AVOIDING IRA TAX TRAPS P. 57

PARTNER INSIGHTS

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RETHINKISAS These plans once merely supplemented health insurance. Now they are a vital part of a broader retirement strategy. Nadine Gordon Lee Managing Director Colony Group

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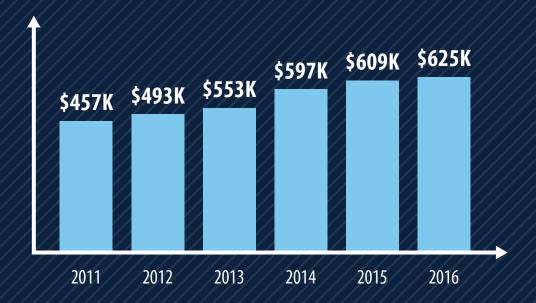
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CONTENT

SEPTEMBER 2017 | VOL. 47 | NO. 9



36 | Rethink HSAs

These plans once just supplemented health insurance. Now they are a crucial part of a broader retirement strategy.

By Charles Paikert

42 | A Steep Price for Medicare

How to help seniors avoid paying up to four times the going rate for Part B and D coverage. By Donald Jay Kom

44 | Advising on Health Care Options

Help could be on the way for retirement-age clients asking about health insurance coverage. By Sean Allocca

48 | Fewer Regrets, Better Retirement

If clients are unhappy with any aspect of their life that financial planning will solve, make that the primary focus.

By Carolyn McClanahan

Financial Planning Vol. 47/No. 9 (ISSN 0746-7915) is published monthly (12 times a year) by SourceMedia, One State Street Plaza, 27th Floor, New York, NY 10004-1505. Subscription price: \$109 for one year in the U.S.; \$129 for one year in all other countries. Periodical postage paid at New York, NY and U.S. additional mailing offices. POSTMASTER: Send address changes to Financial Planning. SourceMedia, One State Street Plaza, New York, NY 10004. For subscriptions, renewals, address changes and delivery service issues contact our Customer Service department at (212) 803-8500 or email: help@sourcemedia.com. Send subscription orders to: Financial Planning, SourceMedia, One State Street Plaza, New York, NY 10004. Please direct editorial inquiries, manuscripts or correspondence to: Financial Planning, One State Street Plaza, 27th Floor, New York, NY 10004-1505. Back issues, when available, are \$10 each, prepaid. Financial Planning is a trademark used herein under license. Copying for other than personal use or internal use is prohibited without express written permission of the publisher. ©2017 Financial Planning and SourceMedia, Inc. All rights reserved.



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CONTENT



COLUMNS

23 A Youth-Led Rebellion Is Brewing

Will young RIAs lead the planning profession's second uprising against the established status quo?
By Bob Veres

25 | The Reluctant Manager

You set out to be an advisor, not an administrator. Here are three steps to get your team to deliver outstanding results.

By John J. Bowen Jr.

27 | Look for That Silver Lining

For an advisor who has lost a great client or staff member, it's natural to fell upset. But there's a better way to respond to challenges.

By Dave Grant

29 | Rethinking Compensation

It may be time to update your salary strategy to encourage better performance and attract promising job candidates. By Kelli Cruz



RIAIQ

32 Doubling Down on Recruiting

As the independent channel become ever more attractive, LPL, the country's largest broker-dealer, intends to become even more aggressive.

By Charles Paikert and Scott Wenger

32 A Winning Combination

Automation and behavioral management will be critical components of LPL advisors' arsenals in the months ahead, the firm's CEO says.

By Tobias Salinger

PRACTICE

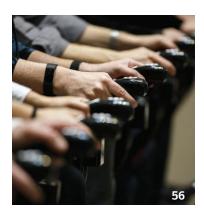
52 Identity Crisis

For advisors starting a new firm, there is agony in deciding what to call themselves. Tradition, trust and Google can all factor in the choice. By Andrew Welsch

TECH ZONE

56 | Wearable Tech and Wise Words

Widespread passive financial data and microadvice are creating the circumstances for a new wave of innovative products. By Suleman Din



CLIENT

57 | Avoiding IRA-Related Tax Traps

Yes, clients can invest funds from tax-deferred accounts in nontraditional assets, but you should know the risks before giving them the OK.

By Ed Slott

PORTFOLIO60 | The Passive Investing Mirage

The fact that more advisors are using ETFs in building porfolios is not a quantum shift. Planners are still mainly active investment managers. By Michael Kitces

64 | Three Against One

Can one total-market index fund top an equally weighted basket of largecap, mid-cap and small-cap funds? The answer may surprise you. By Craig L. Israelsen

SELFIE

72 | Social Security and Billy Joel

An advisor's blog about the Piano Man led to a \$14,000 Social Secuirty payday for a local family. By Patricia L. Burris

UPFRONT & MORE

12 Financial-Planning.com

14 Editor's View

20 Retirement Advisor Confidence Index

70 CE Quiz



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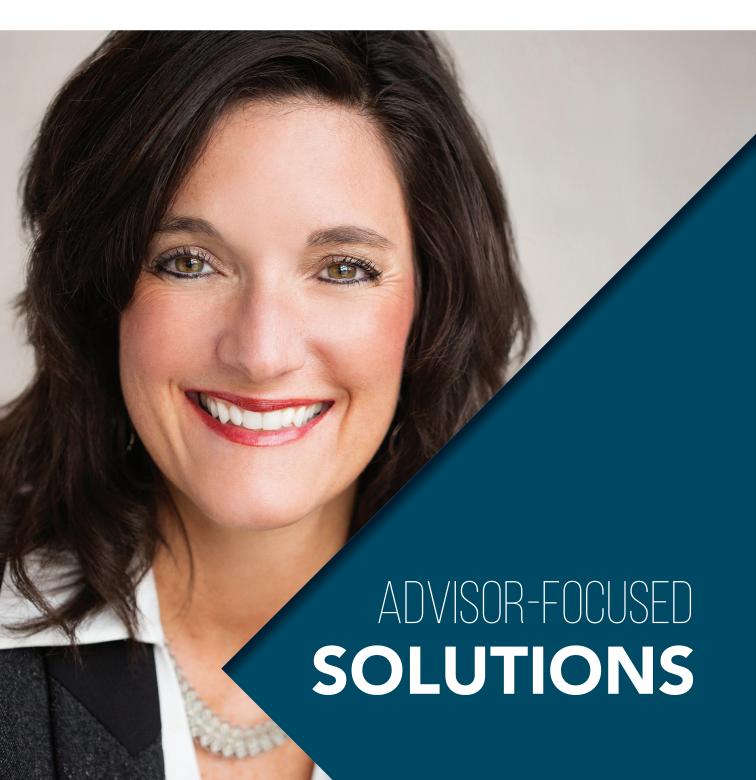
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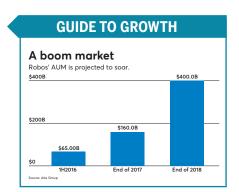
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Robo Advisors' AUM Is on the Rise

Assets under management for robo advisors are rocketing and show no signs of slowing down. Robo AUM is projected to top \$160 billion by the end of the year and could swell to \$400 billion by the end of 2018, according to research from Aite Group. Some firms are developing new technologies while others are turning to partnerships with digital startups. Will digital startups or traditional wealth management take the lion's share of the robo segment? To find out, go to: http://bit.ly/2umELQV



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EDITOR'S VIEW

The Name Game

The most difficult challenge for a new firm? For some, it's not location or even hiring, advisors say.

AT FIRST GLANCE. THESE THREE ADVISORY FIRM NAMES SEEM LIKE

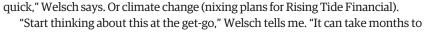
perfectly acceptable choices: Kelly Wealth Management, Rising Tide Financial Planning, Mi Vida Financiera. Yet founding advisors rejected all three. Why?

The answers are myriad, complex and based as much as on psychology as science. In the first case, the practice, which was going through a growth spurt, wanted a name that was not tied to the founder, Leo Kelly. In the second, the firm wanted to avoid imagery tied to climate change. And the third firm loved using Spanish in its

name, but wanted to be sure the appellation would still suit the practice when new planners joined.

Picking a moniker is one of the hardest challenges for new firms, says Senior Editor Andrew Welsch, who wrote "Identity Crisis" (p. 52). "It is particularly challenging when more than one advisor is involved," he tells me. "I guess it's like trying to pick where to eat for dinner when there are six people with completely different tastes."

The difficulty is compounded because many names have already been taken, he adds. Plus, there is certain imagery many advisors want to avoid, "such as get rich



"Start thinking about this at the get-go," Welsch tells me. "It can take months to land upon the right name."

NEW THINKING ON HSAs

Once advisors have picked the perfect moniker, it's time to prepare clients for the latest innovations in retirement planning. For many planners, developing expertise on health savings accounts can't come quickly enough.

Assets in these plans have increased exponentially over the past 10 years, according to this month's feature, "Rethink HSAs" (p. 36).

"Hockey stick growth will continue," says Senior Editor Charles Paikert. "I've been hearing about HSAs more and more over the past year, culminating in the publicity they got as a prominent feature of a Republican proposal to replace Obamacare."

Despite some demerits, which include recurring fees, Paikert says, "their future is very bright."

Bright future. That's exactly the attribute many practice founders want to indicate when picking firm names. Too bad it's already taken. —*Chelsea Emery*

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RETIREMENT ADVISOR CONFIDENCE INDEX

Planners Urge Discipline

Improvement in business conditions accelerates as bull run overwhelms qualms about valuations.

STRONG ECONOMIC FUNDAMENTALS AND

optimism around early summer's stock gains have pushed client risk tolerance higher, according to *Financial Planning's* latest Retirement Advisor Confidence Index.

Investor confidence — or at least the instinct to get in on the upswing — accelerated the pace of equity inflows. And growth in assets under management, in turn, pushed retirement service fees higher.

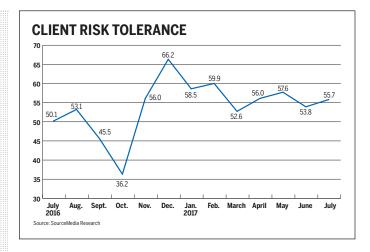
Those factors were the strongest in generating a 0.5-point monthly gain to 54.1 in the composite index, which tracks asset allocation, investment product selection and sales, client risk tolerance and tax liability, new retirement plan enrollees and planning fees.

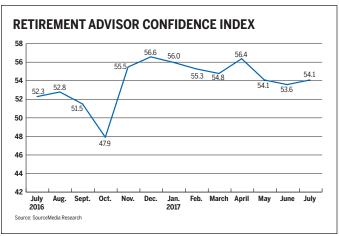
Readings above 50 indicate improving business conditions, readings below 50 indicate deterioration.

The index's risk perception component has been teetering in recent months. The latest gain of 1.9 points to 55.7 followed a 3.8-point dip. But the trend line has stayed above 50 since November, indicating uninterrupted increases in risk appetite. To be sure, some advisors say that clients still harbor some worries about a possible correction and the prospect of a fiscal train wreck over the debt ceiling.

More immediately, some planners say clients are falling prey to ill-advised momentum plays by "jumping on the train" and "chasing gains." Many planners reported they're urging clients to be disciplined and counseling defensive moves into cash and bonds.

"I am advising my clients to take some position in





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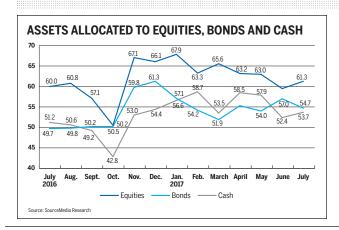


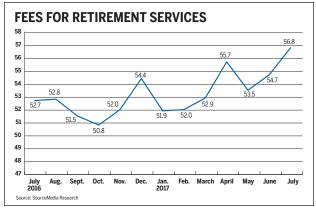
cash, and to expect a correction probably of 10% to 15%," one planner says.

After July's stock market gains lifted clients' net worth, however, there was plenty of money in motion. Flows in equities, bonds and cash instruments continued to grow, with the RACI components tracking them all remaining comfortably above 50. The equity flow component was the

strongest, with a 1.8-point increase to 61.3. Many advisors say increases in client wealth — and consequently AUM — were also behind the favorable trend in wealth management income.

The RACI component tracking fees charged for retirement services rose for the second consecutive month, reaching its highest level in more than a year at 56.8. – *Harry Terris* FP





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INDUSTRY INSIGHT VICES

A Youth-Led Rebellion Is Brewing

Will young RIAs lead the profession's second uprising against the established status quo? Bob Veres is hopeful.

I'M A BIT HORRIFIED BY WHAT I HEAR

from younger advisors today. They say they want to take the next step in their firm's evolution. They say they want to bring financial planning to the blue ocean of younger, not-yet-wealthy individuals who were, ironically, the same type of people that their firm's founder worked with in the early days.

They want to implement robo advisor technology and change their company's fee structure from the old AUM model to something that matches, with more precision, the fee charged for services.

But that is not what I am horrified by. I'm horrified by what happens when they propose these ideas to their firm's founding planner. Too often the answer is a variation of: "You can make all those changes after I retire"

I've actually challenged those senior planners: When will that be? The advisor will smile and say, "I actually never plan to retire."

DRAMATIC DEPARTURE

When I started out following the industry in the early 1980s, advisors were leading a glorious revolution against a stodgy industry. Their first big innovation was the idea that you should sell only the investment products and insurance coverages that people actually needed, based on a new kind of analysis called a financial plan.

This was a dramatic departure from the

typical sale, which proceeded from: "How much money do you have?"

Then, in the early 1990s, a small group began charging only fees for their services. Forward-thinking advisors moved beyond the venerable investment pyramid and began managing portfolios under the mathematical logic (borrowed from the pension consulting industry) of modern portfolio theory. Many advisors embraced the deeper client relationship called life planning.

IDEALISTIC DYNAMOS

The professional advisors I knew were, for the most part, idealistic dynamos of change and innovation, who saw themselves as revolutionaries on behalf of their clients.

Of course the brokerage industry responded to these innovations, but it was kind of lame. The wirehouses introduced canned financial plans and fee-based wrap accounts with an annual 3% all-in fee structure. Life planning was boldly met with advertisements that made it sound as if brokerage representatives had been hired to look after the personal goals of their customers, rather than respond to the orders barked over a squawk box.

WHAT'S CHANGED

The planning profession has simultaneously reached a time of rapid evolution and managerial stagnation. Software is tak-

The planning profession has simultaneously reached a time of rapid evolution and managerial stagnation.

ing over many of the menial chores that once required hours, days or even weeks in the planning office, including automated online performance statements and rebalancing; automated downloading and reconciliation; online client intake forms; tools and self-discovery questionnaires to ready clients for the initial meeting; automated forms generators and electronic signatures for transferring assets and opening new accounts; custodial online tracking of check requests and money movement; single-sign-on for all your software; plus video conferencing to save clients the trip to the office.

Collaborative planning and a pleasant onboarding process that explores life goals first and portfolios later is transforming the client experience.

For the first time too, ordinary consumers are asking advisors if they are willing to act as a fiduciary, thanks to the debate over the Department of Labor rule.

COLLECTIVE IMPATIENCE

While the older generation of advisors who used to drive forward change are recoiling from all these potentially beneficial changes, a generation of younger advisors is chafing with collective impatience.

They feel as if they owe it to their generation to bring the many benefits of financial planning into their lives and they want to start their own prospecting process and build their own client base.

Founding advisors — people who themselves worked with their unwealthy peers back in the day — are complaining that their successors are simply not working hard enough to bring in the aging decumulators who have become their firms' sweet spot.

Perhaps more importantly, the founding generation of advisors somehow allowed their revolutionary spirit to ebb away in the daily effort to maximize profits, generate new business and handle the day-to-day managerial chores associated with a real business.

Financial planning is, at its core, an ideal-

istic alternative to the brokerage industry's founding idea that giving advice is about maximizing profits. But when you talk to many founding advisors today about what's new in their business, you hear about performance metrics.

THE NEXT REBELLION

I'm going to predict that the financial planning profession is about to go through another revolution.

Thousands of younger advisors, fed up with the restrictions at their sclerotic firms, more intent on changing the world than squeezing every last dollar out of their engagements, are going to go out on their own and harvest the next generation of clients long before they'll reach the minimums set by many planning firms today.

These younger firms will struggle at first, just as the founding generation of financial planners did. But with better utilization of technology, they'll be more efficient than the larger firms, and more receptive to client needs — and they'll offer their services at a better price point.

They will, in short, lead the profession's second rebellion against the established status quo, just as the founders of the financial planning movement did, and the profession will once again evolve in ways that dramatically benefit both advisors and clients.

CHANGE IS INEVITABLE

The older advisors who don't want to change will get their wish: they'll work until they drop with an increasingly aging cohort of clients whose heirs will take their inheritances to the younger, vibrant firms that are already helping them achieve their goals.

And I hope that after this next revolution has played itself out, planners will have finally learned a lesson that many of my own generation somehow forgot.

This message is that dramatic change is not just necessary; it is inevitable and it is the small, still-growing profession's everconstant best friend in the competition with the larger brokerage industry.

I'm going to predict that the planning profession is about to go through another revolution.

Bob Veres, a *Financial Planning* columnist in San Diego, is publisher of Inside Information, an information service for financial advisors. Visit financial–planning.com to post comments on his columns or email them to bob@bobveres.com. Follow him on Twitter at @BobVeres.



BOWEN

The Reluctant Manager

Video

There are several methods managers

can use to encourage employees to

work together.

http://bit.ly/2fycLn3

You set out to be an advisor, not an administrator. Here are three steps to get your team to deliver outstanding results, John J. Bowen Jr. says.

YOU BECAME AN ADVISOR TO HELP

make a difference in your clients' lives — not to manage people. And yet, here you are with a team. Many advisors struggle to get their teams to generate high-performance results. In my consulting firm's coaching programs, we estimate that more than 80% of advisor teams aren't getting the results they want.

Here are some of the biggest challenges:

- Empowering team members to be involved in decision making.
- Compensating members appropriately.
- Getting individuals to march together

toward a common goal.

I'd bet at least one of these concerns has kept you up at night. In particular, compensation is a sore spot. Advisors often think if

they solve that issue, they'll have a great team.

But the reality is that there are more foundational issues that must be addressed — like your purpose and the reason your team exists. Compensation, while important, is not a magic pill that solves all issues.

Here are three important elements in building a high-performing team:

PROVIDE CLARITY

1. Convey a clear mission and purpose.

Establishing a common purpose is espe-

cially crucial. If you are the leader, you must provide clarity so that everyone in your organization knows why the team exists and what it is meant to accomplish. If your leadership is accompanied by clear goals and a sense of purpose, you can have a 24% boost in productivity, according to the consulting firm Moss Adams.

To begin, you need to have a clear mission. Ask yourself: What is my vision? Why does my team exist? Use the answers to create a picture of where you are now, where you want to go and recognize the gaps in

between. True clarity results from having four components in place:

- Clearly defined and communicated firm goals.
- Clearly documented and com-

municated roles for all employees.

- Clearly communicated performance reviews and expectations.
- Clear career path and team structure.

As you can see, communication is a key. It's relatively common to encounter advisors who can tell you their mission statement and goals. But when you ask them if anyone else at the firm knows those things too, for many the answer is no.

Advisors want to grow, but they often don't get their teams involved in setting

To begin, you need to have a clear mission
— a firm idea of where you are now, a vision of where you want to go and a recognition of the gaps that need to be bridged.

growth goals and other objectives. Your team needs to understand what you want to achieve as an organization both quantitatively (more AUM, for example) and qualitatively. As the team leader, you are probably dialed in to those goals, but I'd bet that others in your firm are much less clear on them.

Consider meeting with your team and asking members what success looks like. Ultimately, you want everyone to be able to fill in the blanks to the following statement: "We will go from ____ to ___ by ___."

ENCOURAGE COLLABORATION

2. Establish standards that encourage mutual respect and collaboration.

Chances are, you have guiding principles for how you work with clients, but few advi-



Managers can build better teams by embracing the U.S. Navy's Blue Angels' model that everyone's opinions should be respected equally in team meetings.

sors create such principles for their internal teams. Once you have common goals and the team buys in, how are you all going to work with one another and what standards will you adhere to?

Here are some standards that are effective at inspiring greatness from teams:

- The opinions of all team members are equally valued.
- Problems not people will be discussed, analyzed or attacked.
- Once we are in agreement, we will all speak with one voice.

- Consensus, not democracy. We all get our say, not necessarily our way.
- Silence equals agreement.

Some people have a hard time accepting that all team members' opinions are equal. But consider this: The U.S. Navy's Blue Angels flight demonstration squadron has this standard when they debrief after a mission. There's no rank at those meetings. Each member can say what he or she wants.

If you have standards that, "It's my way or the highway," you will squash any inspiration that would otherwise motivate team members. Advisors who communicate such standards formally — such as in a written document for every team member — find that buy-in becomes easier because everyone's opinion is considered.

Standards also fuel collaboration because

they instill trust. Have you ever had team members who either can not communicate with each other or fight when they do? Standards help people have the debates that lead to decisions the whole team can support.

DIVERSITY OF SKILLS

3. Fitting skill sets together.

We surround ourselves with people who think just as we do. These people feel most comfortable to us. And that approach might work when your team is very small.

But as you seek to expand further, you'll find that everyone's skills start to overlap; this can hamper your growth. The most inspired teams I see have a diversity of skills, experiences and knowledge. That diversity helps them think creatively in ways that generate exponential growth and improvements to their businesses.

A team is like a jigsaw puzzle — there are lots of individual pieces and it's not always clear how to make them fit. But by taking the types of steps outlined above, those puzzle pieces will start to come together.

Standards for behavior within the team fuel collaboration because they instill trust and openness among team members.

John J. Bowen Jr., a Financial Planning columnist, is founder and CEO of CEG Worldwide, a global coaching, training, research and consulting firm for advisors in San Martin, California.



NEW GENERATION GRANT

Look for That Silver Lining

For an advisor who has lost a great client or staff member, it's natural to feel upset. But there's a better way to respond to challenges, Dave Grant says.

IN THE COURSE OF ONE'S PRACTICE,

every advisor will at times find himself in a tough spot. Even the best-laid business plans can be disrupted by the sudden loss of a major client. For any advisor caught in trying circumstances, it's natural to feel upset. But there's a more constructive way to respond to challenges.

Sometimes we've sighed in relief when a client decides to cut ties, as they're not our ideal customer. But when others leave, it feels as though we're saying goodbye to a family member.

As we're in the helping profession, these situations can feel as if we haven't done our job to the best of our ability. When a client says, "I don't need your help," it causes us to reel back and ask, "Why not?"

The first instinct is to feel offended. But instead, consider how their departure makes room for another client who has been searching for our exact services among the plethora of advisors.

For advisors who solely focus on planning, the relationship can come to a natural conclusion. The pain level that caused the clients to come into the office has been addressed. They now feel equipped to navigate their financial life by themselves.

This decision is a powerful reflection on our skills as planners: We've educated and empowered an individual (or partners) to a point where they feel confident to go it on their own. For situations like this, we should be acting like a mother bird — it's time to encourage our young children to fly, because if they don't leave the nest we won't have room for more.

IT TAKES TWO

But the dynamic can change when this departure is a staff member. This individual worked alongside you to guide clients and now feels that he or she should work somewhere else.

As a business owner, it is easy to take this personally and subscribe to the notion of, "It's not me, it's them." But let's be honest; it takes two to break up a relationship.

There's a familiar saying: "Employees don't leave companies, they leave bosses." While this is only partly true, relationships play a big part in why employees choose to stay with a company or find somewhere else to go. I've left two planning companies before starting my own — with very different departures.

One held a pompous send-off, but the well-wishes felt empty and forced and cutting words were said in private. The key relationships had broken down.

Another company could not have been more supportive and sent me with best wishes into my next opportunity. I still look back at that firm as one of my favorite places to work

You should view your company as a living entity. At various times, it's going

One company held a pompous send-off, where wellwishes felt empty and cutting words were said in private. to need certain skill sets and professional abilities. But when that time passes, these employees will move on to where they are needed, leaving room to bring in an individual who possesses skills needed for the next phase. It's best for all involved; why would you want to retain an employee or colleague who is not completely committed to the company's vision?

Before they leave, it's also an opportunity to evaluate if that skill set is still needed — can the workload be shared among other staff members, and who is the ideal person who can be added to the firm? The departure of a colleague forces a period of self-reflection that is hard to come by in our fast-paced business. When a team member leaves, it should always be viewed as the progression of the business.

REKINDLE THE FLAME

These scenarios aren't always driven by people. For example, if the market declines significantly, AUM-based advisors are confronted with additional work educating and consoling clients but for less income. No one is at fault in this situation, and it's not something that can be fixed — only time and improving economic conditions can resolve it. While income may have declined, there still are so many positives in this situation.

If the client relationship has gone through a dry patch, it's the perfect time to rekindle the flame and show them how much you understand and are working for them. Bringing a sense of stability to a client relationship in a troubling time can cement it for years to come. You can educate clients about the workings of your team and introduce them to other members who work for them. It's also a time to get to know clients' personal situation.

By uncovering what's important to them, you can deliver a more meaningful financial plan in future meetings. An added benefit: they may also tell you about friends and family members who are looking for financial guidance at this time. This time is also an opportunity to show less experienced team members how client service can be done under trying circumstances and also how technical analysis can be carried out when short-term investment returns might interfere with the success of clients' financial plans. A market downturn is part of a normal economic cycle and keeps advisors from becoming complacent.

REACHING OUT

It's obviously difficult to find the silver lining in a tragic situation or during personal hardship. As people, it is almost impossible to compartmentalize and achieve peak performance in our professional lives while suffering trauma in another.

Our work will suffer and our relationships will be tested. We should be reaching out to others to help carry our burdens at that time. This is where a positive outlook can help. By leaning on others, we realize the generous nature of those we work with and those who support us in our personal lives. Going through something traumatic forces us to not be an emotional island and to use the gifts of those around us.

The experience can also help us to better understand clients going through their own difficulties. When we are forced to prioritize our life, placing what matters most at the forefront, we can understand that while clients pay us for guidance, they are also human and may want to help in ways that goes beyond the professional relationship.

We should embrace human nature at this point and not be constrained by a professional relationship — and in doing so, find that the professional relationship is strengthened for years going forward.

We will experience unfortunate circumstances throughout our lives and we can choose to let them dominate our thoughts and actions.

But by deliberately looking for the silver lining in every situation, we can take the power over the moment and choose how it affects our lives.

Bringing
a sense of
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years to come.

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



Rethinking Compensation

It may be time to update your salary strategy to encourage better performance and attract promising job candidates, Kelli Cruz says.

AS WE ENTER FALL AND THE FOURTH

quarter, you may be pondering a change to your compensation structure for next year.

Although it is extremely critical to develop a salary plan that is profitable for the company, I suggest considering the broader business context first when making changes.

This involves reviewing your firm's strategic priorities, the product and service mix and the approach to finding new business and retaining existing clients. This analysis will help to determine which incentives and pay rewards should be offered.

At its core, a compensation plan can be a recruiting tool, a retention tool and a communication tool for expressing what's important to the organization.

TARGETING MILLENNIALS

Beyond reflecting the core values of your firm, a compensation plan needs to be effective. It should engage and motivate your current employees, and attract future employees. This means moving from a traditional benefits-based plan to a more competitive values-based plan to ensure you're engaging the millennial generation.

Misunderstanding millennial employees could have a devastating effect on a business, according to new research from the insurance brokerage Hub International.

As the largest generation, millennials present a growing influence in the work-

place. This is what the survey found:

- Over 60% of respondents ranked competitive base pay as their No. 1 factor for staying with their current employer. Over 80% ranked competitive base pay first, second or third. Survey respondents ranked merit increases as least important.
- While competitive base pay was the top factor, 45% ranked career opportunity, interesting and challenging work, and incentive opportunity as first, second or third.
- Almost 50% of respondents expect to change jobs within the next six months because of a lack of competitive base pay, career opportunity or interesting work.
- Most survey respondents (92%) agree that competitive base pay and being paid for the value they bring to the company are important. A majority (90%) indicated that understanding how their job impacted the success of the company was very important (56%) or important (34%).
- 75% of respondents said incentive or bonus programs fail to use individual performance results in calculating payouts.

Most advisory compensation plans provide base salary, incentives, paid time off or vacation and such traditional benefits as a retirement plan and medical and life insurance.

Largely, these plans have been created by the founder or owner, who is most likely of the baby boomer generation.

Variable or nontraditional benefits are

To attract millennial employees, you may need to move from a traditional benefits-based plan to a more competitive values-based plan.

what millennials deem as competitive, such as flexible work schedules, telecommuting or working from home, subsidized training programs, maternity/paternity leave, subsidized meals, bonus days off, wellness benefits and college tuition/assistance programs.

Firms should look to understand what motivates millennials and best serves their compensation desires in order to attract them as prospective employees.

COMP 101

Base salary is fair compensation for an employee's roles and responsibilities. Your plan should define a salary range for each position based on the value of the position to the firm and the market value of the position. You should regularly revisit the salary range and adjust as needed.

Here are a suggestions to keep in mind:

- Move an employee within the salary range only as her job size, responsibilities and skill sets change.
- Beware of cost of living adjustments since they increase a firm's fixed costs and are not tied to measurable results that have a positive impact on the firm. Most employees are not actually motivated by cost of living raises and tend to regard them as an entitlement or a guaranteed benefit.
- Avoid paying base salaries that are below the industry average in exchange for offering more in profit sharing or retirement benefits. While this approach may motivate your highly compensated staff, it can lead to turnover in your support staff or entry-level employees.

In contrast to base salary, incentive compensation is variable pay for meeting or exceeding goals that are tied to the overall strategy and vision of the firm.

Incentives illustrate to employees the financial partnership between their individual efforts and the results of the firm. Incentive plans are not a replacement for performance management and should not be used to force a certain behavior, replace active and open communication, or fix a firm's culture.

Advisor incentive goals are usually

based on an individual's total revenue production — new revenue and total revenue that is managed for existing clients. These incentives should also include client production, new clients gained through referrals and the retention and satisfaction of existing clients.

Here are examples of such goals: In client retention, the advisor must retain at least 95% of his clients during the year. As for new revenue, a reasonable expectation is for the advisor to obtain \$50,000 of new annualized revenue from external sources and referrals from clients during 2017.

SUPPORT STAFF

Support staff roles tend to be more difficult to incentivize, as these positions have less impact on the client and results can be harder to measure.

A few examples of potential projects or initiatives for support staff that can be measured include: client segmentation projects, client events, marketing projects, technology projects, client service delivery improvements, developing new skills and attaining certifications.

Team incentive metrics can help motivate and reward groups of employees who are responsible for accomplishing larger firm initiatives.

Examples of such initiatives are selecting and implementing a new software system; updating the firm's website; taking part in social media campaigns, client newsletters and other communication projects; and moving to a new office or expanding the current office space.

The key concept here is that the members of the defined team are eligible to receive the incentive as long as the goal is achieved. This motivates the group to work together to accomplish the goal within specified time frames.

Finally, whether you decide to completely overhaul your existing plan or just make some tweaks, ensure that you create a process for tracking and monitoring the results to avoid problems in determining the final payouts.

Beware of cost of living adjustments since they increase fixed costs and are not tied to measurable results that have a positive impact on a firm.

IF YOU THINK CLIENTS DON'T NEED AN ANNUTY TALK TO SOMEONE WHO OWNED ONE IN 2008.

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LPL FOCUS CONFERENCE

Doubling Down

As the independent channel becomes ever more attractive, the country's biggest broker-dealer intends to become even more aggressive.

BY CHARLES PAIKERT and SCOTT WENGER

LPL FINANCIAL IS ALREADY THE COUNTRY'S LARGEST

independent broker-dealer, but conditions are ripe for the company to be even more aggressive, a senior executive says. "Now is a great opportunity to double down on our core businesses," Bill Morrissey, president of LPL's business development division, said in an interview at the company's annual Focus conference in Boston.

The growing independent channel is becoming even more attractive for advisors, according to Morrissey, who is also an LPL managing director.

"Compared to five years ago, the barriers to going independent have really gone down," he said. "We live in an



Bill Morrissey says LPL's biggest obstacle in recruiting is inertia.

A Winning Combination

Automation and behavioral management will be critical components of LPL advisors' arsenals in the months ahead, CEO Dan Arnold says.

BY TOBIAS SALINGER

ADVISORS MUST USE AUTOMATION AND BEHAVIORAL

management alongside portfolio and planning services to be competitive in the future, according to LPL CEO Dan Arnold.

"If you're providing [all three], then your pricing is going to be a whole lot stickier," Arnold told reporters at the annual Focus conference.

"Maybe I have to discount my pricing 10% to 15%. But if we can give [planners] automation that helps them scale their practice, maybe I could handle 30% to 50% more clients. We'd all take that trade."

Arnold gave hints about the firm's plans for the coming years, discussing both an upcoming app for clients and the possibility of an Alexa-like gadget for advisors.

The chief of the largest independent broker-dealer offered a hopeful view amid gloomy predictions of lower advisor head counts, downward pressure on fees and the prospect of robots replacing humans. Advisors will have to "expand the value proposition" by going beyond their traditional services, though, Arnold said.

"The third scenario that I really like is when advisors are doing portfolio construction, they're doing planning, but they're also doing the behavioral management piece of it, where I'm spending time making sure we built a plan and I help the client execute it," Arnold said. "That's where we see this pivot, this evolution for advisors, where we want to make planning more mainstream."

open-architecture world in which technology is ubiquitous."

LEVERAGING SIZE AND SCALE

What's more, macro trends impacting the industry — such as margin compression, regulatory pressure, clients switching to individual securities from packaged products and the decline of actively managed funds in favor of passive investments — all benefit a firm with LPL's size and scale, Morrissey contended.

About one-third of LPL recruits come from wirehouses, he said. It's a pipeline he expects to remain steady as wirehouses withdraw their generous bonus programs and suffer from attrition. What's more, "they don't offer the kind of succession planning that advisors are looking for," he added.

RIAs account for about one-third of LPL's recruits, while 20% come from the insurance sector and about 10% from

the bank channel.

But LPL's biggest obstacle in recruiting is inertia, Morrissey said. "It's such a fierce competitor," he explained. "If you're a successful advisor, making a change is unnatural. You wonder if clients will follow, who will help me and what happens next."

To ease the anxiety for advisors switching firms, LPL's Business Transition Partner group focuses on advisors' experience. "We measure the speed in which the transition takes place, the asset capture and the net promotion approach, a measure of the advisor's satisfaction," Morrissey said.

Although LPL has lost some ground in the latest FP50 IBD head count rankings, Morrissey said he is unconcerned.

"We're focused on recruiting the right advisors with the right characteristics," he said. "We measure success by our ability to increase asset capture and gross profits."

Charles Paikert is a senior editor of *Financial Planning*. Follow him on Twitter at @paikert. Scott Wenger is group editorial director of SourceMedia's Investment Advisor Group. Follow him on Twitter at @ScottWengerNYC.

THUMBS UP

LPL recently unveiled a no-load mutual fund platform slated for next year, and also lowered fees and added more investment options in its separately managed accounts. The app will show clients a live scorecard based on their goals, and Arnold gave his support for an automated service for advisors.

Asked about the prospect that advisors will one day use an Alexa-like virtual assistant to help them manage their practices, Arnold gave a thumbs up.

"I think whether it's that or whether it's a similar type of technology where you see data meeting artificial intelligence, ... that's where we see real opportunity to continue to evolve this business and reshape the value proposition."

HINTS FOR THE FUTURE

LPL wants to connect data and artificial intelligence "to create an enhanced investor experience," he added.

Executives' other plans for 2018 and beyond include a



CEO Dan Arnold foresees "data meeting artificial intelligence."

focus on training new advisors, in addition to the firm's traditional recruiting. Next year, LPL will begin a pilot experiment with as few as 20 to 30 individuals that is designed to identify the best prospective advisors and connect them with mentors, Arnold said.

Tobias Salinger is an associate editor of Financial Planning, On Wall Street and Bank Investment Consultant. Follow him on Twitter at @TobySalFP.

Siblings And A Parent's Death

Upon the death of a parent, financial advisers are often sitting down for the very first time with their client's children, and often have to deliver difficult news about how the parent wanted their wealth apportioned among siblings. Dr. Kirsty Archuleta, Program Director of Personal Financial Planning at Kansas State University and a Hartford Funds Human-Centric Insights panelist, discusses how advisers can move beyond the emotional landmines buried in decades of family history.

What kind of issues between siblings can be prompted by the death of a parent?

A lot of times, parents are the people who helped keep the relational dynamics calmer; families gather for holidays, and everyone's on their best behavior to make the event work. But when a parent dies, that can raise some of the unresolved conflicts or competitions that have built up over the years.

Why is it easier for siblings to deal with their family dynamics issues if a parent talks to them about their estate plan?

The conversation sets up up the expectations. Imagine a family has an estate that includes farmland and some cash. The parents may have decided to give Sally more land, because she and her husband can help run the farm currently, but to give her brother Billy more cash and less land, because he lives far away. What if Billy was expecting more land because he spent more than than Sally helping his dad farm when he was growing up, and feels a deep connection to it? He never communicated his desires to his parents but assumed that his parents would give him half of the land when their parents passed. If that's never discussed before the death of the parents, the siblings may have very difficult expectations about what they will receive from the estate.

Estate planning conversations between parent and children can be difficult. But open parent-child conversations can help children understand parents' decisions, rather than waiting for them to sort it out after they've died.

Why should parents avoid giving one of the siblings a durable power of attorney for their health care decisions?

If you have another trusted person available, using that person can help reduce the amount of conflict among siblings. If a child is making these health care decisions for a parent, siblings may disagree about the decisions, pointing blame to the appointed person and creating conflict among siblings. It may be a replay of that childhood rivalry. Having another person other than the children as the decision-maker takes the pressure off of the siblings.

When siblings do come into conflict over an estate plan, how can financial advisers address it?

Advisers need to bring everybody into the room, even though it will be a difficult conversation. The financial adviser has to focus them on their common interests going forward, which will lessen their tendency to point fingers at one another over decades of perceived slights and injustices. It may be necessary to bring in a family relationship expert to help siblings process feelings so the emotional and wealth transfer processes can move forward.

The financial adviser needs to be empathetic and genuinely caring as the loss of a parent can be incredibly difficult, regardless of the type of relationship the child had with the parent. Differing reactions from siblings to the death of a parent is normal. Take time to truly listen to the children. Then, identify the tasks the children need to do, and help assign specific, doable tasks to each child that will focus the children on moving the wealth transfer process forward as a team—like gathering certain documents, filing taxes or contacting certain professionals, like insurance agents or accountants.

To learn more about investor psychology and how FAs can better communicate with their clients, go to Hartford Funds' **Humancentricinvesting.com**



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Dr. Barbara Nusbaum

Clinical Psychologist, Ph.D., expert and speaker, specializing in the intersection of money, psychology and life.

She has appeared as an expert for CBS News, Forbes, The Wall Street Journal, Bloomberg, Money Magazine, Daily Worth and The New York Times.



Dr. Kristy Archuleta

Program Director of Personal Financial Planning at Kansas State University

Dr. Archuleta's research relates to the area of financial therapy and includes dyadic processes influencing financial and marital satisfaction.



Dr. Vicki Bogan

Professor and Director of the Institute for Behavioral and Household Finance (IBHF) at Cornell University

The mission of the IBHF is research and education in the areas of behavioral finance and household finance with the goal of better understanding and modeling financial behavior.



Tim Sanders

Author and expert on motivation, emotional talent and sales innovation

Tim is the author of five books including the New York Times bestseller Love Is the Killer App: How to Win Business & Influence Friends. Tim was the Chief Solutions Officer for Yahoo, as well as their Leadership Coach.



Gail Blanke

Celebrated motivational speaker, renowned personal life and executive coach and best selling author, whose vision is to empower women worldwide to lead exceptional lives.

She has appeared on The Today Show, Oprah, CBS and CNN.

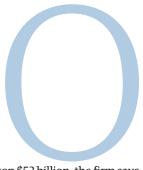


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RETHINK HSAs

These plans once merely supplemented health insurance. Now they are a vital part of a broader retirement strategy.

BY CHARLES PAIKERT



nce a retirement planning afterthought, health savings accounts are now a centerpiece of the conversation.

In the past 10 years, HSAs — tax-favored accounts that allow users to save for health care costs their insurance doesn't cover — have exploded in popularity. Total assets have rocketed to \$37 billion in 2016 from \$1.7 billion in 2006, according to the consulting firm Devenir Group. By next year, HSA assets are projected to

top \$53 billion, the firm says.

Public awareness of the accounts got a boost this summer when HSAs were prominently featured in a Republican plan to replace the Affordable Care Act. And the Department of Labor's fiduciary rule requiring advisors to put their clients' interests first has also enhanced the growing importance of client-friendly HSAs.

"Advisors can't ignore HSAs anymore," says Leo Acheson, a senior analyst at Morningstar. "They're becoming more prevalent and more effective as a vehicle to save for health costs in retirement, compared with 401(k)s or IRAs."

Advisors are, in fact, increasingly enthusiastic about HSAs as an integral part of retirement planning. Above all, they praise the triple tax advantage of the accounts: money is deposited tax-free, grows tax-free and can be withdrawn without paying taxes as long as the money is spent on health and medical expenses.

"From a tax perspective, it's incredible," says Jeff Birnbaum, principal of On Point Financial in New York City. "You just don't get many opportunities like



Nadine Lee, left, and Vicki Fillet Konrad are big fans of HSAs, but say that a client's situation must be considered closely. Lee advises clients to view an HSA as a more conservative investment than other types of retirement accounts, while Konrad encourages millennials to be aggressive in their investment choices within their HSAs. that in the tax code."

Nadine Lee, a planner and managing director of metro New York offices for Colony Group, agrees. "HSAs are as tax-efficient as is possible," Lee says. "The power of compounding interest is magical, and I'm seeing couples amass over \$30,000 in savings through HSAs. That really pops."

SAVINGS VEHICLE

Some advisors, like Vicki Fillet Konrad, founder of Blueprint Financial Planning in Hoboken, New Jersey, advocate HSAs as "a really good savings vehicle."

If her clients can afford to pay their present medical expenses out of their current cash flow, Konrad says, she encourages them to use HSAs for long-term savings. Unlike the case with IRAs, there are no minimum distribution requirements and no requirement to begin withdrawals of HSAs at a certain age.

The maximum allowable contribution to an HSA in 2017 is \$6,750 for families and \$3,400 for individuals,

For some clients, Birnbaum and other advisors say, paying off outstanding medical expenses with HSAs should take priority over savings. "You need to take care of current obligations first," Birnbaum says.

He adds that advisors should also investigate clients' other health insurance options before recommending HSAs, which are available only in conjunction with high-deductible health plans. "If someone ends up paying more for medical expenses compared to what they would have paid with a lower-deductible plan, those additional outlays might leave the person in a worse financial position than if they had the benefit of a plan with a lower deductible," he explains.

Rather than saving for retirement, in such cases someone would be left with less for retirement.

If an HSA is appropriate for a particular client, he or she must then decide what kind of plan to enroll in and what investments to purchase.

Some 400 to 500 plans are available from providers, according to

medical expenses. That plan was the HSA Authority, offered through Old National Bank.

"The industry has a lot of room for improvement," the report concluded.

Advisors should carefully check an HSA's recurring fees and interest rate for clients with savings needs, Acheson says. For clients able to focus on savings for future withdrawal, advisors should evaluate asset classes offered, allocation options, investment quality and costs, particularly the underlying fund fees.

"Much like the 401(k) market, fees vary wildly from one provider to another," the Morningstar report says.

Some monthly account maintenance fees were as high as \$4.50, the report noted, while some providers waived the fee if accounts had more than a stated minimum and still others, decidedly a minority, did not charge a fee at all.

CAUTIOUS ABOUT RISK

Lee says she advises clients to view HSAs as more conservative investments than traditional retirement plans. "If they need the money for medical expenses, chances are those events will happen earlier," she says, "so you can't take as much risk."

Konrad says she encourages younger clients to be more aggressive in their investment choices, especially millennials with a longer-term investing horizon. "I've found that millennials are very savings-minded," she says. "They see HSAs as a medical 529 plan. I tell them to make the investments automatic and don't use the plan as a trading vehicle. Set it and forget it."

Indeed, most clients keep their HSAs assets in cash, according to the Employee Benefit Research Institute, so advisors should remind those with an ability to take on greater risk that a variety of mutual fund options are available in most health savings plans.

AFTER ANALYZING 10 OF THE LARGEST PLANS, MORNINGSTAR FOUND ONLY ONE 'COMPELLING' AS BOTH A SPENDING VEHICLE TO COVER MEDICAL COSTS AND AN INVESTMENT VEHICLE.

plus a \$1,000 catch-up contribution for employees 55 and older.

Even if clients withdraw money from an HSA after age 65 and use it for nonmedical purposes, they do not incur a penalty, although they do have to pay taxes, Konrad points out.

Birnbaum, however, cautions that while HSA accounts and their triple tax benefits initially seem like an ideal retirement savings vehicle, advisors need to look at the big picture with individual clients.

Morningstar. "Despite the increased interest in HSAs, they remain a very under-researched corner of the marketplace," says Acheson, one of the report's authors.

After analyzing 10 of the largest plans — evaluating such criteria as monthly maintenance fees and mutual fund offerings — Morningstar found only one plan "compelling" for use both as a spending vehicle to cover current medical costs and as an investment vehicle to save for future

Advisors should also remind clients to ask their employers to match their HSA contributions, Lee says. "One of my clients is in his 40s, is very healthy and works in the tech business," she says. "He doesn't need much medical attention and wanted to save more money tax-free, so I encouraged him to sign up for a high-deductible insurance policy and open an HSA. Then he talked to his employer, who agreed to match his contribution, so he's now much better off than he was before."

Clients should also consider maxing out yearly HSA contributions, says Paul Norr, a financial advisor in Thousand Oaks, California.

A HUGE TAX BREAK

For Norr and his wife, a biotech executive, maxing out HSA contributions with a high-deductible insurance plan made more sense than having a traditional insurance plan and contributing the maximum to a 401(k).

"The tax breaks are huge for people in the upper 10% of incomes," says Norr, who is also a *Financial Planning* contributing writer. "At a 38% state and federal marginal rate, a \$7,700 HSA contribution saves almost \$3,000 in taxes."

Clients can also use their HSA accounts to pay themselves back for medical expenses they incurred in the past. "There are a lot of wonderful little wrinkles with an HSA," Konrad says. "It can be like getting an inheritance. You can go back to previous medical bills and reimburse yourself out of the HSA as long as you have proof that you paid the bill."

But determining eligibility for health savings accounts can be tricky, she cautions, since it's not always



Jeff Birnbaum, principal at On Point Financial, extols HSAs as "incredible" from a tax perspective, but cautions that advisors must make sure clients don't pay too much in fees.

clear whether a particular health plan meets the necessary requirement of being a high-deductible health plan. "All policies need to be checked to make sure they are high-deductible plans," Konrad stresses.

Advisors should also be aware of alternatives to HSAs, Lee says.

Among her clients is a married couple with two children expecting costly medical expenses; the parents expected to incur over \$15,000 in unreimbursed bills.

The husband had a full-time job as a CPA and was covered by traditional medical insurance, making the family ineligible for an HSA. But he was also working over 20 hours a week for his wife, who was operating a startup taxed as a sole proprietorship and reported on their joint tax returns.

"I advised the wife to formally hire

the husband and work with a benefits consultant to establish a formal Section 105 Medical Expense Reimbursement Plan covering all employees and their families," Lee says, adding that the husband's total compensation needed to be reasonable. "With a salary of about \$30,000 a year, a benefits consultant determined he could be reimbursed up to \$10,000 for family medical expenses."

The couple's joint tax return will show the wife's business declaring \$40,000 in deductions and additional W-2 income of \$30,000 from the husband. "We anticipate that the family will save about \$4,500 by eliminating \$10,000 from their gross income," Lee says.

THE IMPACT OF FEES

For clients who may need all the money they can get for medical expenses and can't risk losing any principal, Birnbaum says advisors should look carefully at how much fees are eating into health savings accounts. "Putting money in a savings account with no fee outside an HSA may be preferable," he says. "Fees charged by HSAs can be a big chunk of a small balance."

One of his clients, a woman in her 50s with heavy medical expenses, had an account balance of \$4,260, with account maintenance and expense ratio fees that could exceed 2%. "Based on the fees we saw, it didn't make sense to put money she needed to pay bills on an ongoing basis into a health savings account," he says.

The lesson for advisors, Birnbaum says, is to make sure an HSA plan, even if highly rated, is appropriate for each client's unique situation.



For your clients' are my investments still on track? side.



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NATIONWIDE SMALL COMPANY **GROWTH FUND**

Out of 599 U.S. Small Growth Funds 3- and 5-vr rating 5 stars out of 599 and 533 respectively.



NATIONWIDE CORE PLUS BOND FUND

Out of 856 U.S. Intermediate-Term Bond Funds 3-. 5- and 10-yr rating 4 stars out of 856, 767 and 540 respectively.



NATIONWIDE HIGHMARK BOND FUND

Out of 856 U.S. Intermediate-Term Bond Funds 10-yr rating 4 stars, 3- and 5-yr rating 3 stars out of 540, 856 and 767 respectively.



NATIONWIDE BAILARD INTERNATIONAL **EQUITIES FUND**

Out of 595 U.S. Foreign Large Blend Funds 3- and 5-yr rating 4 stars and 10-yr rating 3 stars out of 595. 533 and 342 respectively.



NATIONWIDE DESTINATION 2045 FUND

Out of 158 U.S. Target-Date 2045 Funds 5-yr rating 4 stars and 3-yr rating 3 stars out of 117 and 158 respectively.



NATIONWIDE DESTINATION 2050 FUND

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A Steep Price for Medicare

Planning may help high-income seniors avoid paying up to four times the going rate for Part B and Part D coverage.

BY DONALD JAY KORN

hen it comes to Medicare premiums, all is not equal for all clients. In 2017, the

standard premium for Medicare Part B is \$134 a month. Most enrollees pay for Part B via reductions in their Social Security benefits, and the overall average monthly fee is \$109.

Yet some seniors pay almost quadruple that much — \$428.60 a month (\$957.20 for married couples) — for the exact same medical insurance. That may displease even affluent clients.

Seniors who pay more for Part B also pay Medicare as much as \$76 per month extra for prescription drug coverage, known as Part D.

"This is the IRMAA," the incomerelated monthly adjustment amount,



Diahann Lassus of Lassus Wherley says transitioning dollars from regular IRAs to Roth IRAs can reduce RMDs in retirement.

says Craig Carnick, founder and president of Carnick & Kubik, a Colorado Springs, Colorado, advisory firm. "If people are on Medicare, and their tax return shows high income, Medicare adds the IRMAA amount to their monthly premium."

Modified adjusted gross income over \$85,000 (\$170,000 on joint returns) brings IRMAA into play, with amounts increasing as MAGI hits certain thresholds. (Here, MAGI includes tax-exempt interest income.)

Those MAGI thresholds won't increase with inflation until 2020, so more clients may meet IRMAA in the next few years.

THE TWO-YEAR LAG

The Medicare trustees' 2016 report projects that Part B monthly premiums, which have risen from a maximum of \$161.40 in 2007 to \$428.60 today, will continue to climb, reaching as much as \$564 in 2025. Thus, Medicare Part B is likely to become more of a financial planning issue.

How can planners make Part B less of a bother for high-income clients? One key is to realize that there is a two-year lag between the income observed by Medicare and the resulting payments. Money that flows into a Medicare enrollee's pocket in 2017 will be reported on a tax return filed in 2018, which determines Part B premiums due in 2019.

"When seniors retire, they may pay the higher premium for two more years until that income history drops off their records," Carnick says. "In order to reduce Part B premi-



Kathy Stepp of Stepp & Rothwell says bunching deductions may help to reduce taxable income every second year.

ums sooner than two years, advisors should have such clients appeal their higher IRMAA premium immediately upon retirement, if their income has dropped dramatically. One of the things that could qualify Medicare recipients for an IRMAA reduction is that they have stopped working."

Kathy Stepp, principal at Stepp & Rothwell, a financial planning and investment advisory firm in Overland Park, Kansas, recalls two clients who appealed their increases and won.

"In both cases," she says, "they qualified for the appeal under the life-changing event of 'work stoppage.' One called the Social Security Administration and the other visited in person, to present evidence of retirement. Their Medicare premiums were recalculated."

Also listed by the federal govern-

ment as acceptable reasons for Part B relief are marriage, divorce, annulment, death of a spouse, work reduction, loss of income-producing property, loss of pension income, and an employer settlement payment.

Advisors can get the necessary form from Social Security: Medicare Income-Related Monthly Adjustment Amount, Life-Changing Event, Form SSA-44.

The list on the form excludes other reasons that could bump up two-year-ago income.

"It is not uncommon," Stepp says, "for a client to have an outlier year of high income, due to stock option exercises or a sale of a capital asset, for example. Then the higher Medicare premium is just another cost, or 'tax,' of having that higher income, and we must be prepared for it."

A million-dollar profit on a real estate sale could trigger thousands of extra dollars in Part B premiums two years hence, in addition to other taxes generated by the deal.

WHEN IRMAA PERSISTS

For other Medicare enrollees, a high MAGI is not a one-time occurrence. "When clients regularly have substan-



Craig Carnick of Carnick & Kubik says some clients should appeal their IRMAA premium immediately upon retirement.

Premium Pricing

Medicare enrollees with modified adjusted gross income above a certain amount may pay an income–related monthly adjustment amount.

	Monthly		
File individual tax return	File joint tax return	File married and separate tax return	payment for Medicare Part B in 2017
\$85,000 or less	\$170,000 or less	\$85,000 or less	\$134
Above \$85,000 up to \$107,000	Above \$170,000 up to \$214,000	Not applicable	\$187.50
Above \$107,000 up to \$160,000	Above \$214,000 up to \$320,000	Not applicable	\$267.90
Above \$160,000 up to \$214,000	Above \$320,000 up to \$428,000	Above \$85,000 and up to \$129,000	\$348.30
Above \$214,000	Above \$428,000	Above \$129,000	\$428.60

Source: Medicare.gov

tial incomes, it's IRMAA forever," Carnick says.

Then, Part B planning can become part of ongoing tax planning. "We try to avoid triggering taxable income when it becomes an issue," Stepp says, "for Medicare premium reasons as well as for all of the other reasons that might be relevant: the 3.8% surtax on net investment income, the safe harbor threshold for estimated taxes, reduction of itemized deductions and so on."

Another planner, Diahann Lassus, concurs that she pays attention to clients' Medicare Part B premiums and the MAGI level that drives the calculation. "We have found that one of the most effective ways of managing these costs is by transitioning dollars from regular IRAs to Roth IRAs," says the president and co-founder of Lassus Wherley, a wealth management firm in New Providence, New Jersey, and Bonita Springs, Florida. "This sometimes temporarily increases the cost, but if we can reduce the IRA required minimum distributions over the longer term, it makes sense.

"We have clients who have been converting small amounts every year for several years to gradually reduce those RMD and, ultimately, those costs, such as Part B premiums, that are based on income," Lassus adds.

If clients' traditional IRAs are smaller when they reach age 70½ and RMDs kick in, reduced withdrawals can hold down MAGI and the resulting Part B obligation.

Lassus monitors year-end distributions to see if it makes sense to move out of an investment fund before the distribution. "We review on a per client basis any fund that is expected to make a large distribution," she says, "specifically a fund that distributes short-term gains. Our decision is based on what creates the lowest tax liability for the client: the realized gains from selling the fund versus the estimated gains distribution if we continue to hold it. Sometimes there is a significant difference in the tax liability between the two options."

Trading costs also must be considered, Lassus continues, as well as a post-sale strategy. After a capital loss, advisors can buy an asset that's not substantially identical or remain in cash for 30 days, to realize the tax benefit. "If we sell a fund at a loss to avoid a distribution, we might move to an ETF with a similar makeup," she says.

A KEY TO MAKING PART B LESS OF A BOTHER TO CLIENTS IS TO REALIZE THAT THERE IS A TWO-YEAR LAG BETWEEN THE HIGH INCOME OBSERVED BY MEDICARE AND THE RESULTING PAYMENTS.

"If there is a gain, the dollars can be reinvested immediately following the distribution."

BUNCHING DEDUCTIONS

According to Stepp, tactics used by her firm include bunching itemized deductions in order to increase them every other year. "This works when a client's itemized deductions are just below the standard deduction amount," she says. "Then the client ends up alternating years between using the standard deduction and itemizing."

Similarly, she mentions straddling year-ends. "Where we can, we determine in which year to realize income

or deductions when we approach the end of a year," she says. "We analyze the effects of the different timing and how taxes and the Medicare premium change." Choosing December or January for a taxable event can result in reduced income some years, and perhaps lower Part B premiums.

"In order to keep Medicare premiums down," Stepp concludes, "we must keep taxable income down."

As Lassus puts it, "the important part is to understand what drives the premium calculation and to pay attention to income streams where the advisor and/or the client may have some level of control."

Donald Jay Korn is a contributing writer for Financial Planning in New York. He also writes regularly for On Wall Street.

Advising on Health Care Options

Help could be on the way for retirement-age clients asking prickly questions about health insurance coverage.

BY SEAN ALLOCCA

lients are asking deeper questions about the costs of their health insurance coverage, especially as they near retirement, advisors say.

How will affording Medicare affect their retirement plans? What about paying for supplemental or prescription plans?

Health care insurance advising could become a ripe growth area for firms and a way to differentiate themselves from competitors — if they can gain the expertise needed to help their clients.

It's not something advisors have necessarily been jumping to include among their services.



Paul Allen of Wealth Strategies Partners partnered with Bernard Health to provide health care advice to 200 of his clients for \$60,000 a year.

But the rising cost of coverage and a regulatory environment in flux have finally forced them to confront the growing problem.

ASKING THE RIGHT QUESTIONS

How can an advisory firm best guide clients on often complex health care insurance options?

One solution: Some firms have turned to partnerships with outside health insurance advising specialists to help bridge the gap. Instead of bringing in experts to work in-house, they connect with an outside firm to get the best financial services possible at the lowest cost.

Outsourcing health care experts can help lower costs, while still pro-



the way you look at your business.

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viding customers with top-notch services, according to Ryan McCostlin, head of advisory services with Bernard Health, a fiurm in Nashville, Tennessee, that sells health insurance advisory services to other practices.

"Advisors are asking themselves



"Clients have a much better confidence level after talking about their care needs," says Frank McAleer of Raymond James. "They're able to put their heads down on their pillow with a lot more comfort.'

three questions," McCostlin says. "Is health care material to my clients? Do I think this is within my fiduciary scope? And, should I handle health expert - and ensure the expert satisfies compliance rules.

Then, there's the prospect of employee turnover. "The initial feedback we're getting is that firms don't want the burden," McCostlin says.

COVERING THE COSTS

Bernard Health has already signed agreements with three firms and reached out to at least 26, according to McCostlin.

But, services don't come cheap. Paul Allen, of Wealth Strategies Partners in Nashville, says a prospective partnership would be a major investment for his firm.

The deal would cost Allen \$60,000 for the first year alone. He expects 200 of his clients to utilize health care planning services at a cost of \$300 per household.

"It's a big investment that you're going to be making into your practice - a big investment, "Allen says.

The services can cost anywhere from \$10,000 a year to almost \$100,000 for some of the larger firms. One of the biggest practices to sign on is paying an \$86,000 annual retainer, McCostlin savs.

Costs are adjusted annually depending on the number of clients insurance company. The partnership seems like a win-win. Raymond James gets access to expert advising, while HPOne gets access to some of Raymond James' clients.

"There's no fee attached," says Frank McAleer, vice president of financial planning and retirement solutions at Raymond James.

"Obviously, the incentive for HPOne is to do business and write a policy, but they have counseled clients that have already been enrolled," he savs.

POSITIVE FEEDBACK

McAleer says the feedback has been positive. "Clients have a much better confidence level after talking about



"People need more help than ever before," says Bernard Health's Ryan McCostlin, "but there are just fewer and fewer resources."

their health care needs," McAleer says.

"They're able to put their heads down on their pillow with a lot more comfort, he says."

STANDING OUT

Bernard Health has offices in Atlanta, Indianapolis and Austin, Texas, so its experts can meet with clients nation-

FIRMS, ESPECIALLY SMALLER ONES. MAY NOT HAVE THE RESOURCES ON HAND TO HIRE A HEALTH CARE EXPERT — AND ENSURE THE EXPERT SATISFIES COMPLIANCE RULES.

care in-house or partner with an outside firm?"

For McCostlin, the answer has predominantly been to outsource. Firms, especially smaller ones, may not have the resources on hand to hire an

that Bernard ends up advising. The company plans to have 50 licensed advisors on hand in the near future.

Back in April, Raymond James began a partnership with HPOne, a Shelton. Connecticut-based health



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wide. They are also available to consult over the phone.

While the partnership will certainly help clients, Allen is really hoping the services will help his firm to expand.

"The move will help differentiate ourselves from the competition," Allen says.

"Not many financial practices are doing this," he adds.

Allen says he's likely to approve the partnership in the near future.

While there has been an uptick in clients looking for answers about

health insurance in recent years, there are fewer places for them to turn for advice, according to McCostlin.

There are two major factors at play, he says.

MAJOR FACTORS

First, as health insurance premiums continue to soar, clients have taken notice. Those expenditures have now become "material." he says.

Second, there are now fewer resources available.

Historically, clients could turn to

licensed health care insurance professionals to get help and buy tailored insurance products, McCostlin says. But, because of rising prices for health care and a handful of other reasons, health insurance carriers aren't using as many brokers as they used to.

The net result: the avenues available for people to get health insurance advice have dwindled.

"People need more help than ever before," McCostlin says, "but there are just fewer and fewer resources." **FP**

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

Fewer Regrets, Better Retirement

If clients are unhappy with any aspect of their life that financial planning will solve, make that the primary focus.

BY CAROLYN McCLANAHAN

ne of the most difficult aspects of being a physician is telling a patient he has a serious illness that will soon end his life. Bearing this bad news many times in my prior career developed my deep appreciation for the fragility of life.

It significantly shaped the way I now help people prepare for their financial future as well. Instead of focusing on retirement, in our firm we focus on helping clients live a full life now and build resiliency for whatever the future holds.

WE'RE NOT CLAIRVOYANT

When I became a planner, the focus of finance on predicting the unpredictable gnawed at me. Life and finance are great examples of complex adaptive systems. Just like earthquakes, factors such as rates of return, inflation, future taxation, career stability and life expectancy cannot be reliably pinpointed.

Why do we spend so much time trying to predict the unpredictable when the best way to approach a complex adaptive system is to prepare for the most likely occurrences? By falsely pinning clients' hopes on specific outcomes, the clients and the advisors are set up for failure. The future we predict will not happen.

And what if a true



Carolyn McClanahan, an M.D. and a CFP, volunteers twice a month at the health clinic of the Sulzbacher Center in Jacksonville, Florida, to help the working homeless.



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black swan occurs? It isn't just a serious market upheaval. It could be a terrible earthquake in California, a massive war or even a widespread environmental disaster.

If I've made my clients suffer inordinately by focusing mostly on the future, I've done them a grave disservice if the world really does fall apart. There has to be a balance.

Instead of spending an inordinate amount of time predicting the future, we need to switch to preparing for the most likely outcomes and create resiliency for the black swan events. Using the earthquake example, this includes building earthquake resistant homes so we survive the typical earthquake.

hours, take sabbaticals and even go back to school to change careers. If family issues are eating away at current finances, we arrange the appropriate counseling. It is very rewarding to give clients the ability to make radical life changes that renew their vigor.

WHAT ABOUT THE FUTURE?

Balancing current life enjoyment with future preparations builds resiliency for any outcome.

Cornerstones of good resiliency include savings, minimizing debt, maintaining health and tackling the bucket list before there becomes a need to make one.

The retirement discussion morphs

MANY EXPENSIVE ITEMS HAVE OWNERSHIP COSTS WHILE EXPERIENCES ACTUALLY BRING HAPPINESS. IDENTIFYING AND DISPOSING OF PHYSICAL ASSETS IN A CLIENT'S LIFE THAT NO LONGER BRING MEANING HELPS THEM SIMPLIFY THEIR EXISTENCE.

In my work with dying patients, those who had the fewest regrets had the easiest time facing the great unknown of death. One of our goals is to help clients live fully in the present so they have no regrets when major life events occur.

In meetings with new clients, we explore job satisfaction, work/life balance, family concerns and health. We also discuss goals for the future as these goals are often events that would bring delight if they happened in the present.

If clients are unhappy with any aspect of their life that financial planning will solve, we make that the primary focus. If the problem is job satisfaction, can we discover ways to bring back joy in their work?

We've had clients cut back their

into a conversation about financial independence. Many advisors focus the conversation on saving when the most important factor in creating independence is controlling spending. We review how a client spends money and determine what spending provides value.

Many expensive items have ownership costs while experiences actually bring happiness. Identifying and disposing of physical assets in a client's life that no longer bring meaning helps them simplify their existence and expenses.

This exercise subsequently increases the amount available for saving and reduces the financial burden when untoward events occur. The end goal is to have the client save as much as is comfortable while main-

taining the lifestyle that brings the most joy.

LIFE BEYOND WORK

Our ability to work is our safest asset and we can control this much better than market returns. We share the history of retirement with clients. When Social Security began in the 1930s, if someone retired at age 65,he had a 50% chance of living to age 72. With longevity now into the late 80s, retirement can easily last 20 or 30 years.

For clients who may outlive their assets, depending on health and satisfaction with current work, we encourage working longer years but fewer hours. This will provide significant protection if portfolio returns are poor in early retirement.

Even if a client has plenty of money, work provides social interaction and mental stimulation that is important for continued health and sense of well-being.

If staying in a current job is not an option, get creative. Pet sitting through a website like Rover.com may provide excellent opportunities to make extra income and maintain flexibility. Seasonal jobs are another possibility to consider.

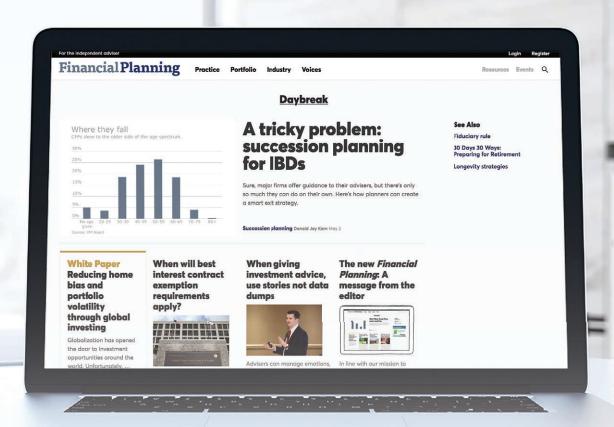
If a client is truly ready to stop working, it is vital to plan for how she will spend her time.

If needed, we connect her with volunteer opportunities that will make good use of her skills and wisdom. Our local volunteer physicians group greatly appreciates our efforts with retiring doctors.

How we work and age has changed, and advisors need to rethink how they plan for these major societal shifts. Flipping our focus to the present and helping clients with what they can control results in a better current life and happier clients.

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

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PRACTICE

Identity Crisis

For advisors starting a new firm, there is agony in deciding what to call themselves. Tradition, trust and Google can all factor in the choice.

BY ANDREW WELSCH

SIX BARCLAYS ADVISORS LAUNCHING THEIR OWN

\$3 billion RIA faced their greatest challenge: What should they call themselves?

Selecting a custodian, finding office real estate in three cities, choosing new reporting software — those were easy tasks compared with the struggle of picking a name.

It was a "painful experience," says managing director Jack Petersen. The team went through more than a hundred choices, says Petersen, recalling one conference call on the subject that dragged on to 3 a.m. The founders actually

delayed their July 2015 launch date by a week before settling on the winning name: Summit Trail Advisors.

Thousands of advisors have been through a similarly exasperating experience. Several planners compare it to naming their firstborn child.

"You've got to be willing to live with the name," says Kevin Reardon of Shakespeare Wealth Management. "I have seen firms with made-up names or names that squish two words together. I'm just like, 'I don't know what that means.'"



Tommy Boyd, center, and the rest of Boyd Financial Group in Selma, Alabama, decided against dropping the surname in the team's name.

While Reardon's muse was the Bard of Avon (the name connotes longevity and quality, he says), other advisors have sought inspiration in meditation, grandmothers, immigrant heritages, sports, mythical beasts, ancient religions, the U.S. Navy, physics and the heavens themselves.

There's a lot at stake, including client referrals and the assets that go with them.

Paul Pagnato says that a few years back, his firm sought expert opinions on whether it should change its name from PagnatoKarp. Search engine considerations — that is, how the firm would show up in Google search results — played the determining factor.

"There's so much content that had been

school dance: All the best dates are quickly spoken for.

"Think of any name in wealth management — it's already taken," says Leo J. Kelly III. "And then take any two words. That's taken too."

Kelly and his 21-member team jettisoned their old name, Kelly Wealth Management, when they left HighTower Advisors in July to form a new RIA. With some outside help, they found their new name: Verdence Capital Advisors, derived from the Latin *vere*, meaning "truly," and "independence."

Many advisors, of course, go with family names. Tommy Boyd says his five-member team, which includes his son and daughter, "I thought about Rising Tide Financial Planning, but that wasn't good, given climate change."



Angel Melgoza's first choice for his firm's name was Mi Vida Financiera, but he opted for the English translation, MyLife Financial.

created — press releases, articles written, TV appearances — so much in the marketplace already that [search engine experts] didn't advise us to change it," he says. "It was not the answer I wanted to hear, to be honest."

But keeping the brand was worth it. Pagnato says about \$100 million worth of new clients found the RIA via Google searches last year.

'IT'S ALREADY TAKEN'

As new RIAs have mushroomed in recent years, picking a name is kind of like asking someone to go with you to a high considered changing their name from Boyd Financial Group when they left Wells Fargo Advisors for the independent side of Raymond James in 2015. But history — the group had used it for over 15 years — and client reactions weighed on their thinking.

"All of us in the industry understand how these relationships are structured between independent advisory teams and a custodian," says Boyd, who is based in Selma, Alabama. "Clients don't always understand that structure. So having the family name can be advantageous."

Yet Boyd and others note that surnames

can be limiting.

A former wirehouse advisor, Patrick Dougherty, who has an eponymous firm, regrets not using his first choice: Copernicus Wealth Management. A fan of science, Dougherty thought the name would match the vision he had for his independent practice, launched in 2005. But the eight-member advisory board he assembled recommended against it.

"I buy them breakfast and we meet twice a year, and this first meeting, they flat-out shot down the name," says the Dallas-based advisor.

Now, however, Dougherty says he has plans to bring on a new partner as part of a succession plan, potentially rendering his last name a bad fit.

FINDING YOUR MUSE

For advisors looking for something

unique, inspiration can arrive at unexpected moments. Brooklyn-based Stephanie Genkin landed upon her firm name over cocktails. "I'm with a client," Genkin remembers, "and she's introducing me to people during a happy hour, and she is saying, "This is Stephanie, and she is my financial planner."

Bingo. Genkin had her name: My Financial Planner.

A former Smith Barney advisor, Abe Ringer, looked close to home for his practice's new moniker: Breakwater Financial, named after the harborside barriers that keep waves from crashing into boats.

"We're in Boston, and we're close to the sea and I've always loved the ocean," he says. "I think I looked up a list on Wikipedia of a thousand nautical terms. When I hit upon 'breakwater,' I liked it." U.S. Navy veteran George Reilly also considered a number of seafaring images before opting for Safe Harbor Financial Advisors.

"I thought about Rising Tide Financial Planning, but that wasn't good, given climate change," says the planner, who is based in Fairfax, Virginia.

To avoid ending up with a dud, Marie Swift, chief executive of the marketing firm Impact Communications, says she typically likes to start working with advisors three to six months ahead of their new firm's launch date.

PASSING THE SPELLING TEST

Swift recommends names that are easy to spell and pronounce. A Romanian name may honor your ancestors' roots, but will clients be able to remember it accurately?

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Similar concerns spurred Angel Melgoza to rethink his first choice. Melgoza, who moved to South Texas from Austin about a year ago, originally wanted to call his firm Mi Vida Financiera.

"I thought, for SEO reasons, there will be a lot of people looking for financial advice in Spanish, and we're close to the border," says Melgoza, who is based in Edinburg.

Yet after reflecting on the complexities of it and his intention not to remain a solo practitioner, Melgoza went with the English translation, MyLife Financial.

Swift's colleague, client strategist Leslie Swid, recommends advisors do something similar: marinate over the choices before making a final decision. "It's good to check in with a few people, but if you didn't go through a process and put some thought behind why you want a particular image, you risk getting a camel instead of the horse you wanted from the outset," Swid says.

Advisors shouldn't second-guess themselves, Swift adds.

'BE DECISIVE'

"Turn over all the stones and talk to other people about it. But once you've settled on a name, be decisive," she says.

Reardon of Shakespeare Wealth Management says he went through a number of choices, looking for something that connoted integrity without specifically using that word.

"People typically end up with a list

of five or 10 names, and then you end up with two or three, and I was searching for feedback," says the planner, who is based in Pewaukee, Wisconsin. "I had one person scoff at the name. They didn't get it. But I didn't care. I was like, 'I'm going with it.""

Reardon says prospective clients respond well to Shakespeare, a bust of whom he has in his office. Plus, his team gets to have fun using Shakespeare quotations.

"That which we call a rose / By any other name would smell as sweet," Juliet famously tells Romeo.

But would a wealth management firm by any other name be as sweet? On this point, Reardon and many other advisors would disagree with Shakespeare: Probably not.

Andrew Welsch is a senior editor of Financial Planning. Follow him on Twitter at @Andrew Welsch.

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TECH ZONE

Wearable Tech and Wise Words

Widespread passive financial data and microadvice are creating the circumstances for a new wave of innovative products.

BY SULEMAN DIN

COULD CLIENTS SOON RECEIVE FINANCIAL ADVICE IN

30-second chunks via their wristwatch?

Not quite yet, but the potential to combine digital advice and big data is spawning an evolution in personal finance management apps that could soon upend how investment advice is delivered and consumed.

Wearable devices such as the Fitbit and Apple Watch have become increasingly seamless and nonintrusive in how they collect data, says Daniel Latimore, senior vice president of Celent's banking practice and author of a new report on how personal finance management apps are evolving.

Personal finance management apps, also known as PFM apps, will follow a similar development path, he says. "Consumers see that, and wonder, 'Why can't my finances be as easy as that? Why can I not in a seamless, nonactive way get insights into my activity?"

BITE-SIZED ADVICE

Clients will be more deeply informed about their finances, Latimore says, and with little effort on their part.

Microadvice, he explains, will be delivered as "hints and nudges in the moment, the right context at the right time, on what you should be doing."

"It's a microburst of education, done in digestible chunks, so the consumer feels like they are learning," he adds. "As you're waiting for the bus, it's 30 seconds of insight or education based on something you've just done, or expenditure that just came in."

Though the advice may come in small pieces, the stakes for monetizing that stream will be high. Banks and wealth managers will fight to control the flow of information, Latimore says.

"What Quicken and other traditional PFM tools showed is that few consumers are dedicated financial obsessives," Latimore noted.



Banks and wealth managers will fight to control the flow of financial information through new wrist-worn devices.

"Automating is crucial in driving the experience and for getting consumers interested in the capabilities," he says.

EVOLVE YOUR OFFERINGS

In fact, he says, firms will have to take up the heavy lifting in figuring out and presenting a client's finances.

"Consumers will often be turned off by even having to put in the slightest effort," Latimore says. "If users have to do their own budgeting, manually calculate to see if they are under or over budget for the month, or click through several screens to find information, they simply won't adopt the product."

Plus, the advent of microadvice will impact advisors, as it will make any prospect that much more knowledgeable about their finances.

"You've got to evolve your offering to provide value to an educated consumer, and in a way that's a lot harder," Latimore says.

Suleman Din is managing editor of SourceMedia's Investment Advisor Group. Follow him on Twitter at @sulemandn



Avoiding IRA-Related Tax Traps

Yes, clients can invest funds from tax-deferred accounts in nontraditional assets, but you should understand the risks before giving them the OK.

BY ED SLOTT

"YES. YOU CAN DO IT."

That's what I told an advisor recently when he asked if his client could use his IRA funds to purchase real estate.

"Yes, you can do it" is the answer I gave to another advisor asking a similar question the week before that, and another one the week before that.

The topic of investing in unconventional assets through an IRA is coming up weekly for me, if not even more frequently. Yes, you can invest IRA funds in nonconventional assets, including real estate, closely held stock, equipment leasing, farming interests, private equity investments and virtual currency. However, there are risks involved.

Advisors working with clients who wish to make nonconventional IRA investments must understand when a client might be entering a tax trap.

They should know the answer to a critical question: When does a transaction become an unintended distribution because the IRA owner has too much control over the funds?

The following cases can help advisors recognize some of the potential dangers involved in investing IRA money in nontraditional assets.

FORCING THE ISSUE

A California resident, Guy Dabney, wanted to buy land in his Charles Schwab IRA, but Schwab refused to hold the investment. IRA custodians have the right to opt not to hold such IRA investments. Clients who are interested in nontraditional IRA investments should look into vehicles such as self-directed IRAs.

Dabney's mistake was to force the issue with Schwab, rather than finding an IRA custodian willing to hold the land, then doing a direct transfer from the Schwab IRA to the new custodian. That would have constituted a tax-free direct rollover and would have allowed the new custodian to purchase the land within the IRA.

Instead, Dabney wired funds from his IRA directly to the



When a California resident wanted to buy land in his Charles Schwab IRA, the firm refused to hold the investment. The client tried to force the issue by wiring funds directly to the title company handling the land sale, and he ended up with a taxable IRA distribution.

title company handling the sale of the land, and instructed the firm to title the land in the name of "Guy M. Dabney Charles Schwab & Co. Inc Cust. IRA Contributory."

Schwab issued Dabney a 1099-R for his distribution and, in error, the title company issued the title to the land in Dabney's name. Later, the IRS challenged Dabney's return for not including the distribution used to purchase the land.

The two parties ended up in court, and the IRS was the victor.

A BOTCHED PARTNERSHIP PLAN

In another case, an unsuccessful attempt to invest IRA funds in a business ended up in a taxable IRA distribution,

accord to a private letter ruling provided by the IRS.

In this case, the IRA owner said his plan was to have this IRA purchase the shares of a partnership interest and continue to be held by his IRA custodian.

His advisor prepared the paperwork for the client to sign. The IRA custodian issued a check payable to the partnership. The partnership agreement indicated the interest was held by the taxpayer's IRA.

However, the custodian was unable to hold the partnership interest and, as a result, issued a Form 1099-R, treating the distribution as taxable.

REAL ESTATE MISTAKES

In another private-letter case, a do-it-yourself IRA investor's self-directed IRA mishap After receiving a 1099-R for the distributions from her new IRA, she then did a little belated investigating and learned some unfavorable news.

Her new IRA custodian did not offer self-directed IRAs. She liquidated the alternative investments and deposited the funds back into an IRA. She also requested a private letter ruling to extend the 60-day rollover deadline. She said her failure to accomplish a rollover within the 60 days was due to her belief that the alternative investments were purchased within the IRA, or rolled over into an IRA within 60 days.

Further, she argued that she never intended to take a distribution and that if the IRA custodian had purchased the alternative investments on behalf of the IRA instead of

A key question:
When does a transaction become an unintended distribution because the IRA owner has too much control over the funds?



A recent Court of Appeals ruling decided in favor of Raymond McGaugh in his use of funds from his Merrill Lynch IRA to buy a company's stock after the request was resisted initially by Merrill.

led to a taxable IRA distribution. The taxpayer wanted to invest her IRA funds in real estate and other alternative investments. Her plan was to use amounts in her existing IRA to fund a new IRA, which she believed was a self-directed IRA that would allow these types of investments.

To put her plan in action, she took a distribution from her IRA and rolled it over to a new IRA. Just days after the rollover, she took four distributions from the new IRA.

making distributions, the funds would not have been taxable.

The IRS denied the request, stating that the distributed funds must be included in the taxpayer's income for the year, and that the deposits to her IRA would be considered excess contributions. In addition, the IRS said she violated the once-per-year IRA rollover rule.

The IRS also shot down her argument that there were no distributions from the

IRA. In fact, the IRS said the IRA custodian did not offer self-directed IRAs and the distributions were made to purchase the alternative investments. Further, the IRS said that if there were no distributions, the taxpayer would not be seeking a waiver.

This private letter ruling also shows some of the risks of using self-directed IRAs for alternative investments. Here, the taxpayer went wrong in two ways.

- 1. First, she did not do her homework and find out what investments were allowed by the IRA custodian.
- 2. She also misunderstood how self-directed IRAs work. When the IRA issued checks made payable to a title company and a limited liability company, these were distributions out of the IRA. She was no longer investing within her IRA. Those funds were no longer IRA funds and because of the violation of the onceper-year IRA rollover rule, they were not eligible to go back into another traditional IRA as a rollover.

DOING IT RIGHT - WITH RISKS

A recent Court of Appeals case illustrates the right way to set up such accounts, but it shows the IRA owner was still acting in a risky manner.

Raymond McGaugh had an IRA with Merrill Lynch. In the summer of 2011, McGaugh requested that Merrill use funds from his IRA to purchase 7,500 shares of First Personal Financial stock.

For some reason, Merrill refused to purchase the shares directly on behalf of the IRA. In this case, the purchase is considered an unconventional IRA investment, because the custodian had a problem with it.

Undeterred, McGaugh requested that Merrill do a wire transfer of \$50,000 directly to First Personal Financial. On Oct. 7, 2011, Merrill sent the wire transfer and the company received it.

McGaugh never requested an IRA distribution payable to himself. That was the key.

On Nov. 28, 2011, First Personal Financial issued the stock certificate in the name of McGaugh's IRA, and sent it to Merrill.

According to Merrill, the firm received the stock certificate more than 60 days after the funds left the IRA. Merrill then attempted to mail the stock certificate to McGaugh, but it was returned by the Postal Service at least twice; it remains missing.

Eventually, Merrill determined that a distribution had been made to McGaugh, and reported the \$50,000 transaction as taxable, subject to the 10% early distribution penalty. The IRS issued a notice of deficiency for the 2011 tax year to McGaugh, and he brought the case to Tax Court.

The court ruled in favor of McGaugh and held that he did not owe taxes or penalties on the \$50,000 used to purchase the stock, because the funds had not been distributed to McGaugh.

According to the court, McGaugh never received any distribution from the IRA when Merrill wired money to First Personal Financial and the company issued shares to the IRA. The IRS appealed to the 7th Circuit Court of Appeals and lost again.

What went right for McGaugh? He did not request or receive a distribution and no funds ever passed through his hands. He was never in constructive receipt of the funds because the funds went straight to the issuing company and the issuing company sent the stock shares to the custodian. He also could not negotiate the stock certificate, which was issued in the name of the IRA. At no time did he have control over the funds.

But McGaugh's outcome does not change the fact that he was engaged in some very risky business with his IRA funds. Even though the ruling was in favor of McGaugh, he still had to prove this to IRS and go to court twice in order to do so.

The bottom line: Clients can invest in nontraditional assets in their IRAs. But if they try to do an end-run around a custodian's policies, they are asking for trouble. **FP**

Clients can invest in nontraditional assets in their IRAs. But if they try to do an end-run around a custodian's policies, they are asking for trouble.

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

PORTFOLIO

ALSO IN PORTFOLIO: P. 64: Three Against One

The Passive Investing Mirage

Contrary to popular thinking, the fact that more advisors are using ETFs is not a quantum shift. We are still mainly active investment managers.

BY MICHAEL KITCES

AS ADVISORS ADOPT ETFS, THE SHIFT FROM actively managed mutual funds to passive ETFs and index funds has sent mutual fund companies scrambling to figure

funds has sent mutual fund companies scrambling to figure out what they must do to stanch the bleeding and regain their market share.

Yet as advisors stop using third-party managers — and instead seek to add value by becoming the investment portfolio managers themselves — the rise of ETFs appears to be not so much a shift from active to passive, but simply a recognition that when advisors build investment portfolios, we prefer to do it using ETFs as our building blocks.

In fact, a recent Trends in Investing Survey from the Financial Planning Association revealed that advisors are increasingly building portfolios with ETFs as well as stocks, bonds and even private equity funds — which means they aren't shifting to passive investment tools, they're just using everything except third-party-managed mutual funds.

This means the perceived shift from active to passive investment management is a mirage.

Of course, there's no indication that advisors are any better at managing investments than mutual fund managers are.

ADVISORS AS GATEKEEPERS

Historically, most advisors functioned as sellers of investment products. From the early days of wirehouses selling proprietary products, to the rise of independent broker-dealers selling third-party products, advisors succeeded by selling investment vehicles that most consumers couldn't access any other way.

But with the advent of the internet, consumers are now able to access virtually any investment product, either directly from the asset manager or product manufacturer, or through a self-

directed brokerage account. This development has led to the rise of no-load products and rising pressure on investment commissions themselves, as consumers increasingly ask, "Where's the value in paying an advisor to provide the same products I could buy directly?"

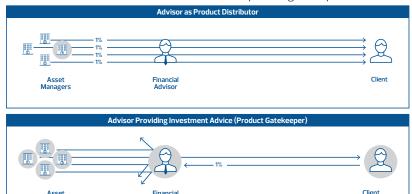
This puts substantial pressure on advisors to justify the 1% 12b-1 compensation layer they often receive — especially when it is stacked on top of the underlying 1% operating and management fees of the mutual fund itself. Consequently, the traditional 1% 12b-1 commission trail for product sales has effectively been rebilled as a 1% advisory fee for ongoing investment advice.

Yet the shift from product distribution to advice means the advisor is shifting from distributor to gatekeeper of those very investment products.

In other words, advisors now have new incentives to control investment costs for clients. And indeed, one of the easiest ways to justify an 1% AUM fee is to save the client 1% of

Substantial Pressure to Provide More Value

Advisors evolution from investment distribution to product gatekeeper



Source: Michael Kitces



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underlying investment costs.

The shift of advisors from product distributors to investment-advice experts means they can now manage portfolios directly, eliminating the fee of the actively managed mutual fund.

After all, if the advisor can reproduce a comparably diversified portfolio without the mutual fund and its cost layer, the advisor can both justify the advisory fee and save on total costs to the client.

ADVISOR TECH SOLUTIONS

In the past, such a shift wouldn't have been possible, as the administrative costs of actively monitoring and implementing an ongoing strategy were prohibitive. However, the rise of advisor technology solutions — in particular, rebalancing software that fully automates investment model implementation across an entire client base — means that any advisor can roll model portfolio strategies out systematically at a reasonable cost.

Add to this the collapse of ticket charges for investment, along with the bargaining power of large advisory firms, and there isn't even a material benefit for using mutual funds to pool assets to reduce transaction costs. These forces have all conspired to trigger a massive outflow from actively managed mutual funds.

Actively analyzing, monitoring and implementing an entire portfolio of individual securities is too arduous and time-intensive for most advisors.

ETFs: THE NEW STOCKS

And thus, the popularity of the ETF. What makes the ETF especially valuable to today's advisor is that, thanks to their proliferation across indexes, asset classes, sectors and industries, ETFs are granular enough for an advisor to pick and choose which ones to buy and sell, but still pooled enough to avoid having to analyze each individual security.

Accordingly, the FPA's survey notes that since the financial crisis advisor adoption of ETFs has continued to rise steadily, now surpassing the adoption of mutual funds, which has been slowly declining.

The key insight of this trend, however, is that the rise of ETFs doesn't necessarily represent a shift to passive investing. After all, despite the total net outflows from mutual funds, the majority of advisors are still using them, at least to some extent.

Even more important, though, is the realization that while ETFs have been on the rise, the use of individual stocks and private equity funds is also rising. And after a few years of decline, individual bonds are on an upswing, too — which makes sense if advisors feel the need to actively manage bond allocations in the face of potential inflation and rising interest rates.

The fundamental point, though, is simply that if advisors were truly shifting to be passive, the use of individual stocks, bonds and private equity should also be declining alongside actively managed mutual funds. But they're not. Those typically-actively-managed investment vehicles are rising alongside the adoption of ETFs as well.

In part, the confusion about whether advisors are going passive or active can be attributed to the fact that there are really two types of "active" investment styles.

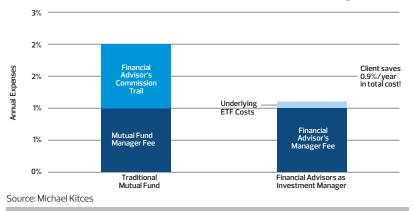
The first is active security selection, where the underlying stocks and bonds are actively traded, which is the domain of most mutual fund managers.

The second is active asset allocation selection, which may also be more active or passive. In the past, most advisors strategically held active funds. Now they're actively managing passive vehicles. This is not indicative of a shift from active to passive, but simply a shift in where the active management occurs.

The point is made even more clearly in a follow-up question in the survey, where the researchers asked whether advisors think it's better to manage portfolios actively, passively or via a blend of the two — the latter being a likely representation of index-based tactical asset allocation. While this survey question has been included only since 2014, the trend is clear: Passive investing is not on the rise, and advisor interest in passive investing is actually declining.

In fact, true passive investing practitioners — those who strategically hold passive index funds — appear to make up little more than 15% of the advisor marketplace.

How Advisors Disintermediate Mutual Fund Managers



The real shift is to tactically managing passive index-based investment vehicles — that is, managing portfolios with ETFs, not passively holding them. Doing so allows the advisor to show value, even while substantially reducing the end cost to investors, and all without the advisor undermining their own fees.

IMPLICATIONS

Given the industry chatter that advisors are "going passive," the implications that advisors are actually staying active and simply disintermediating mutual fund managers is profound.

It suggests that actively managed mutual funds' launching and distribution of actively managed ETFs — in the hopes of (re-)recapturing outflows from mutual funds — is likely doomed to fail. The real reason advisors are shifting is that they don't want to sell someone else's active management strategy packaged in a fund the client could just buy themselves.

To the extent that advisors are continuing to use a subset of actively managed funds, it's because the advisor believes that the value of the active manager justifies the cost.

This means asset managers should spend less time trying to figure out how to chase and offer the hot investment vehicle, and focus more on lowering costs and improving performance of the funds directly to regain the attention of those advisors-as-gatekeepers.

And the onus is certainly on asset managers and their wholesalers: The SPIVA Year-End Scorecard showed that over the past 15 years, 92% of U.S. large-cap and 93% of U.S. small-cap managers underperformed their benchmarks after expenses.

At the same time, as advisors increasingly become investment managers, more advisory firms are taking steps to become compliant with the Global Investment Performance Standards. Advisory firms aren't trying to differentiate by the track records of the mutual fund products they sell; they're trying to differentiate with their own GIPS-compliant investment performance track records.

On the other hand, there is a dark side to this advisor shift. Just as with mutual fund managers, not all advisors will be very good at creating alpha – to

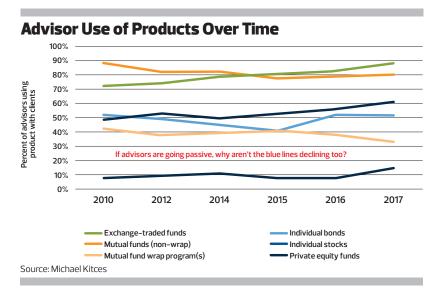
say nothing of the growing evidence that the available pool of alpha appears to be shrinking.

Of course, in the past, poor investment performance of an individual advisor was difficult to determine, in part because every client had a different portfolio, and also because performance reporting tools that accurately calculated performance against a benchmark were complex or just unavailable to consumers altogether. But now, between the rise of firmwide performance reporting under GIPS, and individual performance reporting with a wide array of tools like Orion, Tamarac and Black Diamond, clients will know how well their advisors are really doing.

In turn, this is likely to lead to demand for alternative ways to bring managed portfolios to clients, at a reduced cost relative to the traditional mutual fund manager. This bodes well for separately managed account and turnkey asset management platform providers, as long as they can keep their own costs lower than the typical mutual fund manager fee.

That said, the TAMPs and SMAs themselves are being threatened by a new tech evolution: the rise of the model marketplace, where advisors can manage their own models directly through rebalancing software, while letting a third-party provider design, create and monitor the models. This in turn creates a potential for Indexing 2.0 solutions using technology to allocate among the underlying investments direction, eliminating both the mutual fund or ETF wrappers altogether.

The bottom line, though, is that until there is a larger shift of advisors away from investment-centric value propositions and over to a core value proposition of financial planning, the trend toward passive-investing-that-really-isn't will remain.



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

PORTFOLIO

Three Against One

Can one total-market index fund top an equally weighted basket of large-cap, mid-cap and small-cap funds? The answer may surprise you.

BY CRAIG L. ISRAELSEN

FOR MANY INVESTORS, AN IMPORTANT PART OF their overall investment portfolio is exposure to the U.S. equity market

But is this best accomplished by using a total stock market index fund, or by buying a combination of several different index funds?

One-stop shopping has gained popularity as an investing paradigm during the last decade. Vanguard, for example, has a "one stop" offering for investors looking to simplify their exposure to the U.S. equity market, namely the Vanguard Total Stock Market Index fund (VTSMX). This type of fund is certainly convenient, but is it the best approach?

An alternate approach would be to invest in separate index funds that track three equity market segments based on market capitalization: large-cap, mid-cap, small-cap. For comparative purposes, we can use the Vanguard 500 Index (VFINX), Vanguard Midcap Index (VIMSX) and Vanguard Small Cap Index (NAESX) to track these segments. When used together and rebalanced annually, these three funds provide the same exposure as the Total Stock Market Index provides on its own.

The time frame for this study was the 18-year period from Jan. 1, 1999, to Dec. 31, 2016. Performance data were extracted from the Steel Systems Mutual Fund database.

The annual returns of the three core indexes are shown in the chart "Gang of Three + Mega-Index." Also shown is Vanguard Total Stock Market Index. Over the past 18 years, Vanguard Mid Cap Index and Vanguard Small Cap Index have significantly outperformed both Vanguard 500 Index and Vanguard Total Stock Market Index.

HIGH CORRELATION

VTSMX purportedly attempts to track the performance of U.S. large-cap, mid-cap and small-cap stocks. But, it doesn't. Rather, it primarily replicates the performance of Vanguard 500 Index.

Here's why: VTSMX has an extremely high correlation

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coefficient of 0.998 with the Vanguard 500 Index. Recall that 1 indicates perfect correlation (a measure of the symmetry of their co-movement).

Furthermore, the beta coefficient between VFINX and VTSMX is 0.965. Beta measures the magnitude of their comovement. When both the beta coefficient and correlation coefficient are very close to 1, it is indicative of performance patterns that are extremely similar.

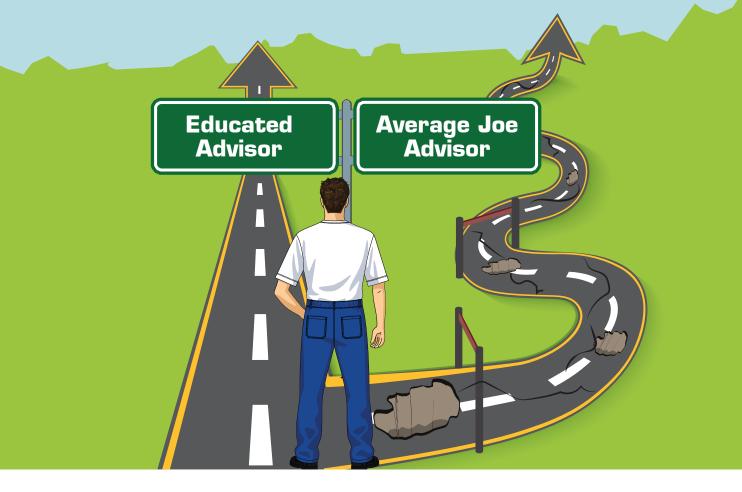
The similarity in the 18-year performance between VFINX and VTSMX is striking — VFINX at 5.26% and VTSMX at 5.89%. By contrast, the mid-cap fund VIMSX had an 18-year annualized return of 9.34%, and the small-cap NAESX was just behind it at 8.91%.

The stellar performance of mid-cap and small-cap U.S. stocks barely shows up in the performance of VTSMX. This is due to portfolio weighting. VTSMX uses market capitalization weighting, meaning that large-cap stocks get roughly 70% of the weight, mid-cap stocks get around 20%, and small-cap stocks get approximately 10%.

There are two solutions that could improve the situation. The first is to invest in the three separate funds (VFINX,



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VIMSX, and NAESX) and allocate your money across them in the same market-cap-weighted allocations that VTSMX uses. That is, 70% of the money goes to VFINX, 20% goes to VIMSX, and 10% goes to NAESX. Then, rebalance each year to keep the allocations in line.

In theory, this should produce nearly the same performance as VTSMX. But, it doesn't.

Performance actually improves, as shown in the chart "Divide and Conquer." The 18-year performance using the three separate funds in market cap weighted alloca-

tions was 6.51% versus 5.89% for VTSMX. Somehow, VTSMX fails to capture the full performance impact of the mid-cap and small-cap stocks that it holds.

ANOTHER OPTION

The second option is to use the three separate funds in equal proportions, 33.33%, and rebalance them annually. Over the past 18 years this approach improved performance even more — up to 7.92%. This added performance translated to \$11,400 more in the investor's account than VTSMX earned (assuming an initial deposit of \$10,000 on Jan. 1, 1999).

Another advantage of a threefund approach to the U.S. equity market is that the performance is separable. The total stock market index fund produces one return. If the return in a particular year is negative and you need to withdraw money, too bad.

By contrast, a three-fund approach produces three separate returns, and even in bear market years, all of them might not be negative. For example, in 2000, Vanguard Total Stock Market Index had a return of minus 10.57%. If that is your only U.S. equity exposure, and you need to withdraw money, you'll magnify the loss by doing so.

By contrast, the investor could

have withdrawn money from Vanguard Mid Cap Index in 2000 because it had a stellar year, a gain of 18.1%. Its neighbors had negative returns in 2000. This shows vividly that the performances of large-cap stocks, midcap stocks and small-cap stocks can vary greatly from year to year.

The next year, 2001, was another one when it paid off to have separable returns. VTSMX lost 10.97%, whereas the three-fund approach lost only 3.14%. Among the three funds, however, the small-cap index fund actually had a gain of 3.1% in 2001.

With a three-fund approach, performance is separable. Even in a bear market, one of the funds might be up.

Gang of Three + Mega-Index

Annual performance from 1999 through 2016

18 Years of Performance Annual Returns	Vanguard 500 Index Investor (VFINX)	Vanguard Mid Cap Index (VIMSX)	Vanguard Small Cap Index (NAESX)	Vanguard Total Stock Market Index (VTSMX)	
1999	21.07	15.32	23.13	23.81	
2000	-9.06	18.10	-2.67	-10.57	
2001	-12.02	-0.50	3.10	-10.97	
2002	-22.15	-14.61	-20.02	-20.96	
2003	28.50	34.14	45.63	31.35	
2004	10.74	20.35	19.90	12.52	
2005	4.77	13.93	7.36	5.98	
2006	15.64	13.60	15.66	15.51	
2007	5.39	6.02	1.16	5.49	
2008	-37.02	-41.82	-36.07	-37.04	
2009	26.49	40.22	36.12	28.70	
2010	14.91	25.46	27.72	17.09	
2011	1.97	-2.11	-2.8	0.96	
2012	15.82	15.80	18.04	16.25	
2013	32.18	35.00	37.62	33.35	
2014	13.51	13.6	7.37	12.43	
2015	1.25	-1.46	-3.78	0.29	
2016	11.82	11.07	18.17	12.53	
18-Yr Annualized Return	5.26	9.34	8.91	5.89	
18-Yr Std Dev of Return	17.89	19.26	20.47	18.51	
Growth of \$10,000	\$25,164	\$49,917	\$46,438	\$28,018	
Expense Ratio	0.14	0.18	0.18	0.15	
Correlation to VTSMX	.998	.903	.956		
Beta with VTSMX	.965	.939	1.058		

Source: Steele Systems Mutual Fund software, calculations by author

Some may feel that equally weighting three separate index funds creates more risk by overallocating to mid-cap and small-cap stocks.

Let's look at the performance record over the past 18 years. This analysis clearly suggests that using three separate indexes — each with an equal share of the allocation — is best for investors.

A performance advantage when using a three-fund approach compared with a single total stock market index fund has been demonstrated over the past 18 years. But what about the results over shorter time periods?

SHORTER-TERM RESULTS

The three separate funds in equal one-third allocations with annual rebalancing outperformed the total stock market index in 75% of the 16 rolling three-year periods from 1999 to 2016.

Using three separate funds to represent each market segment is not just a long-term performance story. It produces results in the short run as well.

It's true that the 18-year standard deviation of return for the mid-cap and small-cap index funds was higher than the total stock market index fund.

But the real measure of risk should be based on the overall portfolio mix, rather than isolating the volatility of the individual ingredients. The 18-year standard deviation for the annually rebalanced equally weighted three fund approach was 18.74%, com-

pared with 18.51% for VTSMX. This represents a fractional and virtually meaningless increase in the standard deviation of return.

Thus, the net result of using three sepa-

Divide and Conquer

Two improved solutions to gain exposure to the entire U.S. equity market

18 Years of Performance Annual Returns	VFINX 70% allocation VIMSX 20% allocation NAESX 10% allocation	20% allocation VIMSX 33.33% allocation		
	Market-cap Weighting	Equal-Weighting	(VTSMX)	
1999	20.13	19.84	23.81	
2000	-2.99	2.12	-10.57	
2001	-8.20	-3.14	-10.97	
2002	-20.44	-18.93	-20.96	
2003	31.34	36.09	31.35	
2004	13.58	16.99	12.52	
2005	6.86	8.69	5.98	
2006	15.23	14.97	15.51	
2007	5.09	4.19	5.49	
2008	-37.88	-38.30	-37.04	
2009	30.20	34.28	28.7	
2010	18.30	22.70	17.09	
2011	0.68	-0.98	0.96	
2012	16.04	16.55	16.25	
2013	33.29	34.93	33.35	
2014	12.91	11.49	12.43	
2015	0.21	-1.33	0.29	
2016	12.30	13.69	12.53	
18-Yr Annualized Return	6.51	7.92	5.89	
18-Yr Std Dev of Return	18.05	18.74	18.51	
Growth of \$10,000	\$31,107	\$39,439	\$28,018	
Expense Ratio	0.152	0.167	0.15	
Correlation to VTSMX	.993	.975		
Beta with VTSMX	.969	.987		

Source: Steele Systems Mutual Fund software, calculations by author

rate U.S. equity funds versus a single total stock market index funds was a dramatic improvement in performance with no material increase in risk.

Divide and conquer.

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

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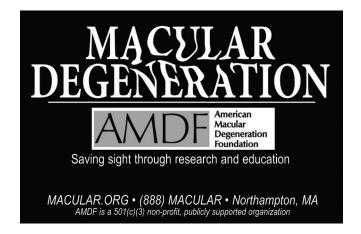
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FROM: A STEEP PRICE FOR MEDICARE

- 1. If an eligible, individual client has modified adjusted gross income of \$85,000 or less, what will the maximum premium for Medicare Part B be?
- 1. \$200/month
- 2. \$150/month
- 3. \$134/month
- 4. \$95/month
- 2. If eligible, married clients have joint modified adjusted gross income of \$214,000 to \$320,000, what will their Medicare B premium be?
- 1. \$187.50
- 2 \$237 40
- 3. \$348.30
- 4. \$267.90

FROM: THE PASSIVE INVESTING MIRAGE

- 3. What is the percentage of advisors using ETFs in client portfolios?
- 1. Approximately 72%
- 2. Approximately 80%
- 3. Approximately 65%
- 4. Approximately 90%
- 4. What is the percentage of advisors using mutual funds in client portfolios?
- 1. Approximately 90%
- 2. Approximately 80%
- 3. Approximately 50%
- 4. Approximately 75%
- 5. Over the past 15 years, what percentage of U.S. large-cap managers underperformed their benchmarks after expenses, according to the SPIVA year-end scorecard for 2016?
- 1.92%
- 2.85%
- 3.75%
- 4.55%

FROM: WHEN AND HOW TO DEDUCT LONG-TERM CARE INSURANCE (online only)

- 6. To be eligible for deductibility, long-term care insurance must be tax-qualified coverage as defined under which part of the Internal Revenue Code?
- 1. Section 7702B(b)
- 2. Section 52
- 3. Section 213(d)(10)
- 4. Section 7702B
- 7. If a client is older than 40 but not 50, what is their limitation on long-term care premium deductibility?
- 1. \$410
- 2.\$770
- 3. \$1.530
- 4. \$2.200

FROM: THREE AGAINST ONE

- 8. In the 18 years from 1999 through 2016, what was the annualized return of a portfolio consisting of these Vanguard funds: large-cap index, mid-cap index and small-cap index (in which the funds were weighted equally)?
- 1.5.89%
- 2.6.51%
- 3.7.92%
- 4.8.91%

FROM: RETHINK HSAs

- 9. Once over the age of 55, an individual can give how much to their HSA above the 2017 maximum?
- 1. \$500
- 2.\$750
- 3. \$1.500
- 4. \$1.000
- 10. By 2018, what are total HSA assets projected to be, according to the Devenir Group?
- 1. \$37 billion
- 2. \$53 billion
- 3. \$42 billion
- 4. \$25 billion

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 Angela R., a clinical nurse and domestic violence survivor

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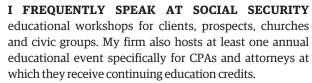


SELFIE

Social Security and Billy Joel

An advisor's blog about the Piano Man led to a \$14,000 Social Security payday for a local family.

BY PATRICIA L. BURRIS



Over the years, I have been fortunate to help many people maximize their Social Security benefits, introducing them to methods of receiving benefits that they didn't even know were available. Often, I do this by writing blogs I post to our website and email to clients and prospects who have opted to receive them.

My most successful blogs are those that include a story. By successful, I mean someone actually benefited from it, or better yet, we obtained a new relationship because if it.

One of my favorites is what I call the Piano Man blog, which I wrote back in 2015 and which still has legs today. The story went like this:

Most baby boomers know who the Piano Man is, Mr. Billy Joel. What you may not know is that he and his 33-year-old bride just had a baby girl and the Piano Man's baby was born with a special spoon in her mouth — a Social Security spoon, that is. Since Billy Joel is age 66 [in 2015], which is his Social Security full retirement age and is therefore eligible for benefits, his child, Della Rose, is too. Little Della Rose may receive up to one-half of Billy's primary insurance amount. Since it's a fair assumption that Papa Joel's PIA is at the maximum, estimated at \$2,685



per month [in 2015], baby Della Rose is eligible for approximately \$1,342 per month until the age 18. This amount is subject to the Social Security COLA increases as well.

A partner in a local law firm who attended one of our continuing legal education workshops passed on the blog to her sister. It just so happens that the sister and her husband have twin 3-year-old girls. The husband was over age 66 at the time and hadn't filed for Social Security, but was considering doing so.

AN IMMEDIATE CALL

As soon as his wife read the blog, she and her lawyer sister called me to see if the girls could receive Social Security benefits based on his work record.

After our conversation, the husband filed for Social Security immediately. About five weeks later, the family received a lump sum of approximately \$14,000, since he had elected to receive benefits back to the date he turned age 66, his Social Security full retirement age.

They will also receive \$2,000 per month in benefits, plus any future cost of living increases, for the girls until age 18 (or 19 if still in secondary school full time).

Now the local law firm, at which Mary's sister is a partner, regularly refers to me their clients who need assistance with Social Security and Medicare filing strategies. And I conduct at least one continuing legal educational workshop at the firm's office each year, pro bono, of course.

This is a win-win situation for both our firms, thanks in part to the Piano Man. ${\bf FP}$

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