription drugs, note the copayment or coinsurance amounts. If the amount of the copayment or coinsurance differs for brand, generic, and formulary drugs, advise the client to compare each plan for all of the maintenance drugs used by any family member. See the end of this section for a sample comparison worksheet.

Flexible Spending Accounts (FSAs)

Medical FSA

The client's employer may offer a flexible spending account (FSA) for unreimbursed medical expenses. A list of eligible expenses can be found in IRS Publication 502. Currently, the IRS is allowing medicines and drugs purchased by an employee without a physician's prescription to be excludible from gross income. Thus, items such as antacid, allergy medicine, pain reliever, and cold medicine without a physician's prescription are considered an expenditure for medical care. These are all items that would not be reimbursable through a health reimbursement arrangement (HRA). Furthermore, they are not eligible to be counted as itemized unreimbursed medical expenses on Schedule A of the federal income tax return Form 1040.

Clients who are not currently availing themselves of the benefits provided by an FSA for medical expenses should be counseled to consider one unless they do not have many medical expenses. Generally, young families would benefit from utilizing an FSA.

Use the worksheet on the next page to estimate how much to withhold from each paycheck. Always recommend a conservative estimate, since the client forfeits any monies left in the FSA at the end of a plan year.

Dependent Care FSA

The dependent care FSA allows you to use pretax dollars to pay for dependent care expenses that are necessary for you to work. Eligible dependents include:

- your children who are less than 13 years of age
- anyone (including your spouse) who is physically or mentally incapable of caring for him- or herself regardless of age

The maximum amount that can be elected is \$5,000 if filing single, \$5,000 aggregate if married and filing a joint return, and \$2,500 if married and filing separate returns. Any expense that would qualify under Internal Revenue Code section 21 for the Child Care Credit will qualify for reimbursement. Please refer to Internal Revenue Service Publication 503 for more information.

One very important planning consideration is helping the client choose between the dependent care FSA and claiming the dependent care tax credit on his or her federal income tax. See the corresponding worksheet at the end of this section.

Medical Expense Coverage Plans

What's Important to the Client?

Ask the client to rate each of the following characteristics of medical expense coverage plans in terms of how important they are to him or her. Note the client's response in Column R. Use letters A through D, A = extremely important, B = very important, C = somewhat important, D = not important. Then, indicate what the cost or answers are for each plan.

Characteristic	R	Plan 1	Plan 2	Plan 3
Plan name				
Company rating				
Choice of doctors				
Choice of hospital				
Minimal paperwork				
Waiting period				
Lifetime maximum benefit				
Deductible				
Coinsurance maximum out-of-pocket				
Physicians services benefit				
Hospital care				
Emergency room				
Outpatient lab & X-ray benefit				
Prescription drug benefit				
Preventive care				
Maternity coverage				
Well-baby care				
Other services you need that are excluded				

What's the Cost?

In this section, you will help the client estimate the total cost of health care. This means the premium plus the out-of-pocket costs for deductibles, copayments, and coinsurance. Lower premiums do not always mean the lowest total cost!

Estimated number of doctor visits	
Estimated number of specialists visits	
Prescription drugs	
• Maintenance	
• Estimated other	
Anticipated surgeries	
Anticipated laboratory/X-rays	

	Plan 1	Plan 2	Plan 3
A. Client's monthly premium (out-of-pocket)			
B. Multiply by 12 for annual cost			
C. Estimated cost for physician services			
D. Estimated cost for prescription drugs			
E. Estimated costs for surgeries			
F. Estimated costs for laboratory/X-rays			
G. Estimated cost for one trip to the emergency room			
H. Estimated cost for maternity care (if applicable)			
I. Estimated costs for well-baby care (if applicable)			
J. Estimated costs for immunizations (if applicable)			
K. Total costs = (Add lines B through J)			

Medical FSA Payroll Deduction Amount Worksheet

	Expenses for this year	Projected expenses for next year
Insurance deductibles	\$	\$
Insurance copayments/coinsurance	\$	\$
Dental copayments/coinsurance	\$	\$
Uncovered immunizations, vaccinations	\$	\$
Birth control expenses	\$	\$
Routine exams and physicals	\$	\$
Orthodontic expenses	\$	\$
Vision exams	\$	\$
Eyeglasses and contacts	\$	\$
Hearing exams	\$	\$
Nonprescription drugs and medicines	\$	\$
Other expenses (list)		
	\$	\$
Total		\$
Amount of Medical FSA payroll deduction (divide Total by 12)		\$

Estimated Tax Savings Associated with Medical FSA

A. Enter FSA annual payroll deduction amount		\$
B. Enter federal income tax rate		
C. Enter state tax rate (if applicable)		
D. FICA tax rate	7.65 %	
E. Add lines B, C, and D		%
F. Multiply line A by line E		\$

Dependent Care Tax Credit and FSA Comparison Worksheet

	Tax Credit	FSA
A. Enter total annual estimated dependent care expenses ¹	\$	\$
B. Enter the rate for your Federal Dependent Care Tax Credit	%	
C. Enter the federal tax rate		%
D. Enter state income tax rate (if applicable)		%
E. FICA tax rate		%
F. Add lines C, D, and E		%
G. Multiply line A by lines B and F respectively	\$	\$

¹ The dependent care tax credit cannot exceed \$3,000 for one qualifying dependent and \$6,000 for two or more qualifying dependents. Furthermore, it cannot exceed the income of either the client or the client's spouse.

Federal Dependent Care Tax Credit	
Client's AGI	Rate
Less than \$15,000	35%
\$15,000–\$17,000	34%
\$17,000–\$19,000	33%
\$19,000–\$21,000	32%
\$21,000–\$23,000	31%
\$23,000–\$25,000	30%
\$25,000–\$27,000	29%
\$27,000–\$29,000	28%
\$29,000–\$31,000	27%
\$31,000–\$33,000	26%
\$33,000–\$35,000	25%
\$35,000–\$37,000	24%
\$37,000–\$39,000	23%
\$39,000–\$41,000	22%
\$41,000–\$43,000	21%
More than \$43,000	20%



Breakout—Class 3

3-1. From the benefits listed below, select those that you feel relate to products you sell. Then, briefly describe how an employee’s access to them needs to be reflected in the financial planning you currently conduct with prospects. For example, if you market life insurance, you would indicate that group term life insurance amounts need to be coordinated with personal insurance amounts, and any voluntary group plans should be checked to see if your plan might be more appropriate and affordable.

- group medical expense insurance
- group life insurance
- group disability insurance
- flexible spending account (FSA)
- health reimbursement account (HRA)
- accidental death and dismemberment
- dependent life insurance
- dental insurance
- vision insurance
- legal expense insurance
- long-term care insurance
- property and liability insurance
- education assistance
- adoption assistance
- dependent care assistance
- qualified retirement plan
- nonqualified retirement plan

Benefit	How It Is Reflected in Your Financial Planning Process

Benefit	How It Is Reflected in Your Financial Planning Process

3-2. For each of the following coverages, describe situations when you would recommend a client buy them and when a client should not buy them.

Coverage	Situations Coverage Should Be Purchased	Situations Coverage Should Not Be Purchased
Hospital indemnity insurance		
Specified (dread) disease insurance		
Critical illness insurance		
Legal expense insurance		
Accidental death and dismemberment		
Dependent life insurance coverage for children		

Quiz—Class 3

(Due Class 3)

Instructions: Study the reading assignment from Class 3, then circle the correct answer for each of the following questions. Each question is worth 10 points (100 points total).

1. Which of the following statements regarding traditional major medical plans is correct?
 - (A) They restrict insureds to specific physicians and hospitals.
 - (B) They limit reimbursement to reasonable and customary charges.
 - (C) They are typically less expensive than managed care plans.
 - (D) They negotiate deep discounts with physicians and hospitals.

2. Dental expenses are paid on a reasonable-and-customary basis (subject to any exclusions or limitations in the contract) under this type of dental plan.
 - (A) scheduled plan
 - (B) nonscheduled plan
 - (C) nonqualified plan
 - (D) combination plan

3. Markita quits her job at ABC Company to start her own business. Under COBRA, she will be eligible to extend her current group health plans for up to
 - (A) zero months
 - (B) 12 months
 - (C) 18 months
 - (D) 36 months

4. Preferred provider organizations (PPOs) typically differ from HMOs in which of the following ways?
 - I. Employees are not required to use the practitioners or facilities that contract with the PPO.
 - II. The preferred providers are generally paid on a fee-for-service basis as their services are used.
 - (A) I only
 - (B) II only
 - (C) Both I and II
 - (D) Neither I nor II

5. Which of the following statements regarding taxation of employee benefits is (are) correct?
- I. The cost of providing benefits is generally tax deductible for the employer.
 - II. Taxation is consistent from benefit to benefit.
- (A) I only
(B) II only
(C) Both I and II
(D) Neither I nor II
6. Which of the following statements regarding the taxation of disability benefits is (are) correct?
- I. All benefits paid from fully contributory plans are taxable income to the employee.
 - II. All benefits paid from noncontributory plans are received by the employee tax free.
- (A) I only
(B) II only
(C) Both I and II
(D) Neither I nor II
7. Which of the following statements regarding an employer-sponsored health savings account (HSA) is (are) correct?
- I. Contributions can be made by the employee and the employer in the same year.
 - II. Distributions from HSAs for qualified medical expenses are made tax-free.
- (A) I only
(B) II only
(C) Both I and II
(D) Neither I nor II
8. Comprehensive legal expense insurance plans typically provide coverage for all of the following types of legal services EXCEPT
- (A) class-action suits
 - (B) name changes
 - (C) IRS audits
 - (D) adoptions

9. All of the following statements regarding the taxation of group term life insurance are correct EXCEPT
- (A) Premiums are taxable income for key employees if the plans are considered discriminatory.
 - (B) Death proceeds are generally paid to beneficiaries with no income tax consequences.
 - (C) Employer contributions for dependent life coverage are not taxable to the employee if benefits are de minimis.
 - (D) Self-funded plans have the same tax consequences as an insured plan.
10. All of the following are additional benefits sometimes included in accidental death and dismemberment insurance EXCEPT
- (A) daily flat amount for days an employee is hospitalized due to an accident
 - (B) rehabilitation benefits for an injured employee
 - (C) monthly income benefits for an employee who is permanently disabled
 - (D) monthly income benefits for an employee who becomes a para- or quadraplegic

Sales Planning Project 3

Medical Expense Coverage Checkup

(Assigned Class 3—Due Class 5)

Purpose

Financial advisors need to understand employee benefits so they can incorporate them into the financial plans they develop for their clients. Probably the most important employee benefit is medical expense coverage (health insurance). In this project, you will learn more about your medical expense coverage or that of a client or prospect.

Assignment

In this sales planning project, you are to analyze your medical expense coverage or that of a client or prospect. You will compare at least two plan options for benefits and total cost.

Procedure

1. Read through the questions that are asked in this sales planning project to determine what information you will need to complete the project. For example, you will need to have a summary of each medical expense coverage plan you are reviewing.
2. You have two options for completing this project.
 - OPTION 1: Gather information regarding your medical expense coverage plan options.
 - OPTION 2: Contact a client or prospect who has two or more medical expense coverage options (people who work for large employers will have a greater likelihood of having more than one option) and ask if he or she would like to compare their options. Ask the client or prospect to bring a summary of benefits for at least two of the plans.
3. Analyze and compare at least two plans. If a plan has different copayments, coinsurance, and deductibles for using network versus nonnetwork health care providers, focus on the benefits that apply to you. In other words, if you will use network providers, don't spend time analyzing the nonnetwork copayments, coinsurance, and deductibles.
4. Calculate a feasible amount to place in a flexible spending account (FSA) for medical expenses (regardless of whether or not one is available). Also, calculate the potential tax savings.
5. Answer the summary questions.

Name _____ Date _____

Sales Planning Project 3

Medical Expense Coverage Checkup

Report Form (1 of 4)

What's Important to the Client?

Ask the client to rate each of the following characteristics of medical expense coverage plans in terms of how important they are to him or her. Note the client's response in Column R. Use letters A through D, A = extremely important, B = very important, C = somewhat important, D = not important. Then, indicate what the cost or answers are for each plan.

Characteristic	R	Plan 1	Plan 2	Plan 3
Plan name				
Company rating				
Choice of doctors				
Choice of hospital				
Minimal paperwork				
Waiting period				
Lifetime maximum benefit				
Deductible				
Coinsurance maximum out-of-pocket				
Physicians services benefit				
Hospital care				
Emergency room				
Outpatient lab & X-ray benefit				
Prescription drug benefit				
Preventive care				
Maternity coverage				
Well-baby care				
Other services you need that are excluded				

Sales Planning Project 3

Medical Expense Coverage Checkup

Report Form (2 of 4)

What's the Cost?

In this section, you will help the client estimate the total cost of health care. This means the premium plus the out-of-pocket costs for deductibles, copayments, and coinsurance. Lower premiums do not always mean the lowest total cost!

Estimated number of doctor visits	
Estimated number of specialists visits	
Prescription drugs	
• Maintenance	
• Estimated other	
Anticipated surgeries	
Anticipated laboratory/X-rays	

	Plan 1	Plan 2	Plan 3
L. Client's monthly premium (out-of-pocket)			
M. Multiply by 12 for annual cost			
N. Estimated cost for physician services			
O. Estimated cost for prescription drugs			
P. Estimated costs for surgeries			
Q. Estimated costs for laboratory/X-rays			
R. Estimated cost for one trip to the emergency room			
S. Estimated cost for maternity care (if applicable)			
T. Estimated costs for well-baby care (if applicable)			
U. Estimated costs for immunizations (if applicable)			
V. Total costs = (add lines B through J)			

Name _____

Sales Planning Project 3

Medical Expense Coverage Checkup

Report Form (3 of 4)

7. Based on the above costs, what would be a reasonable amount to contribute to a flexible savings account for medical costs (regardless of whether or not one is available)? Remember, FSA monies are forfeited if not used by the end of the plan year.

8. How much would be saved in taxes if an FSA is used?

Summary Questions

1. Which plan was the best in terms of the cost (if applicable)?

2. What other factors besides price play a role in deciding which medical expense coverage to choose?

3. What coverage gaps do you see in the medical expense coverage? What are some ways these gaps could be closed?

Sales Planning Project 3

Medical Expense Coverage Checkup

Report Form (4 of 4)

4. How would you recommend your clients select a medical expense coverage plan if they have a choice between plans?

5. What two things did you learn from completing this project?

Action Project 1

Discovering a Client's Goals and Obstacles

(Assigned Class 3—Due Class 5)

Purpose

The purpose of this project is to experience the process of discovering a client's financial goals and obstacles.

Assignment

Discuss a client's financial goals and obstacles using the process from Sales Planning Project 1.

Procedure

1. Identify a client or prospect with whom you are comfortable. Ask him or her to help you. Explain that you are taking a course on financial planning that requires you to discuss financial goals and obstacles with someone and then gather some additional information regarding his or her attitudes toward financial planning. The process will take about 30 minutes.
2. Conduct the interview by asking questions that reveal the client's financial goals and potential obstacles. Use the following line of questioning or develop your own.
 - Do you have a comprehensive financial plan? If you have one, what does it look like? Does it have goals, strategies, a spending plan (budget), and so on? If you don't have one, why don't you?
 - What are your top five to 10 goals? These could be goals such as buying a home, retirement, a vacation trip, purchasing a vacation home, and so forth, or they could be anticipated events such as marriage, birth of a child, post-secondary education for a child or yourself, a child's marriage, beginning a second career, buying a car, and so forth.
 - Rank your goals in the order of importance to you. (*Have the client number them from 1 to 10, or the number of goals they have identified, if less.*)
 - Which of these goals have a financial impact on you? In other words, which goals will require money to attain? (*Circle these goals.*)
 - Which of these goals have you assessed and begun funding? (*Place a check mark next to these goals.*)
 - I'm going to show you a timeline. I would like you to put a star on the timeline that corresponds to your age.
 - When do you see yourself achieving your first goal? How many years from now? (*Place an abbreviation or the letter associated with each goal on the timeline with the number of years until it is to be achieved in parentheses. Repeat this step for each goal.*)
 - In life, serious obstacles can arise. There are some goals in life that are so important that we want to do whatever we can to protect them. Let's take a look at some of life's more serious obstacles and how you feel about your goals in light of them. Which of your goals would you want to achieve if one of the following events happened to you or your

partner (if applicable). (*List the letter of the goals in the space provided on the report form.*)

- How concerned are you about your premature death? What financial impact do you think that would have on your goals? Which goals might it jeopardize? What strategies have you implemented to mitigate the impact of such an event? (*Repeat this question for each situation listed on the report form.*)
- What other potential and plausible obstacles could inhibit you from achieving your goals? Focus on obstacles that are both real and preventable, such as credit card debt, out-of-control spending, and so forth. What is your strategy for avoiding these obstacles?
- After completing this exercise, what actions do you feel you might need to take?
- How did you feel about this process? What was effective? What could I have done differently?

3. Answer the summary questions.

Name _____ Date _____

Action Project 1

Discovering a Client's Goals and Obstacles

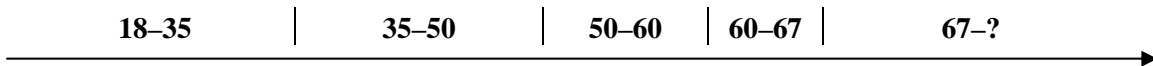
Report Form (1 of 4)

1. Do you have a comprehensive financial plan? If you have one, what does it look like? Does it have goals, strategies, a spending plan, and so on? If you don't have one, why don't you?

2. Identify five to 10 goals (or anticipated events). Prioritize them. Then, circle those that require money. Finally, place a check mark next to those you have identified as a financial goal and have started funding.

	Goal/Event	Priority		Goal/Event	Priority
A			F		
B			G		
C			H		
D			I		
E			J		

3. Draw a star for your current age on the timeline below. Plot the goals from above along with the estimated number of years before they are expected to be achieved or to occur.



Action Project 1

Discovering a Client's Goals and Obstacles

Report Form (2 of 4)

4. Which of these goals would you want to achieve if one of the following events happened to you or your partner (if applicable)? List the letters of these goals.

	You	Partner
Died tomorrow		
Disabled tomorrow		
Hospitalized tomorrow		
Needed LTC at age 65		
Parents needed LTC tomorrow		

5. Describe the financial impact each of the following situations would have on you and/or your family. Also indicate your level of concern with such an event occurring.

Event	Concern	Financial Impact/Strategy
Your premature death		
Your disability		
Your need for LTC		
Losing your job		
Totaling your car		
Your house burning down		
Getting sued		

Name _____

Action Project 1

Discovering a Client's Goals and Obstacles

Report Form (3 of 4)

6. List other potential and plausible obstacles that could inhibit your achieving these goals. Focus on obstacles that are real and preventable, such as credit card debt, out-of-control spending, and so forth. Describe your strategy for avoiding these obstacles.

Potential Obstacle	Strategy

7. What actions do you feel you may need to take after having this conversation?

8. How did you feel about this process? What was effective? What could I have done differently?

Name _____

Action Project 1
Discovering a Client's Goals and Obstacles
Report Form (4 of 4)

Summary Questions

Think about your interaction with the client and answer these questions.

1. How did you feel the process went? What went well? What would you change?

2. What two things did you learn about discussing financial goals and obstacles with a client?

Supplemental Reading 4

Explaining Investment Risk

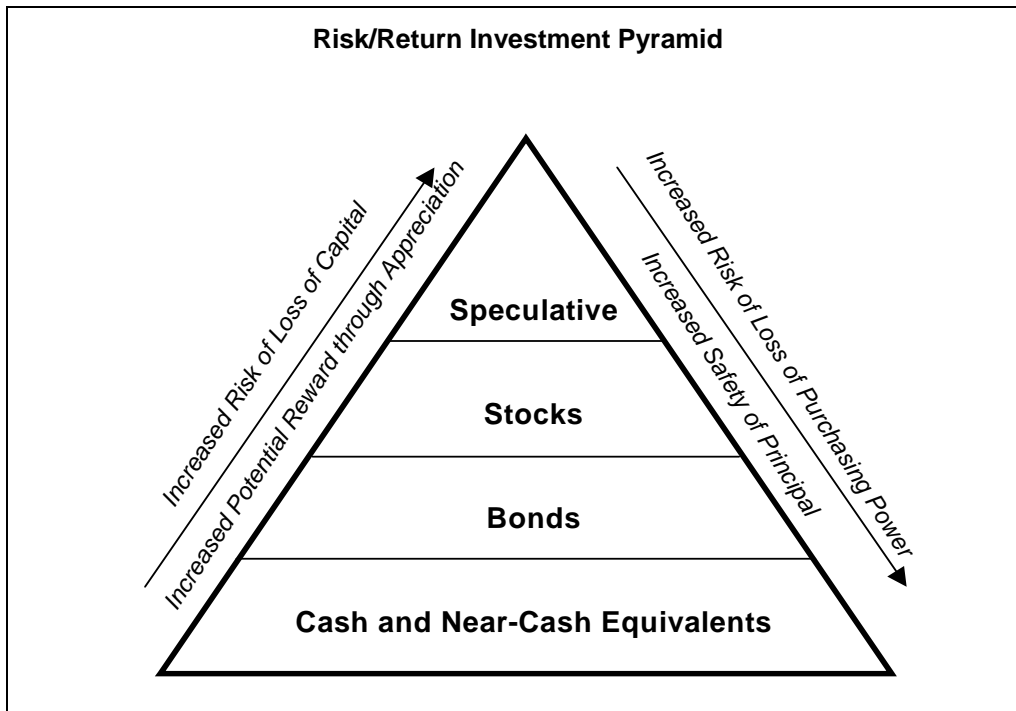
For some of your clients, you need to be able to explain the concept of investment risk. Otherwise, they may have unrealistic expectations. For example, Pat Pessimist would like a risk-free return of 8 percent. Thus, it is important to establish early on in the process the concept that there is no free lunch.

Your objective is to ensure that clients understand the relationship between risk and reward. Higher returns require higher risks. Take betting as an example. If you are betting on horses, a horse (Bluezy Suzy) that is 100:1 has a much lesser chance of winning than say a horse (Reddy Freddy) that is 2:1. Translated into money, the odds makers tell you, “We will pay you \$100 for every \$1 you bet if Bluezy Suzy wins. We will pay you \$2 for every \$1 you bet if Reddy Freddy wins.” Obviously, you are at a greater risk of losing your money if you bet Bluezy Suzy, but if she happens to win you stand to make 50 times more than if Reddy Freddy wins. (In horse racing, the only sure winners are the bookmakers.)

Fortunately, in the investment world “losing” does not mean you will lose all of your money as in the horse-racing world. But the concept of a higher payout being associated with higher risk is the same. For example, bonds will generally have a lower return than stocks. As a result, their rate of return will typically fluctuate less. Compare the S&P 500 with long-term government bonds. The average rate of return for the S&P 500 over the last 70 years has been around 10 percent, and the long-term government bonds have averaged around 5.5 percent. It would seem that the obvious choice would be to buy stocks. But stocks are more volatile by almost 2.5 times. That means they are more likely to generate losses, and losses will typically be bigger than any losses generated by long-term government bonds. Thus, the appropriate investment strategy will depend on the client’s risk tolerance, goals, time horizon, and so forth.

A good way to explain risk and reward to a prospect is by using the *Risk/Return Investment Pyramid* shown on the next page. Typical investment media are arranged in a pyramid with the most conservative, least risky, and (generally) lowest-yielding media at the broad base of the pyramid. The investment media become progressively riskier as they approach the apex where speculative investments are located. Toward the apex there is typically a corresponding and commensurate potential for higher return.

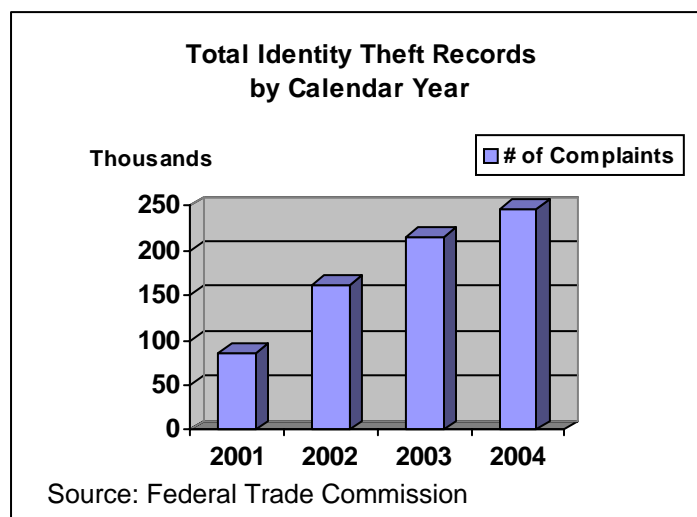
The arrows along the sides of the pyramid demonstrate the relationship between risk and return as one ascends or descends through this pyramid of investment possibilities. The pyramid illustrates that all investments bear an element of risk and that the rate of return is inextricably related to a corresponding degree of risk of loss. There is no way out of this risk/return trade-off; even investment in the most conservative media risks erosion of capital if the rate of return is less than the rate of inflation. In other words, all efforts to manage money involve a trade-off of risk against return. Clients must choose the investment media most closely suited to both their financial objectives and their range of psychological comfort as represented by their risk-tolerance levels.



Investment Principles, Strategies, and Techniques

Defending Against Identity Theft

There are many ways for clients to lose their nest egg. Lawsuits, an underinsured home, a lack of disability income insurance or life insurance, and so forth. But one growing threat to your clients' financial well-being is identity theft. Part of the value you can provide your clients is alerting them to the dangers of identity theft and providing some recommendations for reducing exposure to and mitigating damage caused by identity theft.



Reduce Exposure—Although there is no way to prevent identity theft, your clients can reduce their exposure by taking several precautions:

- Safeguard and avoid disclosing forms of identification such as Social Security number, date of birth, mother's maiden name, driver's license, and so forth.
- Consider using a post office box or using a locked mailbox or slot to receive mail at home.
- Limit the number of credit cards you have. Cancel any unused credit cards. Travel with the fewest number of credit cards as possible.
- Shred any documents with personal information on them, including credit card receipts and bills, utility bills, phone bills, and so forth. Also, shred pre-approved credit card applications.
- Avoid maintaining passwords and PINs in any form in which someone may gain access to them.
- Opt out of pre-approved credit card offers by calling 1-888-567-8688.

Monitor Financial Statements—Recommend to clients that they always review monthly bank, credit card, and brokerage statements for accuracy. Report any problems without delay. In addition, they should order copies of their credit report each year.

Thanks to an amendment to the federal Fair Credit Reporting Act (FCRA), each of the three nationwide consumer reporting companies (Equifax, Experian, and TransUnion) are required to provide consumers with a free copy of their credit report, at their request, once every 12 months. This program is being phased in by states and will be completed by September 1, 2005. Check www.ftc.gov for details as to the availability of this provision. A good strategy is to order a report from one of the reporting companies every four months.

Managing Debt

Unfortunately, many of your clients will have debt to manage. Poor use of credit, unavoidable health expenses, divorce, and so forth can cause a client to depend on credit. Your advice can help them minimize debt, get out of debt, and protect (or improve) their credit scores.

Minimize Debt—Educate clients on the impact of debt on achieving their financial goals. Debt generally means someone else is earning money with your money! In general, debt should be avoided, and when it cannot be avoided, it should be minimized. Your clients should consider the following:

- Avoid carrying a balance on credit cards.
- Create an emergency fund of 3 to 6 months of income held in a money-market account.
- Finance needed items only (a car to get to and from work is a need, a boat to enjoy on the weekends is a want).
- Shop around for big-ticket need items.
- Buy a car that is one or two years old rather than new.
- Plan and save for big-ticket items ahead of time (a new water heater, car, furnace, and so forth).
- Create and follow a spending plan.

The ideal would be for clients to be debt-free. For those clients who do not have an extra \$200,000 lying around to buy a house outright, a mortgage will be necessary. Mortgages are referred to as *good debt* because the homes they purchase hopefully appreciate in value. However, any debt that is burdensome is bad debt. Educate clients on the merits of keeping even good debt manageable. For example, before purchasing a home, dual-income couples should consider the impact that one of them losing his or her job could have on their ability to make mortgage payments. Many dual-income families buy houses based on both incomes. When one of the clients is out of work for an extended period of time, they could potentially struggle to make mortgage payments.

Get Out of Debt—Many of your clients will come to you already laden with consumer debt. Their debt can inhibit their ability to reach their financial goals. Here are a few common sense ways to get out of debt. Recommend that the client

- avoid new debt. If credit cards are the problem, recommend that the client stop using credit cards until the debts are paid.
- call credit card companies and see if they will give the client a lower interest rate.
- consolidate credit card debt to the card with the lowest interest rate. If balances cannot be transferred, pay off the card with the highest interest rate first.
- look into a home equity loan to pay off and consolidate high-interest, consumer debt (a home equity loan is tax deductible)
- create and follow a spending plan.

Protecting or Improving Credit Scores—Unfortunately, debt may be unavoidable, as in the case of financing a home purchase with a mortgage. In times when credit is needed, it is very important that your client have good credit, which means that he or she has a good credit rating. The three major credit rating services are Experian, TransUnion, and Equifax. All three of them rate credit differently. Fortunately, they use variations of the same basic score known as a FICO® score. Scores range from 300 to 850. There is no standard “good score.” What is a good score will vary from lender to lender. A good fact to keep in mind is that approximately 40 percent of all FICO® scores are over 740.¹ What follows is a brief overview of what determines a FICO® score and how to protect or improve a FICO® score.

The FICO score has five major areas. The two that weigh most heavily on a score are past payment history and amounts owed. Together they make up over 60 percent of the credit score. The third factor, length of credit history, takes into account how long you have been using credit and even the length of time since you last used a particular account. The fourth factor looks at the amount of new credit you have applied for and/or received. The last factor, types of credit, looks at whether the credit is credit cards, retail accounts, and installment loans.

The best way for a client to protect or improve his or her score is for the prospect to pay his or her bills on time and limit the amount of credit used. Clients should avoid taking credit cards and lines of credit to or above their maximum limits. But limit does not mean do not use it at all. It is important to establish a long history of paying bills consistently and timely. A good strategy with credit cards is to use them and pay the balance off each month. In addition, opening several new accounts in a short period of time can negatively affect one’s credit score. Related to that,

¹ Understanding Your Credit Score, Fair Isaac Corporation, p. 6., 2003.

having too many accounts will reduce one's score as well. Pay down accounts one at a time, paying a minimum on the other accounts. But be careful in canceling accounts that have been paid off. Older and zero-balance accounts help one's score. Finally, having balances on several different accounts will also negatively impact one's score. For a score simulator and more information, go to www.myfico.com.

Using Financial Statements

There are two things that are really helpful for you to know. First, it is good to know what the client's assets and debts are. Second, it is good to know how the client manages his or her money.

A financial position statement tells you the client's assets and liabilities. From an insurance perspective, assets create a need for insurance. Without insurance, the only way to recover from an auto, homeowners, health, life, liability, or disability loss is to liquidate assets. From an investing perspective, the type of assets a client owns will help you understand their risk tolerance and ensure they are properly allocating their assets. It will also help you gauge where they are in meeting important goals such as funding a retirement or child's education. In addition, you will be able to see what kind of debt they are carrying. In general, debt is a barrier for savings and investing.

Second, it is important to know how a client manages his or her money. Thus, you will want to help the client create a cash-flow statement, describing the client's income and expenses. Knowing this will give you a feel for what the client can afford. It will also give you an opportunity to help clients weigh their current financial priorities. Is saving for a vacation to Europe more important than paying off some debt? Is it more important than saving for retirement? Once you know where the money is spent, you may be able to help the client create a spending plan in order to achieve their financial goals.

FINANCIAL POSITION STATEMENT

Assets		Projections for Subsequent Years			
Cash and Near-Cash Equivalents	Current Value	Assumptions	20____	20____	20____
Checking accounts/cash					
Savings accounts					
Money-market funds					
Treasury bills					
Commercial paper					
Short-term CDs					
Life insurance/annuity cash values					
Life insurance, accumulated dividends					
Savings bonds					
Other (specify)					
Subtotal					
Other Financial Assets					
U.S. government bonds					
Municipal bonds					
Corporate bonds					
Preferred stock					
Common stock					
Nonmarketable securities					
Warrants and options					
Mutual funds					
Investment real estate (residential/commercial)					
Long-term CDs					
Vested retirement benefits					
Annuities (fixed/indexed/variable)					
HR-10 plan (Keogh)					
IRAs (Roth/traditional)					
Mortgages owned					
Land contracts					
Limited partnership units					
Interest(s) in trust(s)					
Receivables					
Patents, copyrights, royalties					
Value of business interest (from page 15)					
Other (specify)					
Subtotal					

FINANCIAL POSITION STATEMENT (continued)

Assets (continued)	Current Value	Projections for Subsequent Years			
Personal Assets		Assumptions	20____	20____	20____
Personal residence					
Seasonal residence					
Automobile(s)					
Recreation vehicles					
Household furnishings					
Boats					
Jewelry/furs					
Collections (art, coins, etc.)					
Hobby equipment					
Other (specify)					
Subtotal					
Total assets					

Liabilities					
Charge accts./credit cards					
Family/personal loans					
Margin/bank/life ins. loans					
Income taxes (fed., state, local)					
Property taxes					
Investment liabilities					
Mortgage(s)					
Lease(s)					
Child support					
Alimony					
Other (specify)					
Other (specify)					
Other (specify)					
Total Liabilities					

Net Worth					
Total assets minus total liabilities					

CASH FLOW STATEMENT

Annual Income

	Current Yr.	Projections for Subsequent Years				
	20____	Assumptions	20____	20____	20____	20____
Wages, salary, bonus, etc.: Client						
Wages, salary, bonus, etc.: Spouse						
Income as business owner (self-employment)						
Real estate rental						
Dividends—investments						
Dividends—close corporation stock						
Interest on bonds: taxable						
Interest on bonds: tax exempt						
Interest on savings accts., CDs						
Interest on loans, notes, etc.						
Trust income						
Life insurance settlement options						
Annuities						
Child support/alimony						
Other sources (specify)						
Total annual income						

Fixed Expenses

Housing (mortgage/rent)						
Utilities and telephone						
Food, groceries, etc.						
Clothing and cleaning						
Income and Social Security taxes						
Property taxes						
Transportation (auto/commuting)						
Medical/dental/drugs/health insurance						
Debt repayment						
House upkeep/repairs/maintenance						
Life, property, and liability insurance						
Child support/alimony						
Current education expenses						
Total fixed expenses						

Discretionary Expenses

Vacations/travel/etc.						
Recreation/entertainment						
Contributions/gifts						
Household furnishings						
Education fund						
Savings/investments						
Other (specify)						
Total discretionary expenses						
Total annual expenses						
Net cash flow (total annual income minus total annual expenses)						



Breakout—Class 4

- 4-1 Explain the concept of investment risk (risk versus reward) as you would to a client. Bring any visual aids you would use to class. You may be asked to participate in a role-playing exercise based on this question.

- 4-2 Explain the concept of purchasing power (inflation) risk as you would to a client. Bring any visual aids you would use to class. You may be asked to participate in a role-playing exercise based on this question.

4-3 Les Moore is 33 years of age, single, and earns \$48,000 per year. Les owns a home, in which he has \$25,000 in equity. He has credit-card debt of \$5,000, with a minimum payment of \$100, and a car loan of \$10,000. His employer offers a dollar-for-dollar match up to 5 percent of income for any contributions to the 401(k) plan it offers. Les does not currently participate in the 401(k) plan. Les's savings consists of \$1,300 in his checking and savings account. You find out that Les spends a lot on dining and vacations.

Les wants to start savings and investing for his retirement. You note that there are some obstacles in the way. What are the obstacles? Based on the information given, what recommendations might make sense for Les?

Quiz—Class 4

(Due Class 4)

Instructions: Study the reading assignment from Class 4, then circle the correct answer for each of the following questions. Each question is worth 10 points (100 points total).

1. Harry owns some municipal bonds that provide him with a tax-exempt yield of 4 percent. If Harry is in the 20 percent marginal income tax bracket, what is his equivalent fully taxable yield from the bonds?
 - (A) 3.20 percent
 - (B) 4.80 percent
 - (C) 5.00 percent
 - (D) 20.00 percent
2. Jasmine owns stock that currently sells at \$100 per share and pays an annual dividend of \$4 per share. If Jasmine is in the 20 percent marginal income tax bracket, what is her after-tax current yield from the stock?
 - (A) 0.80 percent
 - (B) 3.20 percent
 - (C) 4.00 percent
 - (D) 4.20 percent
3. Which of the following is a privilege that provides preferred stockholders a preferential position relative to common stockholders?
 - (A) Preferred stockholders have the right to receive dividends before dividends are paid out to the common stockholders.
 - (B) Preferred stockholders have the right to maintain their relative voting power by purchasing shares of any new issues of common stock.
 - (C) Preferred stockholders generally have the right to elect the board of directors.
 - (D) Preferred stockholders vote on issues such as mergers and stock splits.
4. The net asset value of a mutual fund is equal to
 - (A) $\text{number of shares outstanding}/(\text{total assets} + \text{total liabilities})$
 - (B) $\text{number of shares outstanding}/(\text{total assets} - \text{total liabilities})$
 - (C) $(\text{total assets} + \text{total liabilities})/\text{number of shares outstanding}$
 - (D) $(\text{total assets} - \text{total liabilities})/\text{number of shares outstanding}$

5. Which of the following statements regarding an investment's expected return and risk is (are) correct?
- I. An asset with a wide range of possible returns is considered a risky investment.
 - II. Investing is based on a reasoned consideration of expected return and the risk associated with that return.
- (A) I only
(B) II only
(C) Both I and II
(D) Neither I nor II
6. Which of the following characteristics accurately describe(s) the investment nature of corporate debt instruments?
- I. They have short maturities.
 - II. They have good liquidity.
- (A) I only
(B) II only
(C) Both I and II
(D) Neither I nor II
7. Investment risk is caused by which of the following?
- I. purchasing power risk
 - II. nominal return risk
- (A) I only
(B) II only
(C) Both I and II
(D) Neither I nor II
8. All of the following statements regarding asset allocation models are correct EXCEPT
- (A) They are portfolio recommendations of asset categories.
 - (B) They emphasize the category and percentage to be placed in each category.
 - (C) They provide specific assets in which clients should invest.
 - (D) They are most effective when they reflect a client's risk-tolerance level.

9. All of the following are ways to reduce exposure to identity theft EXCEPT

- (A) use a post office box or locked mailbox to receive mail
- (B) carry all of your credit cards with you at all times
- (C) opt out of pre-approved credit card offers
- (D) shred any documents with personal information

10. All of the following are ways to minimize debt EXCEPT

- (A) avoid carrying a balance on credit cards
- (B) create an emergency fund of 3 to 6 months of income
- (C) create and follow a financial position statement
- (D) shop around for big-ticket items

Sales Planning Project 4

Financing Your Goals

(Assigned Class 4—Due Class 6)

Purpose

After financial goals have been identified, an advisor needs to evaluate investment planning strategies and progress. This project explores some of the basics of investment planning.

Assignment

In this sales planning project, you are to analyze your investment planning strategies and progress regarding the financial goals identified in Sales Planning Project 1.

Procedure

1. If you have determined your risk tolerance, indicate what it is and how you determined it. If you have not, locate a risk-tolerance tool and complete it. Vanguard has an “Investor Questionnaire” on its website (www.vanguard.com) that can be used free of charge. Click on the “Personal Investors” area and run a search for “investor questionnaire.”
2. Select your top three goals (other than retirement income) from Sales Planning Project 1. Do the following:
 - Indicate the time horizon: when will money be needed?
 - Indicate the amount you have determined will be needed. (Only the moderator should read your answers. However, if you are concerned about your privacy, then express the amount as a percentage of your annual income. For example, if you make \$50,000 per year and your goal is to have \$30,000 for your child’s education, you would indicate “60%” in the “Amount” column.)
 - Describe briefly how you determined the amount needed. What assumptions did you make? What factors were involved?
3. For each goal, describe the desired asset allocation you have determined. Describe the portfolio, not specific stocks and bonds. For example, “50% large cap, 10% small cap, 5% foreign, 25% corporate bonds, and 10% government bonds.” Then, describe the progress toward your goal. How much of the goal has been achieved? Where should you be?
4. Answer the question regarding your emergency fund.
5. Answer the summary questions.

Sales Planning Project 4

Financing Your Goals

Report Form (1 of 4)

1. What is your risk tolerance? How did you determine it?

2. For each of your financial goals, identify the time horizon, the amount of the goal (expressed as a percentage of your annual income), and how you determined the amount you needed.

Goal	Time Horizon	Amount	How You Determined the Amount Needed
1			
2			
3			

3. For each of your financial goals, give your desired asset allocation and your current asset allocation (an estimate). Then, evaluate your progress toward meeting your goal.

Goal	Asset Allocation	Progress
1	Desired: Current:	

Sales Planning Project 4

Financing Your Goals

Report Form (2 of 4)

Goal	Asset Allocation	Progress
2	Desired: Current:	
3	Desired: Current:	

4. Do you have an emergency fund? If so, how much (either the dollar amount or the percentage of your income that it represents) and how is it invested? If not, why not?

Summary Questions

1. When is the last time you reviewed the asset allocation and progress for each of your goals?

2. Try to evaluate your situation through the eyes of a third party. What recommendations would you make to someone in your situation?

Name _____

Sales Planning Project 4

Financing Your Goals

Report Form (3 of 4)

3. How did you select your investments? What were the factors that influenced your selections?

4. How do you determine asset allocation? What factors do you examine?

5. How do you evaluate your investments' performance?

Name _____ Date _____

Sales Planning Project 4

Financing Your Goals

Report Form (4 of 4)

6. Describe two insights you gained about investment planning from this exercise.

Supplemental Reading 5

Inflation-Adjusted Items

This chapter makes reference to several inflation-adjusted items. The updated numbers are as follows.

Inflation-Adjusted Item	2005 Amount	Page Ref.
Tax Rate Schedules for Individuals	(See table below)	5-23

	If Taxable Income Is:	The Tax Is:
Single Taxpayer	Not over \$7,300 Over \$7,300 but not over \$29,700 Over \$29,700 but not over \$71,950 Over \$71,950 but not over \$150,150 Over \$150,150 but not over \$326,450 Over \$326,450	10% of taxable income \$730 plus 15% of the amount over \$7,300 \$4,090 plus 25% of the amount over \$29,700 \$14,652.50 plus 28% of the amount over \$71,950 \$36,458.50 plus 33% of the amount over \$150,150 \$94,727.50 plus 35% of the amount over \$326,450
Unmarried Head of Household	Not over \$10,450 Over \$10,450 but not over \$39,800 Over \$39,800 but not over \$102,800 Over \$102,800 but not over \$166,450 Over \$166,450 but not over \$326,450 Over \$326,450	10% of taxable income \$1,045 plus 15% of the amount over \$10,450 \$5,447.50 plus 25% of the amount over \$39,800 \$21,197.50 plus 28% of the amount over \$102,800 \$39,019.50 plus 33% of the amount over \$166,450 \$91,819.50 plus 35% of the amount over \$326,450
Married Taxpayer Filing Jointly	Not over \$14,600 Over \$14,600 but not over \$59,400 Over \$59,400 but not over \$119,950 Over \$119,950 but not over \$182,800 Over \$182,800 but not over \$326,450 Over \$326,450	10% of taxable income \$1,460 plus 15% of the amount over \$14,600 \$8,180 plus 25% of the amount over \$59,400 \$23,317.50 plus 28% of the amount over \$119,950 \$40,915.50 plus 33% of the amount over \$182,800 \$88,320 plus 35% of the amount over \$326,450
Married Taxpayer Filing Separately	Not over \$7,300 Over \$7,300 but not over \$29,700 Over \$29,700 but not over \$59,975 Over \$59,975 but not over \$91,400 Over \$91,400 but not over \$163,225 Over \$163,225	10% of taxable income \$730 plus 15% of the amount over \$7,300 \$4,090 plus 25% of the amount over \$29,700 \$11,658.75 plus 28% of the amount over \$59,975 \$20,457.75 plus 33% of the amount over \$91,400 \$44,160 plus 35% of the amount over \$163,225

Planning Considerations

Maximizing Deductions and Credits

As you work with clients, note any tax credits for which they may be eligible. You need not explain them in detail (leave that to their tax professional unless you are their tax professional) but make your clients aware of them. Here are examples of planning situations in which tax deductions and tax credits may apply.

Parents of Young Children—Parents of young children should be aware of the tax advantages associated with young children.

- *Child and Dependent Care Expense Tax Credit*—Expenses for child care for children under 13 years of age may be eligible for the child and dependent care expense tax credit. There is a dollar limit on the amount of eligible work-related expenses a taxpayer can use to figure the credit. This limit is \$3,000 for one qualifying child or \$6,000 for two or more qualifying children. The actual credit amount is a percentage of eligible work-related expenses. The maximum percentage of 35 percent applies to those making \$15,000 or less. The minimum percentage of 20 percent applies to income earners making more than \$43,000.
- *Child Tax Credit*—This is a \$1,000 tax credit (scheduled to revert back to \$500 in 2011) for dependent children under age 17 at the end of the calendar year.

Note that the child and dependent care expense tax credit information also would apply to clients who care for a disabled dependent, defined by the IRS as a spouse who is mentally or physically unable to care for himself or herself or a dependent of any age who is physically or mentally incapable of self-care if the person can be claimed as an exemption on your tax return (or could have been claimed, except for the fact that the person had \$3,100 or more of gross income).

College Student in Household—Qualified higher education expenses associated with the enrollment of the client, the client’s spouse, or the client’s dependents in an eligible educational institution may qualify for a tax deduction or a tax credit. Both apply only to qualified tuition and fees required for the student’s enrollment or attendance at an eligible educational institution; they exclude room and board, books, supplies, equipment, and so forth. Nor are these available to married taxpayers who file separate returns. In addition, the tax deduction and tax credit cannot be claimed for the same student in the same year.

- *Education Credits*—The client can take either a Hope Credit (for the first 2 tax years on any student) or the lifetime learning credit. Note that the Hope Credit limit applies per student whereas the lifetime learning credit applies to the family’s total expenses. For example, if Anna and Barbara are twins with expenses of \$10,000 in college tuition and fees, their parents could take a Hope Credit of \$1,500 (the sum of 100 percent of the first \$1,000 of qualified education expenses paid for the eligible student and 50 percent of the next \$1,000 of qualified education expenses paid for that student) per child for each of the first 2 years of school. However, in the years that follow, their parents can only take a lifetime learning credit up to \$2,000 (20 percent of the first \$10,000 of a family’s total qualified education expenses), even though the girls have eligible expenses of \$20,000. See the chart below for availability.

	Single*	Married Filing Jointly
No tax deduction	AGI is more than \$52,000	AGI is more than \$105,000
Prorated amount	AGI is more than \$42,000	AGI is more than \$85,000
Full amount	\$AGI is \$42,000 or less	AGI is \$85,000 or less
*Also for head of household and qualifying widow(er)		

As the chart shows, there is a phaseout for both tax credits. To calculate the pro rata that applies to the tax credit, use the following steps:

1. Subtract the client's AGI from the dollar figure of the phaseout.
2. Divide the amount from step 1 by \$10,000 for single filers (\$20,000, if married filing jointly).

This is the amount to multiply the tentative education tax credits.

EXAMPLE: Meg and Tom are married, file jointly, and have an AGI of \$90,000, which puts them into the 25 percent tax bracket. Their daughter, Cybil, is in her sophomore year at Podunk University. The percentage of any education tax credit that Meg and Tom could take on their current income tax return would be:

$$\frac{\$105,000 - \text{AGI}}{\$20,000} = \frac{\$105,000 - \$90,000}{\$20,000} = \frac{\$15,000}{\$20,000} = .75$$

If the tentative total credit amount were \$1,500, Meg and Tom could take a tax credit of \$1,125 (\$1,500 x .75). The amount of the tuition and fees deduction available to a client will depend on the client's adjusted gross income.

- *Tuition and Fees Deduction*—See the chart below. A maximum of \$4,000 can be deducted regardless of the number of students involved. The deduction is available through 2005 (unless extended by further legislation).

	Single*	Married Filing Jointly
No tax deduction	AGI is more than \$80,000	AGI is more than \$160,000
Maximum of \$2,000	AGI is more than \$65,000 but not more than \$80,000	AGI is more than \$130,000 but not more than \$160,000
Maximum of \$4,000	AGI is \$65,000 or less	AGI is \$130,000 or less
* Also for head of household, and qualifying widow(er)		

At times, decisions will need to be made concerning which to take, a tax credit or a tax deduction. You can figure this out by taking the amount of expenses and comparing the amount deductible with the amount of a possible tax credit.

EXAMPLE: In Meg and Tom's situation, they could claim up to \$4,000 in a tax deduction (based on their AGI and filing status). This translates into a \$1,000 (\$4,000 x 25% = \$1,000) reduction in their tax bill. Thus, the \$1,125 tax credit would be a better choice. However, if Meg and Tom had an AGI of \$95,000, then they would be able to take only a \$750 tax credit. In that case, the tax deduction would be the way to go.

Adoptions—Couples adopting children should be aware of the adoption tax credit. Expenses attributed to the adoption of a child may be eligible for a tax credit of up to \$10,390 per child (in 2005). (For a taxpayer in the 25 percent tax bracket, that would be the equivalent of taxes on

\$41,560.) The adoption tax credit needs to be coordinated with any employer-provided adoption benefits.

Have High-Deductible Health Insurance Coverage—For clients covered by a high-deductible health insurance plan, consider a health savings account (HSA). This plan enables the client to pay deductibles, copayments, coinsurance, and other unreimbursed medical expenses using tax-deductible dollars. The HSA contributions are an above-the-line tax deduction which lowers a client's adjusted gross income (AGI).

Student Loan Balance—For clients with a student loan, there is an above-the-line tax deduction for student loan interest. In addition to this tax impact, student loan interest rates tend to be very low. Thus, when paying off debt, student loans should typically be one of the last types of debt to be repaid ahead of schedule.

Divorce and Income Taxation

Divorce rates are still hovering around 50 percent. Thus, an advisor should be aware of some of the income taxation implications of a divorce.

Claiming a Dependency Exemption—The general rule for claiming a dependency exemption for a child of divorced or separated parents is that the custodial parent (the parent who has custody of the child for the greater portion of the calendar year) is entitled to the dependency exemption. However, if the custodial parent signs a written declaration that he or she will not claim the child as a dependent for tax purposes, the noncustodial parent may claim the exemption if the written declaration is attached to his or her tax return.

Alimony and Child Support—The term alimony refers to payments that have all of the following characteristics

- made in cash or cash equivalents (not property or services)
- received by or on behalf of a spouse under a divorce or separation agreement
- not required under the divorce or separation agreement to be made for any period or in any other form after the death of the payee spouse, and are not in fact so paid
- not designated under the divorce or separation agreement as payments for the support of minor children, in other words, child support

EXAMPLE: Brad and Jennifer are divorcing. As part of the divorce agreement, Brad is required to purchase and pay for a life insurance policy on himself to secure future alimony payments. The premium for the policy will be treated as alimony.

The tax treatment of alimony and child support payments is as follows:

- Alimony payments are tax deductible to the payer and taxable to the recipient.
- Child support payments are not tax deductible to the payer and are not taxable to the recipient.

EXAMPLE: Richard and Liz are getting divorced. They have two children ages 12 and 10. Liz is required to pay Richard \$7,000 in alimony and \$10,000 in child support each year. Liz is in the 27 percent tax bracket and Richard is in the 25 percent tax bracket.

Here is what the alimony would mean from an income tax perspective. Liz would take a \$7,000 deduction, which would mean a decrease in taxes of \$1,890 ($\$7,000 \times 27\% = \$1,890$). Richard would have to declare the \$7,000 in income, which would mean an additional \$1,750 ($\$7,000 \times 25\% = \$1,750$) in taxes. Effectively, this means that Liz is paying \$5,110 in alimony and Richard is receiving \$5,250.

On the other hand, the \$10,000 in child support is not deductible for Liz and is not taxable for Richard.

Finally, when there are large variances in the annual amounts of alimony paid in the first 3 years, a special rule applies to include the excess payment in the gross income of the payer in the third postseparation year. The payee spouse would receive a corresponding tax deduction.

Transfer of Property—In general, the transfer of any property between spouses or between former spouses incident to a post-July 18, 1984, divorce is a nontaxable event under IRC Sec. 1041.

Quiz—Class 5

(Due Class 5)

Instructions: Study the reading assignment from Class 5, then circle the correct answer for each of the following questions. Each question is worth 10 points (100 points total).

1. Helen has unreimbursed medical expenses totaling \$7,000. If Helen's adjusted gross income (AGI) is \$40,000 and she itemizes deductions, how much of the medical expenses will she be allowed to deduct for income tax purposes?
 - (A) \$3,000
 - (B) \$4,000
 - (C) \$6,475
 - (D) \$7,000

2. Marco owns a rental property but the income goes to his grandson. Most likely, Marco will be taxed on the income based on the
 - (A) fruit-and-the-tree doctrine
 - (B) assignment-of-income doctrine
 - (C) constructive-receipt doctrine
 - (D) economic-benefit doctrine

3. Which of the following statements regarding the income tax implications of a divorce is correct?
 - (A) Alimony payments are not taxable to the recipient.
 - (B) Alimony payments are not tax deductible to the payer.
 - (C) Child support payments are taxable to the recipient.
 - (D) Child support payments are not tax deductible to the payer.

4. Taxpayers must generally include which of the following in their gross incomes?
 - I. gifts and inheritances
 - II. workers' compensation benefits
 - (A) I only
 - (B) II only
 - (C) Both I and II
 - (D) Neither I nor II

5. Which of the following statements regarding “tax-preference items” is (are) correct?
- I. They provide a taxpayer with greater tax benefits than regular deductions.
 - II. They are items deductible for regular tax but face different rules under the alternative minimum tax (AMT).
- (A) I only
 - (B) II only
 - (C) Both I and II
 - (D) Neither I nor II
6. Which of the following business would be classified as a taxable entity?
- I. C corporation
 - II. S corporation
- (A) I only
 - (B) II only
 - (C) Both I and II
 - (D) Neither I nor II
7. All of the following statements regarding itemized deductions are correct EXCEPT
- (A) All itemized deductions are below-the-line deductions.
 - (B) A taxpayer can either itemize deductions or claim the standard deduction.
 - (C) Itemized deductions are claimed on Schedule B.
 - (D) The standard deduction amounts are indexed annually for inflation.
8. All of the following statements regarding tax credits are correct EXCEPT
- (A) Tax credits are more beneficial to the taxpayer than deductions of an equal amount.
 - (B) A tax credit is a dollar-for-dollar reduction of the actual tax payable.
 - (C) The main tax credits are credits for children.
 - (D) Tax credits are itemized on Schedule A.
9. All of the following are categories of a taxpayer’s filing status EXCEPT
- (A) married taxpayer filing jointly
 - (B) married head of household
 - (C) married taxpayer filing separately
 - (D) single taxpayer
10. All of the following are pass-through entities for federal income tax purposes EXCEPT
- (A) C corporations
 - (B) limited liability companies (LLCs)
 - (C) S corporations
 - (D) partnerships

Action Project 2

Life-Cycle or Market Survey

(Assigned Class 5—Due Class 7)

Purpose

This sales planning project will help you learn more about the financial planning needs of a life-cycle segment or a market segment of your choosing.

Assignment

You will interview three members of a life-cycle or market segment about their financial planning needs and products.

Procedure

To complete this assignment, do the following:

1. Select either a life-cycle segment (see page 1-23) or a market segment of your choosing.
2. Identify 10 clients and/or prospects from the segment (you will only conduct three interviews; however, you may find some people unable or unwilling to help you out).
3. Review the questions on the report form that follow these instructions.
4. Call and interview three clients and/or prospects. See the following suggested approach and explanation of the interview questions.

Hello, [Client], this is _____. How are you? I am currently taking a class on financial planning. One of my assignments is to survey some of my current clients about their experience with and feelings toward financial planning. Would you be able to give me 10 minutes of your time to answer a few questions?

- *What three financial goals are most important to you? (Give examples, if necessary: saving for retirement, funding higher education, paying off your mortgage, saving for a down payment on a house, paying less in taxes, and so forth.)*
 - *How do you feel about your plan for each goal? How do you feel about your progress toward each goal?*
 - *How do you make financial decisions? How do you gather information? With whom do you consult?*
 - *What type of insurance products do you own? (Give examples, if necessary: medical expense insurance, life insurance, disability insurance, auto insurance, homeowners insurance, and so on.)*
 - *What type of investment products do you own? (Give examples, if necessary: individual stocks and bonds, mutual funds, CD's, bank savings accounts, real estate, and so on.)*
 - *Do you have a comprehensive financial plan? Why or why not?*
 - *Are you interested in the services of a financial planner? Why or why not?*
5. Record their responses on the report form pages.
 6. Complete the summary questions found on the report form pages.

Name _____ Date _____

Action Project 2

Life-Cycle or Market Survey

Report Form (1 of 4)

Survey #1

1. What three financial goals are most important to you? How do you feel about your plan for each goal? How do you feel about your progress toward each goal?

Financial Goal	Feelings Toward Plan and Progress

2. How do you make financial decisions? How do you gather information? With whom do you consult?

3. What type of insurance products do you own?

4. What type of investment products do you own?

5. Do you have a comprehensive financial plan? Why or why not?

6. Are you interested in the services of a financial planner? Why or why not?

Action Project 2

Life-Cycle or Market Survey

Report Form (2 of 4)

Survey #2

1. What three financial goals are most important to you? How do you feel about your plan for each goal? How do you feel about your progress toward each goal?

Financial Goal	Feelings Toward Plan and Progress

2. How do you make financial decisions? How do you gather information? With whom do you consult?

3. What type of insurance products do you own?

4. What type of investment products do you own?

5. Do you have a comprehensive financial plan? Why or why not?

6. Are you interested in the services of a financial planner? Why or why not?

Name _____

Action Project 2

Life-Cycle or Market Survey

Report Form (3 of 4)

Survey #3

1. What three financial goals are most important to you? How do you feel about your plan for each goal? How do you feel about your progress toward each goal?

Financial Goal	Feelings Toward Plan and Progress

2. How do you make financial decisions? How do you gather information? With whom do you consult?

3. What type of insurance products do you own?

4. What type of investment products do you own?

5. Do you have a comprehensive financial plan? Why or why not?

6. Are you interested in the services of a financial planner? Why or why not?

Action Project 2

Life-Cycle or Market Survey

Report Form (4 of 4)

Summary Questions

1. What were the common financial goals in the life cycle or market segment you surveyed? In general, how did most people feel about their plans and progress toward each goal?

2. What was the prevailing approach to financial planning and financial decision making in general? Did you find people seek advisors, do it themselves, or a combination of the two?

3. What reasons did people give for not having a financial plan? What does this indicate about the openness of this market toward financial planning?

4. Were people generally interested or not interested in the services of a financial planner? Why or why not?

5. Describe two practical applications of what you learned from conducting the surveys.

Supplemental Reading 6

Inflation-Adjusted Items

This chapter makes reference to some inflation-adjusted items. The updated numbers are as follows.

Inflation-Adjusted Item	2005 Amount	Page Ref
Additional standard deduction (married, over age 65).....	\$1,000 each.....	6-7
Additional standard deduction (single, over age 65).....	\$1,250.....	6-7
Standard deduction (married).....	\$10,000.....	6-7
Standard deduction (single).....	\$5,000.....	6-7
Maximum benefit (defined-benefit plan).....	\$170,000.....	6-31
Maximum contribution (defined-contribution plan).....	\$42,000.....	6-32
Maximum compensation limit (qualified plans).....	\$210,000.....	6-35
Modified AGI limits for fully deductible IRA contribution (married filing jointly).....	\$70,000 or less.....	6-48
Modified AGI limits for fully deductible IRA contribution (single or head of household).....	\$50,000.....	6-48
Social Security earnings test exempt amount (under full retirement age).....	\$12,000.....	6-55
Social Security earnings test exempt amount (year individual reaches full retirement age).....	\$31,800.....	6-55
Modified AGI limits for deductible IRA contributions.....	see chart below.....	6-45

Filing Status	Full IRA Deduction	Reduced IRA Deduction	No IRA Deduction
Individual or head of household	\$50,000 or less	\$50,000.01–\$59,999.99	\$60,000 or more
Married filing jointly	\$70,000 or less	\$70,000.01–\$79,999.99	\$80,000 or more
Married filing separately	Not available	\$0.01–\$9,999.99	\$10,000 or more

* Explaining how AGI is modified is beyond the scope of this introductory chapter.

Planning Considerations

Discussing Inflation

Purchasing power risk was a topic in the discussion on investments. The textbook provides an example of its impact on retirement income, illustrating the formidable foe inflation can be to accumulating a sufficient retirement nest egg. Depending on the client's awareness of inflation, it may be helpful to provide some context for such a discussion and a basis for using the consumer price index (CPI) to make an assumption for the inflation rate you will use in calculations. One approach is to give examples of changes in the prices of some commonly consumed products.

Examples of Inflation				
	1985	1995	2005	Avg. Annual Inflation Rate
Consumer Price Index (CPI)	105.5	150.3	190.7	2.99%
White Bread	0.55	0.77	1.00	3.03%
1 lb. 100% ground beef	1.28	1.38	2.19	2.72%
1 lb. T-Bone Steak	3.96	5.80	7.55	3.28%
1 lb. Cheddar Cheese	3.10	3.41	4.21	1.54%
1 lb. Red Delicious Apples	0.65	0.77	0.97	2.02%
Source: U.S. Bureau of Labor Statistics				

Roth IRA versus a Deductible IRA

Some clients will have to make a decision between contributing to a Roth IRA (which allows for tax-free qualified distributions) or to a deductible IRA. In general, the Roth IRA is a better vehicle if the client anticipates his or her income tax bracket will be the same or higher during retirement. If the client anticipates that his or her income tax bracket will be substantially lower when he or she retires, then the deductible IRA would most likely be the way to go. See the comparison on the next page.

In addition, there are other planning considerations to consider. For example, if the client would like to have access to the funds before age 59 ½, the Roth IRA will allow him or her to withdraw contributions anytime without penalty or tax, assuming that the Roth IRA has been in existence for at least 5 years. Furthermore, if the client desires to avoid required minimum distribution at age 70 ½, the Roth IRA will allow him or her to do that as well.

Finally, the comparison is very similar between a Roth IRA and a 401(k) or other tax-advantaged retirement plans. Many advisors suggest that contributions be made to a 401(k) up to the maximum that a company may match them. Then, the client should maximize contributions to a Roth IRA. Any amount of retirement savings above the contribution limits of the Roth IRA could be made to the 401(k) plan. Note, however, that a 401(k) plan or other similar employer-sponsored plan offers the advantage of payroll deduction and possibly lower expenses. Payroll deduction is a feature that is especially critical for undisciplined savers. Also, compare the expenses between the employer-sponsored plan and the Roth IRA.

Comparison Between a Roth IRA and a Deductible IRA

Assume the following:

- Both the Roth IRA and deductible IRA grow at a rate of return of 8 percent per year until age 70 and 5 percent per year after age 70.
- The client invests the tax savings of the tax-deductible contributions of the deductible IRA into a taxable side fund earning the same 8 percent and 5 percent as both IRAs.
- The accumulation tax rate is the tax rate applicable when the client is making contributions.
- The distribution tax rate is the tax rate applicable when the client is making distributions.
- The client withdraws \$31,750 per year (an amount that will liquidate the funds around age 100) beginning at age 80.
- The client pays the taxes on the withdrawal from the deductible IRA from the taxable side fund. Once the taxable side fund is exhausted, the client pays the taxes out of pocket. A negative balance in the side fund indicates the total out-of-pocket cost to the client in taxes.

Scenario 1: Tax Rate Stays the Same			
Accumulation Tax Rate: 25%			
Distribution Tax Rate: 25%			
Age	Roth	Deductible	Side Fund
40	\$4,000	\$4,000	\$1,000
50	\$66,582	\$66,582	\$14,972
60	\$201,692	\$201,692	\$39,993
70	\$489,383	\$489,383	\$83,802
80	\$397,806	\$397,806	\$36,667
85	\$332,274	\$332,274	\$2,938
100	\$5,654	\$5,654	(\$115,978)

Scenario 2: Tax Rate Increases			
Accumulation Tax Rate: 25%			
Distribution Tax Rate: 27%			
Age	Roth	Deductible	Side Fund
40	\$4,000	\$4,000	\$1,000
50	\$66,582	\$66,582	\$14,972
60	\$201,692	\$201,692	\$39,993
70	\$489,383	\$489,383	\$83,802
80	\$397,806	\$397,806	\$28,680
83	\$332,274	\$332,274	\$6,176
100	\$5,654	\$5,654	(\$139,248)

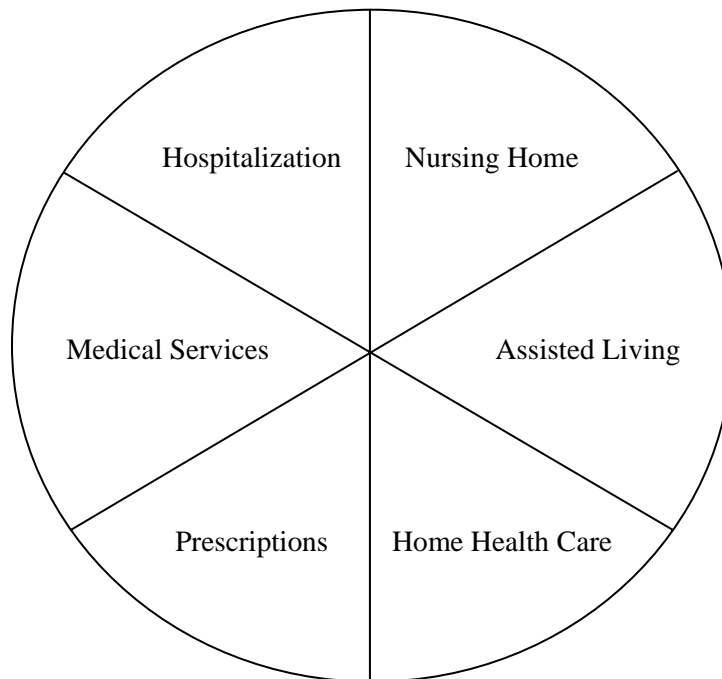
Scenario 3: Tax Rate Decreases			
Accumulation Tax Rate: 25%			
Distribution Tax Rate: 15%			
Age	Roth	Deductible	Side Fund
40	\$4,000	\$4,000	\$1,000
50	\$66,582	\$66,582	\$14,972
60	\$201,692	\$201,692	\$39,993
70	\$489,383	\$489,383	\$83,802
80	\$397,806	\$397,806	\$76,602
90	\$248,636	\$248,636	\$64,874
100	\$5,654	\$5,654	\$45,771

When the tax rate stays the same (Scenario 1), the Roth IRA begins to outperform the deductible IRA around age 85. When the tax rate increases (Scenario 2), the Roth IRA begins to outperform the deductible IRA around age 83. Only when the tax rate decreases (Scenario 3) does the deductible IRA outperform the Roth IRA. It is important to note that if the tax rate decrease is nominal, say 5 percent, the Roth IRA will outperform the deductible IRA in the long run. Also, as the accumulation tax rate increases, the distribution tax rate must decrease more in order for the deductible IRA to be a better strategy.

Postretirement Medical Expense Coverage

A client's retirement plan should also include an analysis of postretirement medical expense coverage. According to the Bureau of Labor Statistics, the cost of health care in 2003 for persons age 65 to 74 was 19 percent more than for persons age 55 to 64, and 46 percent more than for persons age 45 to 54.

One way to engage a client in this conversation is to use a diagram known as the Circle of Health Protection. Beginning with medical services, ask the client how they plan on paying for such expenses during retirement. Will they depend on employer-sponsored post-retirement medical expense coverage? Medicare Part A? Work around the circle in a counter-clockwise fashion. More than likely, the client will not have coverage for home health care, assisted living, and nursing home care. This would be an excellent way to introduce the need for long-term care insurance.



Protecting Retirement Savings

Finally, accruing large amounts of assets should always cause an advisor to examine or re-examine a client's insurance coverage. A person who is saving for retirement needs to consider the effects of a lawsuit due to an auto or homeowners claim. In addition, he or she should be aware of the drain that could be created by unreimbursed medical expenses, disability, and the need for long-term care. Long-term care issues are especially important the closer one gets to retiring.



Breakout—Class 6

6-1 What aspects of retirement are important to discuss in retirement planning with a client?

6-2 How do you discuss the need for starting early with younger clients?

6-3 John and Mary are married, make \$50,000 each, and file a joint income tax return. Both have a 401(k) at work. Mary's employer provides a dollar for dollar match up to 3 percent of income. John's employer does not offer a match. They would like to save 10 percent of each salary toward retirement. What recommendations would you make? Why?

Quiz—Class 6

(Due Class 6)

Instructions: Study the reading assignment from Class 6, then circle the correct answer for each of the following questions. Each question is worth 10 points (100 points total).

1. Which of the following correctly describes the unit-benefit formula found in defined-benefit pension plans?
 - (A) It directly ties the participant's pension benefit to both service and salary.
 - (B) It bases the participant's pension benefit on final average salary only.
 - (C) It provides each participant with the same pension benefit.
 - (D) It provides each participant with a flat benefit amount for each year of service.

2. Which of the following is a method for determining retirement income that assumes that the standard of living enjoyed during the years just prior to retirement will be the determining factor for the standard of living during retirement?
 - (A) expense method
 - (B) capital-utilization method
 - (C) capital-retention method
 - (D) replacement-ratio method

3. Which of the following statements regarding contributions to traditional IRAs is correct?
 - (A) Contributions may be used to buy life insurance policies.
 - (B) Contributions may be deductible or nondeductible.
 - (C) Contributions may be commingled with a taxpayer's other assets.
 - (D) The maximum contribution is 15 percent of the taxpayer's income.

4. Which of the following statements regarding target-benefit pension plans is correct?
 - (A) It is a defined-benefit plan.
 - (B) Investment risk falls on the employer.
 - (C) A defined-benefit formula is used to determine the annual contribution.
 - (D) Actuaries are not utilized at all in these types of plans.

5. Which of the following expenses tend to decrease for retirees?
- I. mortgage payments
 - II. medical and dental costs
- (A) I only
(B) II only
(C) Both I and II
(D) Neither I nor II
6. Which of the following statements regarding defined-contribution plans (is) are correct?
- I. The employer assumes the preretirement inflation and investment risks.
 - II. All contributions are allocated to the accounts of individual employees.
- (A) I only
(B) II only
(C) Both I and II
(D) Neither I nor II
7. Which of the following statement(s) regarding Roth IRAs is (are) correct?
- I. Contributions are not deductible.
 - II. Qualifying withdrawals are not subject to income tax.
- (A) I only
(B) II only
(C) Both I and II
(D) Neither I nor II
8. Nonqualified retirement plans are potentially subject to all of the following problems EXCEPT
- (A) somewhat inflexible withdrawal provisions
 - (B) the forfeiture or loss of benefits
 - (C) nondiscrimination rules that limit benefit amounts
 - (D) the threat of immediate taxation that would reduce the benefit amount
9. All of the following statements regarding money-purchase pension plans are correct EXCEPT
- (A) It is a type of defined-contribution plan.
 - (B) The employer's annual contributions are mandatory.
 - (C) Participants have individual accounts.
 - (D) Benefits are stated as a formula usually based on years of service.

10. All of the following statements regarding simplified employee pension plans (SEPs) are correct EXCEPT
- (A) Contributions must generally be allocated as a level percentage of compensation.
 - (B) The allocation formula may be integrated with Social Security.
 - (C) All employer contributions are 100 percent vested.
 - (D) Annual employer contributions are always required.

Sales Planning Project 5

Retirement Planning

(Assigned Class 6—Due Class 8)

Purpose

One of the more prominent client goals should be retirement planning because of the large amount of money that must be amassed to finance retirement. This project will give you insight into some of the basics of retirement planning.

Assignment

This sales planning project asks you to consider your own retirement plan. It asks you to describe your retirement goals and quantify them financially. It then asks you questions related to the financing of your retirement goals.

Procedure

Answer the questions about your retirement planning process. Then, complete the summary questions.

Name _____ Date _____

Sales Planning Project 5

Retirement Planning

Report Form (1 of 3)

1. Approximately how many more years do you have before you would like to retire?

2. Describe what you want your retirement years to look like. Answer questions like: What will you do? Will you work? Will you travel? Where will you travel? Do you plan on relocating? Where?

3. How much will you need to save to be able to achieve your goals? Use the worksheets on pages 6-25 through 6-28 in the textbook to estimate this amount (if you do not have a method already). You may give the amount as either a dollar figure or the number of times current income. (For example, "\$3.2 million" or "31.5 times current income.")

4. What should your asset allocation be? What is it currently?

Sales Planning Project 5

Retirement Planning

Report Form (2 of 3)

5. Describe your current retirement savings strategy. What are you currently doing to achieve your goal? What savings vehicles are you using? How are you coordinating multiple savings vehicles?

6. Describe your current progress. What percentage of your goal has been attained? Are you on target to meet your goal?

7. What are your plans if you and/or a partner require assistance with activities of daily living like eating, dressing, bathing, toileting, or transferring? Where do you want care provided? Who will provide care?

8. How much will care cost in today's dollars? (Call a nursing home for an approximate cost.)

9. What percentage of this care have you prefunded? How have you prefunded it?

10. Describe your current progress. What percentage of your goal has been attained? Are you on target to meet your goal?

Name _____

Sales Planning Project 5

Retirement Planning

Report Form (3 of 3)

Summary Questions

1. When is the last time you reviewed the asset allocation and progress of your goals?

2. Try to evaluate your situation through the eyes of a third party. What recommendations would you make to someone in your situation?

3. Describe two insights you gained about retirement planning from this exercise.

Action Project 3

Retirement and the Early-Career Segment

(Assigned Class 6—Due Class 8)

Purpose

The purpose of this project is to give you insight into younger clients' perspectives toward retirement and retirement planning. As a consequence, you may give some an invaluable education on the value of starting their retirement plan earlier rather than later.

Assignment

Give a member of the early-career segment, preferably under age 30, a copy of the illustration, "Retirement Funding Plans: The Advantages of Starting Young." Ask a few brief questions to gauge their reaction and understanding.

Procedure

1. Make copies of the "Retirement Funding Plans: The Advantages of Starting Young" that appears on the next page.
2. Talk to three persons in the early-career segment of the life cycle, preferably under age 30. They can be current clients (unless you have already discussed retirement planning with them) or prospects.
3. Give them a copy of the illustration, "Retirement Funding Plans: The Advantages of Starting Young."
4. Ask the questions on the report form.
5. Complete the summary questions.

Retirement Funding Plans: The Advantages of Starting Young *

Plan One			Plan Two		
Age start	18		Age start	27	
Age end	26		Age end	65	
Amount per year	\$3,000		Amount per year	\$3,000	
Rate of return	8%		Rate of return	8%	
Value at age 65	\$753,572		Value at age 65	\$713,823	
Total amount contributed	\$27,000		Total amount contributed	\$114,000	
Age	Amount	Value	Age	Amount	Value
18	\$3,000	\$ 3,240	18	0	0
19	3,000	6,739	19	0	0
20	3,000	10,518	20	0	0
21	3,000	14,600	21	0	0
22	3,000	19,008	22	0	0
23	3,000	23,768	23	0	0
24	3,000	28,910	24	0	0
25	3,000	34,463	25	0	0
26	3,000	40,459	26	0	0
27	0	43,696	27	\$3,000	\$ 3,240
28	0	47,192	28	3,000	6,739
29	0	50,967	29	3,000	10,518
30	0	55,044	30	3,000	14,600
.
.
.
.
60	0	512,869	60	3,000	472,880
61	0	553,898	61	3,000	513,950
62	0	598,210	62	3,000	558,306
63	0	646,067	63	3,000	606,211
64	0	697,752	64	3,000	657,947
65	0	753,572	65	3,000	713,823

* This comparison is hypothetical; no guarantees are implied for specific investments. The interest rate is assumed to remain unchanged for the entire period.

Name _____ Date _____

Action Project 3
Retirement and the Early-Career Segment
Report Form (1 of 4)

Person 1

1. Are you surprised by the outcome? Why or why not?

2. Have you started saving for retirement? If yes, when did you start saving? If not, why not?

3. In which types of retirement vehicles do/would you participate?

4. How did/would you determine the amount you need to save?

5. How did/would you decide which investments you would use to fund your savings?

6. How has this conversation affected you? (Circle any that apply.)

- (a) It has had no effect.
- (b) It has affirmed that I am on the right path.
- (c) It has made me think I need to get started now or increase my savings.
- (d) It has made me realize I need to figure out how much I need to save.
- (e) It has made me realize I need help choosing my investments.

Action Project 3

Retirement and the Early-Career Segment

Report Form (2 of 4)

Person 2

1. Are you surprised by the outcome? Why or why not?

2. Have you started saving for retirement? If yes, when did you start saving? If not, why not?

3. In which types of retirement vehicles do/would you participate?

4. How did/would you determine the amount you need to save?

5. How did/would you decide which investments you would use to fund your savings?

6. How has this conversation affected you? (Circle any that apply.)

- (a) It has had no effect.
- (b) It has affirmed that I am on the right path.
- (c) It has made me think I need to get started now or increase my savings.
- (d) It has made me realize I need to figure out how much I need to save.
- (e) It has made me realize I need help choosing my investments.

Name _____

Action Project 3
Retirement and the Early-Career Segment
Report Form (3 of 4)

Person 3

1. Are you surprised by the outcome? Why or why not?

2. Have you started saving for retirement? If yes, when did you start saving? If not, why not?

3. In which types of retirement vehicles do/would you participate?

4. How did/would you determine the amount you need to save?

5. How did/would you decide which investments you would use to fund your savings?

6. How has this conversation affected you? (Circle any that apply).

- (a) It has had no effect.
- (b) It has affirmed that I am on the right path.
- (c) It has made me think I need to get started now or increase my savings.
- (d) It has made me realize I need to figure out how much I need to save.
- (e) It has made me realize I need help choosing my investments.

Action Project 3

Retirement and the Early-Career Segment

Report Form (4 of 4)

Summary Questions

1. How did people generally respond to the illustration?

2. What reasons did people give for not starting to save for retirement?

3. How did people determine the amount they needed to save for retirement?

4. How did people decide how to invest for retirement?

5. How did people receive your information? Were they generally motivated or unmotivated? Why do you think they responded that way?

6. List two important things you learned from completing this exercise.

Supplemental Reading 7

Inflation-Adjusted Items

This chapter makes reference to some inflation-adjusted items. The updated numbers are as follows.

<u>Inflation-Adjusted Item</u>	<u>2005 Amount</u>	<u>Page Ref</u>
Generation-skipping transfer tax	47%	7-28
Annual gift tax exclusion.....	\$11,000.....	7-29

Planning Considerations

Basic Estate Planning Issues

Even if you do not specialize in estate planning, you can help your clients become more aware of their need to plan for an orderly handling of affairs at their death to ensure the smoothest possible transition during an emotionally difficult time. In addition, they can ensure that certain matters are handled the way they would want. Here are a few basic recommendations to consider.

Wills—Anyone who owns property ought to consult an attorney about the need for a will or other effective means to pass on property. Ask your clients questions about their wills. For example:

- Do you have a will?
- How did you prepare your will? Was a qualified attorney involved?
- When did you create your will?
- When was the last time you reviewed your will?
- Have there been any changes to your life since that time—marriage, divorce, a new child (birth or adoption), a disinherited heir, death of a person named in your will, relocation to a different state, and so forth?

Obviously, if any of your clients do not have a will, consider recommending they look into one immediately. Help them understand the potential problems of not having a will: “Ms. Client, without a valid will, the state will decide how your property is divided. The process will generally be more expensive and it will place added stress on your loved ones during an already very difficult time. A will is your way of having your affairs handled in a manner you would want. How important is that to you?” If possible, have the names of a few qualified attorneys whom you trust and would recommend to your clients.

Of course, life is full of changes. A will created 5 years ago may not reflect a client’s current wishes. Perhaps relations between the client and his son are strained or a child has become

disabled. Or, if a client has relocated from another state, her previous state may have different rules and taxes that apply. Furthermore, a new tax law could affect the client's will. An updated will may be required to reflect these changes.

Guardianship—Ask clients with minor children whether or not they have named a guardian in their will. If they have not, recommend that they identify someone whom they trust to raise their children and who is willing to do so should both parents be deceased. If clients do not name a guardian, the state will appoint one—perhaps one that the clients would not have approved.

Revocable Trusts—Revocable trusts are another effective way to transfer property at death. They could be particularly useful in several different situations include the following:

- The clients own real estate in another state and would be required to open a separate probate proceeding in that state.
- The clients have concerns that one or more of their heirs may make legal challenges to the disposition of assets. This might be the case in a situation involving a disinherited heir or where family members have a history of conflict.
- The clients want their affairs to be kept private.

If clients find themselves in any of these situations and have not investigated the possibility of using a revocable trust, the advisor should recommend that they do so.

Advance Medical Directives—At the time of this writing, the case involving Terri Schindler-Schiavo was dominating the front pages and the Internet. This case and many like it underscore the need for clients to have advanced medical directives in the form of a durable power of attorney for health care and a living will. If the client's wishes are not spelled out in writing, there will be no way to ensure that their situation is handled as they want.

Expenses Associated with Dying—Clients should be made aware of the costs associated with death. The average funeral costs around \$7,000, not including cemetery costs.¹ Probate costs can run anywhere from 3 to 10 percent of the client's probated estate. State death, estate, and/or inheritance taxes should be factored into the cost as well. Life insurance is a good way to pay for these expenses.

Potential Estate Tax Exposure—If you have created a financial position statement with the client, you will be well on your way to creating an asset inventory. Already you will know much of what the client owns and what it is worth. You also know the client's main liabilities. Subtracting liabilities from assets gives you the client's net worth. As clients near the estate tax threshold, help them understand the potential impact that estate taxes could have on their estate.

EXAMPLE: Maria is 35 years old and single. She has amassed a net worth of \$1 million. Although the applicable exclusion amount is \$1.5 million in 2005 (\$2 million in 2006 and 2007),

¹ NFDA Fact Sheets, National Funeral Directors Association, Web site at www.nfda.org/nfdafactsheets.php

she is getting close to that threshold, and if she has not done some estate planning already, she should consider it.

Remember, too, that if a client owns a life insurance policy insuring his or her life, the death benefit will be includible in the estate. Although the proceeds generally would not be subject to probate, and the named beneficiary generally would not be taxed on the proceeds because the insured had incidents of ownership (outright ownership, the ability to name a beneficiary, and so on), the estate is increased by the death benefit.

EXAMPLE: Maria has a \$150,000 group term policy through her employer. She also purchased a \$500,000 variable universal life policy. The beneficiary of both policies is her brother José. Also, Maria has incidents of ownership in both policies. Thus, her estate will increase substantially at her death. If Maria currently has a net worth of \$1 million, her estate would be worth approximately \$1.65 million if she were to die today.

Irrevocable Life Insurance Trust—As stated earlier, if the client has incidents of ownership (outright ownership, ability to name a beneficiary, and so forth) in a life insurance policy insuring his or her own life, the death proceeds will be includible in his or her estate for estate tax purposes. Obviously, the client could make someone else the owner. However, if the client's relationship with that person sours, he or she could have some very big problems. A better solution is to consider an irrevocable life insurance trust (ILIT).

EXAMPLE: José has \$500,000 in term insurance. He has named Maria as the beneficiary. The policy was purchased and placed into an irrevocable life insurance trust. Therefore, the death benefit would not be included in José's estate for estate tax purposes. In addition, the death benefit would not be subject to probate.

In general, an ILIT is appropriate for executives who have fringe benefits that contain large amounts of life insurance benefits, individuals with substantial amounts in term life insurance, or in conjunction with the purchase of a second-to-die policy. In cases in which clients own permanent life insurance with substantial cash values, the ILIT may also be appropriate. However, if there is any remote possibility that a client could need access to the cash value, an ILIT is probably not a very good solution.

Ownership Issues

There are both advantages and disadvantages to joint tenancies with right of survivorship and tenancies by the entirety beyond tax considerations. Advantages of these forms of joint ownership include the following:

- Under most state laws, property owned as tenants by the entirety generally cannot be reached by a spouse's creditors. Only joint creditors can reach such property.
- These forms of ownership are convenient for certain types of assets, such as bank accounts, because either tenant has access to the account.
- Joint tenancies and tenancies by the entirety may give one or both of the tenants a feeling of security. This is especially true when the owners are spouses and one spouse has contributed most of the funds.

- When one tenant dies, the property passes directly to the surviving joint tenant. There are no probate delays. There may be little or no administrative and transfer cost. The property will remain fully accessible to the surviving owner.
- In many states, these forms of property ownership between spouses pass free of state death taxes.
- Because such property passes by operation of law and not under the will, it is a private arrangement and not open for public scrutiny.

While these forms of ownership may be both convenient and psychologically comforting, they may not constitute the best estate plan for all persons and may severely impair an appropriate estate plan when used improperly. As an individual's estate increases, a review and analysis of such property should be made to determine if it is the best form of ownership for the individual's needs.

There are also some disadvantages inherent in these jointly held property arrangements. Some of these disadvantages include the following:

- Under most state laws, property owned as joined tenants with rights of survivorship can be reached by creditors of an individual joint tenant.
- There are potential gift taxes at the creation of some of these property ownership interests. (*Note:* Transfers may qualify for the unlimited marital gift tax deduction.)
- There may be additional federal estate taxation. The entire value of property held jointly with right of survivorship, except for spousal joint tenancies created after December 31, 1976, may be in the estate of the first joint owner to die. The entire property will then be owned by the surviving tenant and will be fully subject to testate taxation again at the survivor's death. (*Note:* Transfers may qualify for the unlimited estate tax marital deduction.)
- The surviving tenant will gain full control over the property and may ultimately dispose of it in any way desired. The deceased tenant's will, trust, or other dispositive documents will have no effect on the disposition of the jointly held property.
- The deceased tenant's estate may be faced with a liquidity problem. Property passing directly to the surviving tenant may not be made available to the decedent's estate for the payment of taxes, debts, or expenses.

EXAMPLE: Sonny and Tillie Graham have \$4 million in assets. In each of their wills, Sonny and Tillie have left \$1.5 million to be set up in a trust for their children Millie and Holly. Consider what would happen based on the types of ownership. Assume Sonny dies in 2005 and Tillie in 2006.

Tenants in Common	Joint Tenants with Rights of Survivorship
<ul style="list-style-type: none"> • Assets are transferred directly to the trust. • The deceased utilizes his or her lifetime exclusion (\$1.5 million in 2005). • Survivor's estate is now worth \$2.5 million. • At second death, the survivor can utilize his or her lifetime exclusion (\$2 million in 2006). • Only \$500,000 of a \$4 million estate is taxed! 	<ul style="list-style-type: none"> • Assets are all transferred to the survivor—bypassing the will. • The survivor transfers the assets to a trust and they are treated as a completed gift. With the annual gift exclusion and the lifetime gift credit, a total of \$1,011,000 can be transferred tax free. • \$489,000 will be taxed. • At the second death, an additional \$1 million can be transferred tax free. • About \$2 million of the \$4 million estate is taxed!

There are both tax and nontax reasons to create different forms of property ownership when held by more than one individual concurrently. There is no one answer with regard to arrangements of property. Generally, a combination of different ownership arrangements will provide the best results in good estate planning. One important factor to examine is the size of the relative estates of potential co-owners of property.

BREAKOUT



Breakout—Class 7

7-1 How do you go about introducing the topic of estate planning to a client? What would you say?

7-2 How do or would you explain to a client what a will does and why he or she should have one?

Quiz—Class 7

(Due Class 7)

Instructions: Study the reading assignment from Class 7, then circle the correct answer for each of the following questions. Each question is worth 10 points (100 points total).

1. Which of the following provides the holder the ability to transfer property to a limited class of potential recipients?
 - (A) power of appointment
 - (B) power of attorney
 - (C) durable power of attorney
 - (D) special power of appointment

2. Jointly owned property becomes part of the probate estate at an owner's death if the property interest is titled as which of the following?
 - (A) tenancy by the entirety
 - (B) community property
 - (C) joint tenancy with right of survivorship
 - (D) tenancy in common

3. Which of the following can be an advantage to owning property as joint tenants with rights of survivorship (JTWROS)?
 - (A) Under most state laws, property cannot be reached by creditors of an individual joint tenant.
 - (B) When one tenant dies, the property passes directly to the surviving joint tenant.
 - (C) The deceased tenant's estate can use property passing to the surviving tenant to pay taxes, debts, or expenses.
 - (D) JTWROS can always be created without being subject to a gift tax liability.

4. Which of the following statements regarding estate tax planning with AB trust arrangements is (are) correct?
 - I. The A, or marital, trust receives all assets not placed in the B trust.
 - II. The B, or family, trust is subject to estate taxation when the surviving spouse dies.
 - (A) I only
 - (B) II only
 - (C) Both I and II
 - (D) Neither I nor II

5. Which of the following statements regarding a durable power of attorney is (are) correct?
- I. It takes effect immediately upon execution.
 - II. It can replace or complement a revocable trust.
- (A) I only
(B) II only
(C) Both I and II
(D) Neither I nor II
6. Which of the following is referred to as an advance medical directive?
- I. durable power of attorney for health care
 - II. living will
- (A) I only
(B) II only
(C) Both I and II
(D) Neither I nor II
7. All of the following statements regarding tenancy by the entirety are correct EXCEPT
- (A) It is a property interest restricted solely to spouses.
(B) It is joint ownership of the property with rights of survivorship.
(C) The property is subject to disposition by the will of the deceased spouse.
(D) Tenancy by the entirety is severed automatically upon divorce.
8. All of the following statements regarding planning for state death taxes are correct EXCEPT
- (A) Some states do not tax property held jointly by an individual at the time of his or her death.
(B) State death taxes are typically inconsequential and do not require any advanced planning.
(C) Life insurance owned individually by an insured is often not taxable if payable to a named beneficiary.
(D) Some states provide for no marital deduction for individually owned property transferred to a surviving spouse.
9. A revocable trust would be useful in all of the following situations EXCEPT
- (A) The client does not want life insurance death benefits to be subject to estate taxes.
(B) The client has concerns that a disinherited heir will make legal challenges to a will.
(C) The client owns real estate in several states.
(D) The client wants his or her affairs to be kept private.

10. All of the following statements regarding testamentary trusts are correct EXCEPT

- (A) The trust escapes probate even though it is in the client's will.
- (B) The trust does not receive property until the client dies.
- (C) The proceeds are transferred to the trust by the executor.
- (D) The testator retains legal capacity and is not irrevocable until his or her death.

Supplemental Reading 8

Inflation-Adjusted Items

This chapter makes reference to some inflation-adjusted items. The updated numbers are as follows.

Inflation-Adjusted Item	2005 Amount	Page Ref
Social Security taxable wage base.....	\$90,000.....	8-4
Medicare Part B premium	\$78.20.....	8-4
Required annual earnings for one quarter of coverage under Social Security.....	\$920.....	8-5
Substantial gainful employment	\$830/mo.....	8-8
Average PIA for a retired worker.....	\$955.....	8-10
Maximum PIA at full retirement age of 65 years and 6 months	\$1,939/mo.....	8-10
Maximum PIA for disability and survivors benefits ranges from.....	\$1,925 to \$2,100.....	8-10
Earnings test before full retirement age.....	\$12,000.....	8-13
Earnings test in the calendar year the worker reaches full retirement age	\$31,800.....	8-13
Medicare Part A monthly premium (fewer than 30 quarters).....	\$375.....	8-15
Medicare Part A monthly premium (30 to 39 quarters)	\$206.....	8-15
Medicare Part A hospital deductible	\$912.....	8-17
Medicare Part A copayment	\$228.....	8-17
Medicare Part A copayment for lifetime reserve days	\$456.....	8-17
Medicare Part A copayment for skilled nursing facility (days 21 to 100)...	\$114.....	8-18
Medicare Part B deductible	\$110.....	8-22
Medigap policy deductible when used with an MSA.....	\$1,730.....	8-28

Taxation of Benefits

Social Security benefits are taxable if the total of 50 percent of benefits and all other income is greater than \$25,000 (\$32,000 if filing single). How much is taxable will depend on the total amount of a client's benefit plus other income and filing status. In general, up to 50 percent of benefits will be taxable. However, up to 85 percent of benefits can be taxable in either of the following situations:

- The total of 50 percent of benefits and all other income is greater than \$34,000 (\$44,000 if married filing jointly).

- The client is married filing separately and lived with his or her spouse at any time during the tax year that is being filed.

Taxation of Social Security Benefits (50% of Social Security Benefit + Other Income)		
Single*	Married Filing Jointly	Taxable Benefit
\$25,000 or less	\$32,000 or less	None
Over \$25,000 to \$34,000	Over \$32,000 to \$44,000	Up to 50%
Over \$34,000	Over \$44,000	50% to 85%
* For this purpose, the “single” column also applies to persons filing as heads of household, as married but separate and having lived apart for the entire year, or as qualified widows/widowers.		

Social Security Statements

Requesting a Social Security Statement

You may ask your clients to bring their Social Security statement to a planning session. If they have misplaced the one they receive each year, they can request one from the Social Security Administration. The request can be made online or by regular mail (go to www.ssa.gov for more information). Clients will need

- their name as shown on their Social Security card
- their Social Security number
- their date of birth
- their place of birth
- their mother’s maiden name—last name only (to help identify them)

Highlights of the Statement

The meat of the statement is found on pages 2 and 3. On page 2, you find the client’s estimated benefits. Page 3 provides the client’s earnings record. A sample statement can be found at www.ssa.gov.

Estimated Benefits—At the top of page 2 you will find the assumptions that are made in estimating benefits. It is important to know that the estimated benefit is based on the client’s average earning over his or her working lifetime. Future salary is based on the assumption that the client will earn about the same as he or she did the past 2 years. See the estimated benefits on the excerpt from the statement below.

Notice for the retirement benefits, the statement gives the amount the client would receive for early retirement, full retirement age (for this worker, it is 67 years), and then age 70. Also, the survivors benefits lists the benefit for the child, the spouse who is caring for the client’s child, and the spouse’s benefit at full retirement age. This section also lists the total family benefits, which would come into play if the client had a surviving spouse and two or more children all eligible for benefits.

You may have noticed that the amounts in the survivors benefits section do not calculate according to the information provided on page 8-11 of the textbook. For example, the surviving spouse at full retirement age receives 100 percent of the worker’s PIA. The sample statement

**Estimated Benefits
(Excerpt from Social Security Statement)**

▼ *Retirement	<p>You have earned enough credits to qualify for benefits. At your current earnings rate, if you stop working and start receiving benefits...</p> <p style="padding-left: 40px;">at age 62, your payment would be about... \$ 903 a month</p> <p style="padding-left: 40px;">If you continue working until...</p> <p style="padding-left: 80px;">your full retirement age (67 years), your payment would be about... \$1,309 a month</p> <p style="padding-left: 80px;">At age 70, your payment would be about... \$1,633 a month</p>
▼ *Disability	<p>You have earned enough credits to qualify for benefits. If you became disabled right now, your payment would be about... \$1,197 a month</p>
▼ *Family	<p>If you get retirement or disability benefits, your spouse and children also may qualify for benefits</p>
▼ *Survivors	<p>Suppose you have earned enough credits for your family to receive survivors benefits. If you die this year, certain members of your family may qualify for the following benefits.</p> <p style="padding-left: 40px;">Your child... \$ 933 a month</p> <p style="padding-left: 40px;">Your spouse who is caring for your child... \$ 933 a month</p> <p style="padding-left: 40px;">Your spouse, if benefits start at full retirement age... \$1,245 a month</p> <p style="padding-left: 40px;">Total family benefits cannot be more than... \$2,286 a month</p>
▼ *Medicare	<p>You have enough credits to qualify for Medicare at age 65. Even if you do not retire at age 65, be sure to contact Social Security 3 months before your 65th birthday to enroll in Medicare.</p>

shows a PIA of \$1,633 but the survivors benefit for the spouse at full retirement age is \$1,245. The reason for this discrepancy is that the survivors benefit is calculated based on the client dying this year. Thus, future earnings to retirement age would not be earned and the PIA would be lower than the projected retirement benefit.

Earnings Record—Page 3 contains the client’s earnings record, showing the years worked, and the wages that were taxed for both Social Security and Medicare. See the example below.

Years You Worked	Your Taxed Social Security Earnings	Your Taxed Medicare Earnings
1998	28,222	28,222
1999	30,373	30,373
2000	32,510	32,510
2001	33,833	33,833
2002	34,646	34,646
2003	35,897	35,897
2004	37,023	37,023
2005	Not yet recorded	

The client should check the earnings each year to verify they are correct. The statement instructs to call the Social Security Administration immediately if the records are in error. Remember the taxable wage base limit.

At the bottom of page 3, you will find a summary of the estimated taxes paid for both Social Security and Medicare. This area lists the amounts paid by the employee and the employer.

Special Insert for People Age 55 or Older—Finally, clients age 55 or older will receive a special insert that reviews the options and the impact of retiring early, retiring at full retirement age, and delaying retirement.

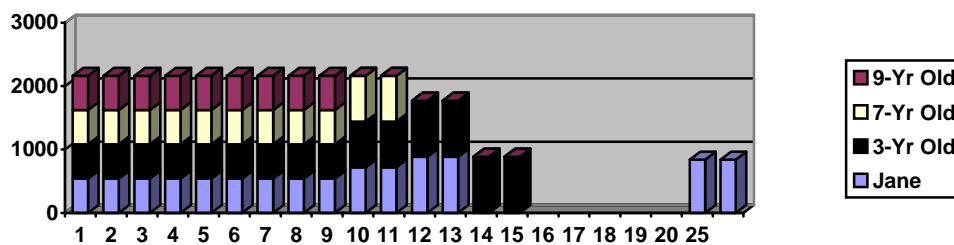
Sample Application for Survivors Benefits

Social Security benefits should be taken into account when calculating a family’s life insurance need. Remember that the survivors benefits provided by the annual statement are based on the worker’s death in the current year.

John Doe’s Survivors Section of Social Security Statement	
You have earned enough credits for your family to receive the following benefits if you die this year:	
Total family benefits cannot be more than...	\$2,164 a month
Your child...	\$ 884 a month
Your spouse who is caring for your child...	\$ 884 a month
Your spouse who reaches full retirement age...	\$1,179 a month

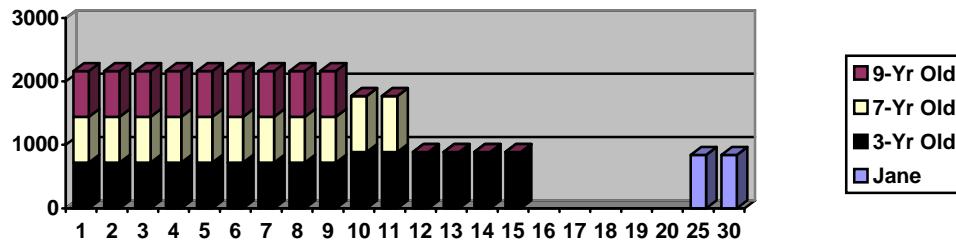
Consider the following scenario: John and Jane have children ages 3, 7, and 9. The survivors benefit portion of John’s statement is shown above. If John were to die today and Jane earns \$12,000 or less, the family would receive the family maximum of \$2,164 for the first 11 years (see Figure 1). In years 12 and 13, Jane and the 3-year old would be eligible for their maximum benefits (\$884 each) because the other two children are now over age 18 and no longer eligible for benefits (assuming they are neither disabled nor still in high school). In years 14 and 15, only the 3-year old would receive a benefit. Years 16 through 24 represent the *black-out period* during which no benefits are payable to the family. When Jane turns 60-years-old in year 25, she is eligible to receive the reduced “widow’s benefit” ($71.5\% \times \$1,179 = \843), or she can wait until full retirement age and receive the full amount (\$1,179).

Figure 1: Survivor Benefits: Full Mother's Benefit



If Jane earns over \$12,000, her “mother’s benefit” would be reduced \$1 for every \$2 of all earned income over the \$12,000 in 2005 (indexed annually for inflation). However, if Jane works and earns enough to eliminate her “mother’s benefit,” the family would still receive the family maximum until the oldest child turns 18 in year 9 and is no longer eligible for benefits (see Figure 2). Furthermore, Jane would still be entitled to the reduced “widow’s benefit” at age 60 or full amount at full retirement age.

Figure 2: Survivor Benefits - No Mother's Benefit



Social Security’s many caveats and exceptions can be complex. For example, a divorce can result in survivor benefits being paid to both a current and a former spouse. Understanding the nuances of Social Security will allow you to better analyze your client’s financial situation and illustrate the necessity to complement the benefits Social Security provides. It also will demonstrate that you have answers and solutions to the questions and problems important to your client.

Sample Application for Retirement Benefits

The most obvious use for the statement’s estimated retirement benefits is to use them in reducing the retirement income need. For example, in the sample statement on page W-155, the amount of Social Security benefits would be \$1,309 if the client were single. If the client were married, the total possible benefit on his or her earnings record would be \$1,963.50 (spouse’s benefit is \$1,309 x 50% = \$654.50).

When considering early retirement benefits, your client should consider the breakpoints (when the latter retirement date overtakes the earlier retirement date in total benefits paid). The Social Security Administration website has a calculator. See www.ssa.gov/retire2/breakeven.htm for more information. In addition to the breakpoints, the Administration recommends clients consider the following factors:

- Longevity of family members—the longer the client is expected to live, the more beneficial it may be to delay benefits.
- Continuing employment—if the client plans to continue working, there are limits on how much the client can earn each year between age 62 and full retirement age and still receive all of his or her benefits.
- The client’s health—unhealthy clients should consider taking benefits earlier.
- Other family members will qualify for benefits with the client on his or her record. If a spouse, minor children, or disabled children qualify for benefits with the client, the value of their benefits added to the client’s benefits may move the break-even point out further. Thus, it may be more advantageous to take the benefits sooner.

BREAKOUT



Breakout—Class 8

8-1 Consider the following fact pattern. Noah and Annie Boddy are prospects who have two children, Everett and Summer, ages 10 and 8 respectively. Noah is 35-years-old and earns \$45,000. Annie is 32-years-old and has just graduated from law school (she went part-time while she stayed at home with the children). She just started working at a law firm earning \$40,000 a year.

How could you use Noah’s Social Security statement to discuss Noah and Annie’s need to plan for retirement, disability, and death: What could you teach them using the statement? What related information could you share that does not appear on the statement? What questions could you ask?

Estimated Benefits (Excerpt from Social Security Statement)	
▼ *Retirement	<p>You have earned enough credits to qualify for benefits. At your current earnings rate, if you stop working and start receiving benefits...</p> <p style="padding-left: 40px;">at age 62, your payment would be about... \$1,068 a month</p> <p style="padding-left: 40px;">If you continue working until...</p> <p style="padding-left: 80px;">your full retirement age (67 years), your payment would be about... \$1,548 a month</p> <p style="padding-left: 80px;">Age 70, your payment would be about... \$1,931 a month</p>
▼ *Disability	<p>You have earned enough credits to qualify for benefits. If you became disabled right now, your payment would be about... \$1,350 a month</p>
▼ *Family	<p>If you get retirement or disability benefits, your spouse and children also may qualify for benefits</p>
▼ *Survivors	<p>Suppose you have earned enough credits for your family to receive survivors benefits. If you die this year, certain members of your family may qualify for the following benefits.</p> <p style="padding-left: 40px;">Your child... \$1,035 a month</p> <p style="padding-left: 40px;">Your spouse who is caring for your child... \$1,035 a month</p> <p style="padding-left: 40px;">Your spouse, if benefits start at full retirement age... \$1,380 a month</p> <p style="padding-left: 40px;">Total family benefits cannot be more than... \$2,468 a month</p>

8-2 How could you use the Social Security statement in your practice? How could it be used to market financial planning or approach prospects?

8-3 How would you describe Medicare to a client? What gaps would you discuss, and how would you discuss them?

Name _____ Date _____

Quiz—Class 8

(Due Class 8)

Instructions: Study the reading assignment from Class 8, then circle the correct answer for each of the following questions. Each question is worth 10 points (100 points total).

1. Which of the following statements regarding medigap insurance plans is correct?
 - (A) Employer-provided Medicare carve-out plans must meet all medigap requirements.
 - (B) Persons age 65 or older may buy any medigap plan after enrolling in Medicare Part B.
 - (C) Medigap insurance only covers deductibles and copayments for expenses paid under Medicare Part B.
 - (D) All of the medigap insurance plans are required to provide prescription drug coverage.

2. Jean died and left behind a surviving spouse, age 37, and a child age 15. The surviving spouse's salary exceeds the earnings test threshold by \$2,000. The surviving spouse's annual benefit amount will be reduced by
 - (A) \$500
 - (B) \$1,000
 - (C) \$1,500
 - (D) \$1,750

3. Which of the following statements regarding quarters of coverage under Social Security is correct?
 - (A) The amount of earnings necessary for a quarter of coverage is adjusted annually.
 - (B) Credit for no more than 12 quarters of coverage may be earned in any one calendar year.
 - (C) A person is fully insured if he or she has at least 20 quarters of coverage.
 - (D) A person is currently insured if he or she has at least 4 quarters of coverage.

4. Which of the following statements regarding the Medicare SELECT program is correct?
 - (A) They generally cost more than policies that do not use preferred-provider networks.
 - (B) An insured can switch to any regular medigap policy at any time.
 - (C) Policies in the SELECT program can vary greatly from regular medigap policies.
 - (D) They are issued by insurance companies as PPO or HMO products.

5. Which of the following is a requirement for a worker to be “disability insured?”
- I. be fully insured under Social Security
 - II. have a minimum amount of work under Social Security within a recent time period
- (A) I only
(B) II only
(C) Both I and II
(D) Neither I nor II
6. Up to 85 percent of Social Security benefits can be taxable for a person filing single in which of the following situations?
- I. the total of 50 percent of benefits and all other income is greater than \$34,000
 - II. the person is earning over \$12,000 in other income
- (A) I only
(B) II only
(C) Both I and II
(D) Neither I nor II
7. Tracy dies, leaving behind a spouse and a child under age 16. Tracy’s PIA is \$2,000 per month. Which of the following statements regarding the surviving spouse and child’s benefits is (are) correct?
- I. The surviving spouse will receive \$1,500 per month.
 - II. The child will receive \$1,000 per month.
- (A) I only
(B) II only
(C) Both I and II
(D) Neither I nor II
8. All of the following persons are also eligible for monthly benefits if a retired worker is receiving retirement benefits EXCEPT
- (A) a spouse age 62 or older
 - (B) a divorced spouse if the marriage lasted at least one year
 - (C) dependent unmarried children under 18
 - (D) disabled children of any age if disabled before reaching age 22

9. All of the following are factors clients should consider when thinking about taking early retirement benefits EXCEPT
- (A) longevity of family members
 - (B) the client's health
 - (C) continuing employment
 - (D) titling of property interests
10. All of the following statements regarding the Social Security portion of the FICA payroll tax are correct EXCEPT
- (A) They are paid by all persons covered under Social Security.
 - (B) They are paid by the employers of all covered persons.
 - (C) All wages are subject to Social Security payroll taxes.
 - (D) The tax rate applicable is 6.2 percent for both employees and employers.

Name _____ Date _____

Most Valuable Concepts

Reflection is an important part of the learning process that is often overlooked. Take a minute to think about what you have learned and write the most valuable concept, sales idea, marketing strategy, and so forth that you learned in class.

Class 1:

Class 2:

Class 3:

Class 4:

Class 5:

Class 6:

Class 7:

Class 8:
