

# Financial Planning

INVESTED IN ADVISERS / JULY 2017

## AWAY FROM HOME

**There's a lot more  
to real estate  
investing than  
thinking locally**

FINANCIAL-PLANNING.COM / @FINPLAN

MICHAEL MARTIN, FOUNDER, MARIUS WEALTH MANAGEMENT



FRANKLIN TEMPLETON  
INVESTMENTS

Franklin LibertyShares™

It's time for ETFs to go beyond the benchmarks. Franklin LibertyShares active ETFs offer investors the potential for better outcomes, leveraging seven decades of active experience. Because there's simply no substitute for the Human Factor™.

[libertyshares.com](http://libertyshares.com)



*Investors should carefully consider a fund's investment goals, risks, charges and expenses before investing. To obtain a Franklin Templeton fund summary prospectus and/or prospectus that contains this and other information, call 1-800-342-5236. Investors should read the prospectus carefully before investing.*

**BECAUSE  
WE THINK  
ETFs  
DESERVE THE  
BENEFITS  
OF  
ACTIVE  
INSIGHTS TOO**

All investments involve risks, including possible loss of principal.

© 2017 Franklin Templeton Distributors, Inc. All rights reserved.



# CONTENT

JULY 2017 | VOL. 47 | NO. 7

COVER PHOTO AND PHOTO RIGHT BY JORDAN HOLLENDER



Real estate is "a very fickle market," says Michael Martin of Marius Wealth Management, and it might not be appropriate for some clients.

## 26 | Away From Home

There's a lot more to real estate investing than thinking locally. Some advisers are helping clients invest in charter schools, partnerships and even properties to be listed on Airbnb.

By Charles Paikert

## 33 | A Profitable Sale Without Taxes

Section 1031 of the IRS Code may seem arcane, but using it can be highly beneficial to certain clients as real estate prices climb.

By Miriam Rozen

*Financial Planning* Vol. 47/No. 7 (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](mailto: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.



# CONTENT



## COLUMNS

### 13 | Life Insurance Industry Evolution

The sector may catch up in the areas of trust, transparency and a fiduciary mindset, and a promising app may help.  
By Bob Veres

### 15 | Get a Confidence Boost

It's not uncommon to feel unsure, but there are many things you can do — and people you can lean on.  
By Dave Grant

### 17 | A Road Map for Hiring Top Talent

Your current superstar employees hold the secrets to making future crucial hires.  
By Kelli Cruz

## RIA IQ

### 19 | Serving Military Clients

A retired Air Force colonel turned CFP says advisers should take a closer look at armed services personnel and be aware of their unique needs.  
By Charles Paikert

## HIGH NET WORTH

### 21 | The Beauty of Irrevocable Trusts

For ultrawealthy clients who invest in real estate, an adviser's starting point should be an irrevocable trust. But you can't stop there.  
By Martin M. Shenkman

## PRACTICE

### 35 | A 'Grave' Threat for Advisories

Pershing Advisor Solutions' CEO challenged advisers to diversify their staffs — or become irrelevant.  
By Tobias Salinger

### 36 | Should I ... Do a Client Survey?

It's a good source for a honest critique, especially when a client might be hesitant to give one in person, but it does take time and money.  
By Ingrid Case

## CLIENT

### 37 | Deducting in Reverse

Reverse mortgages present a number of appealing features for borrowers — and a number of confounding tax implications.  
By Michael Kitces

### 41 | Vacation Property Angst

Certain planning techniques allow estate owners to distribute this valuable asset without triggering hard feelings and large expenses.  
By Donald Jay Korn

### 44 | The Best Fit for a Trusteed IRA

Here's what advisers should know about this increasingly available option so they can help clients make the most suitable choice.  
By Ed Slott

## PORTFOLIO

### 47 | Destructive Impact of Fund Fees

A retiree living off her portfolio may lose hundreds of dollars a year in income for each added basis point of fund expense ratio — or adviser fee.  
By Craig L. Israelsen

### 50 | Smart Beta vs. Active Managers

Studies show smart beta ETFs beating benchmarks more than funds with human drivers, but some advisers doubt they can do it across the board.  
By Bryan Borzykowski

## SELFIE

### 56 | A Teachable Moment for All

Not providing guidance on budgeting and cash flow management is a disservice to clients.  
By Scott Schutte

## UPFRONT & MORE

### 5 Financial-Planning.com

### 6 Editor's View

### 10 Retirement Adviser Confidence Index

### 55 CE Quiz

**FOREVER-  
TAXED**

**NEVER-  
TAXED**

## BE A FIDUCIARY AND LEAD YOUR CLIENTS TO A **TAX-FREE** RETIREMENT

As the fiduciary rule takes effect, advisors who position themselves as leaders committed to continuing their education will distinguish themselves from the pack. At **Ed Slott and Company's 2-Day IRA Workshop, *Instant IRA Success***, we provide advisors with the most cutting-edge training so they are equipped to manage their clients' most difficult retirement obstacles.

This is your opportunity to make a pledge to your clients that you are looking out for their best interest. Advance your education today so you can guide your clients to a tax-free retirement tomorrow.

**Join us this summer in Boston, MA on July 14-15**

**REGISTER WITH PROMOTION CODE  
**FINPLAN** AND **SAVE \$300****

**Web:** [www.irahelp.com](http://www.irahelp.com) **Email:** [info@irahelp.com](mailto:info@irahelp.com) **Phone:** 800-663-1340



## TOP FUNDS OVER 10 YEARS



## Be Wary of Fees' Damaging Effects

When the markets are strong, it's easy for clients to lose sight of the importance of expenses. Conscious of the damaging effects of fees, we researched funds that offer solid performance at a low price. We collected all the funds with more than \$1 billion in assets and expense ratios of 10 basis points or less. Then we ranked them on their 10-year annualized returns. Type the link into your browser to see how these funds stack up: <http://bit.ly/2rjMFrk>

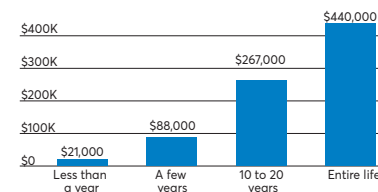
## Plan Early to Reap Big Savings Later

Less than a third of U.S. adults out of a group of several hundred polled by Morningstar think about their money in terms of the next 10 or more years. Yet there are dramatic benefits for those who do. The people who planned ahead by a decade or more reported the highest retirement savings, regardless of age, income, education or gender. To read more of this story, type this link into your browser: <http://bit.ly/2pg8fxA>

### GUIDE TO GROWTH

#### How much it pays to think ahead

Clients' average reported retirement savings correlate with how far in advance they've planned



Source: Morningstar



Follow *Financial Planning* on Twitter at @finplan for analysis, breaking news, commentaries and more from our editors and contributors.



Join the conversation and interact with the planning community on LinkedIn by joining *Financial Planning* | Discussion Group.



Like us at [facebook.com/FinancialPlanningMagazine](https://www.facebook.com/FinancialPlanningMagazine) to get analysis and news updates, highlights from the website and magazine, slideshows and more.



Download the *Financial Planning* app for iOS or Android.

## EVENTS

JULY	SEPTEMBER	OCTOBER
<b>11-12 In Vest</b> New York <a href="http://bit.ly/1T97nON">http://bit.ly/1T97nON</a>	<b>6-8 Morningstar ETF Conference</b> Chicago <a href="http://bit.ly/1wNOgiK">http://bit.ly/1wNOgiK</a>	<b>2-4 FPA BE Conference</b> Nashville <a href="http://bit.ly/2rzKz6Y">http://bit.ly/2rzKz6Y</a>
	<b>12-13 Disrupt Advice</b> New York <a href="http://bit.ly/2q6sLxA">http://bit.ly/2q6sLxA</a>	<b>18-21 NAPFA Fall Conference</b> Orlando, Florida <a href="http://bit.ly/2s29nFD">http://bit.ly/2s29nFD</a>

## NEWSLETTERS

Our free newsletters help advisers keep up on industry news and analysis. For delivery to your inbox, go to [financial-planning.com](http://financial-planning.com).



**FOLLOW  
THE  
LEADER**



## STAY CONNECTED. STAY ENGAGED.

From breaking news and commentary to valuable observations, our Twitter feed provides a real-time connection to an influential community of independent financial advisers.

**JOIN THE CONVERSATION  
@FINPLAN**

# EDITOR'S VIEW

## Going It Alone

It's possible for clients to invest in real estate without an adviser, but it's not the best idea.

**WHEN MY HUSBAND AND I BOUGHT OUR FIRST HOME, WE MADE A FEW** mistakes along the way. Among them, we bought the first house we saw, perhaps overly influenced by a backyard hot tub and not wary enough of the town's history of raising property taxes.

A few years later, my father moved cross-country to buy a home just one mile from ours. Swayed by the beauty of a quiet street in a convenient location, he overpaid by about 20%.

The common thread in our hasty decisions: None of us was working with an adviser at the time.

There are few times a client needs the services of an adviser more than when they are buying, selling, managing or investing in real estate. Tax planning, retirement planning, budgeting and even family dynamics all play a role in these expensive decisions, and advisers can guide clients through all of them.

And as the variety of real estate investments has mushroomed, even planners who think they have a pretty good handle on unlocking home equity or picking REITs may become overwhelmed.

"I was most surprised by the many different, creative vehicles available to clients," Senior Editor Charles Paikert tells me. Paikert, who wrote the main feature, "Away From Home," says he was particularly intrigued by one client's tactic: "Buying an RV to rent out to Airbnb customers — who would have thought?"

Another intriguing idea: A San Francisco wealth management firm has partnered with American Infrastructure MLP Funds to buy buildings that house charter schools. With all the new possibilities — and potential for both risk and reward — it behooves advisers to get up to speed.

Advisers can also play roles that reach far beyond watching the money. When clients seek to bequeath a family vacation home, an experienced planner can craft a plan that may avert jealousy or inflated expectations that can damage relationships, according to contributing writer Donald Jay Korn, who wrote "Vacation Property Angst."

"If advisers get involved while original vacation homeowners are still alive and healthy, quite a bit of frustration can be avoided," Korn writes.

Perhaps quite a bit of frustration could have been avoided if my family had sought the counsel of an adviser before we made our real estate purchases. That's one mistake we won't make again. —*Chelsea Emery*



# Meet the Innovators & Disruptors Changing Wealth Management



Come to In|Vest and meet disruptors, established leaders and venture investors actively engaged in the wealth management market. In 2017, we expect to attract 1,000+ executives to explore and debate the state of the industry—where it's at, where it's going, and who the winners will be when we get there.



**Bill Crager**  
*President,*  
ENVESTNET, INC.



**Joe Duran**  
*Founder and CEO,*  
UNITED CAPITAL



**Mark Goines**  
*Vice Chairman,*  
*Digital Wealth*  
*Management,*  
PERSONAL CAPITAL



**Naureen Hassan**  
*Chief Digital Officer,*  
MORGAN STANLEY  
WEALTH MANAGEMENT



**Timothy Heier**  
*EVP and CEO,*  
CHARLES SCHWAB

**Register Online At**  
[Invest.Events](#)

## Questions?

Contact **Ingrid Olsen** at (212) 803-8456 or  
**Vernesa Merdanovic** at (212) 803-8393

## Sponsorship Opportunities

Contact **Stacy Gellman** at (212) 803-8841 or  
[Stacy.Gellman@sourcemedia.com](mailto:Stacy.Gellman@sourcemedia.com).

PRESENTING  
PARTNERS

AMERICAN BANKER.

Financial  
Planning

OnWallStreet

BankInvestmentConsultant

# Financial Planning

# REGISTER TODAY

www.financial-planning.com

**Financial Planning** delivers the essential information that independent advisers need to make informed decisions about their business and the clients they serve. Get real-time news, opinion, expert advice and practical business building ideas – all accessible 24/7 at Financial-Planning.com.

## REGISTER TODAY TO ENJOY THESE BENEFITS:

- The leading brand for financial planning professionals
- Topic-specific newsletters delivering the latest in-depth analysis and planning advice
- Unlimited access to thousands of searchable archived online articles
- Access to the *Financial Planning* mobile app
- White papers, web seminars and CE exams
- Complete schedule of upcoming live industry events



FOR ALL ACCESS, VISIT: **Financial-Planning.com**

# Financial Planning

Financial-Planning.com

1 STATE STREET PLAZA, 27<sup>TH</sup> FLOOR  
NEW YORK, NY 10004-1505 • (212) 803-8200

EDITOR-IN-CHIEF  
Chelsea Emery

MANAGING EDITOR  
Suleman Din

SENIOR EDITORS  
Ann Marsh (West Coast Bureau Chief), Charles Paikert

ASSISTANT MANAGING EDITORS  
Andrew Pavia, Maddy Perkins

ASSOCIATE EDITORS  
Tobias Salinger, Andrew Shilling

COLUMNISTS  
John J. Bowen Jr., Joel Bruckenstein, Kelli Cruz,  
Kimberly Foss, Dave Grant, Glenn G. Kautt, Bob Veres

CONTRIBUTING WRITERS  
Ingrid Case, Kenneth Corbin, Craig L. Israelsen,  
Michael Kites, Donald Jay Korn, Joseph Lisanti,  
Carolyn McClanahan, Allan S. Roth, Miriam Rozen,  
Martin M. Shenkman, Ed Slott

COPY EDITORS  
Fred Eliason, Daniel Martinez, Rebecca Stropoli

GROUP EDITORIAL DIRECTOR,  
INVESTMENT ADVISER GROUP  
Scott Wenger

GROUP EDITORIAL DIRECTOR,  
PROFESSIONAL SERVICES GROUP  
John McCormick

VP, RESEARCH  
Dana Jackson

VP, CONTENT OPERATIONS AND  
CREATIVE SERVICES  
Paul Vogel

DIRECTOR OF CREATIVE OPERATIONS  
Michael Chu

SENIOR ART DIRECTOR  
Nick Perkins

ART DIRECTOR  
Nikhil Mali

DIRECTOR OF CONTENT OPERATIONS  
Theresa Hambl

SENIOR VICE PRESIDENT, GROUP PUBLISHER  
Rob Whitaker (212) 803-8844

PUBLISHER  
Michael Schott (212) 803-8567

CENTRAL-SOUTHEAST SALES MANAGER  
Frank Rose (212) 803-8872

NORTHEAST SALES MANAGER  
Hilary Whidden (212) 803-8643

MID-ATLANTIC SALES MANAGER  
Jim Shannon (434) 202-8226

MIDWEST SALES MANAGER  
Victoria Hamilton (312) 833-7613

WEST COAST SALES MANAGER  
Jason Anculis (847) 337-0149

CLIENT SERVICES MANAGER  
Christina Melomo (212) 803-8586

SENIOR MARKETING MANAGER  
Susan Zeqiri

For more information about reprints and licensing  
content from Financial Planning, please visit  
SourceMediaReprints.com or contact PARS  
International at (212) 221-9595.

CUSTOMER SERVICE  
help@sourcemedia.com or (212) 803-8500



CHIEF EXECUTIVE OFFICER..... Douglas J. Manoni  
CHIEF FINANCIAL OFFICER..... Michael P. Caruso  
CHIEF REVENUE OFFICER..... Marianne Collins  
EVP & CHIEF CONTENT OFFICER..... David Longobardi  
CHIEF PRODUCT & AUDIENCE OFFICER..... Minna Rhee  
CHIEF MARKETING OFFICER..... Matthew Yorke  
SVP, CONFERENCES & EVENTS..... John DeMauro  
SVP, HUMAN RESOURCES..... Ying Wong





*“Without this program, I don’t know where my girls and I would be. My financial planner helped me fix my credit, save over \$2,000 and buy my first home.*

***My family’s life is forever changed.”***

*– Angela R., a clinical nurse and domestic violence survivor*

The Foundation for Financial Planning has provided over \$6.2 million in grants to nonprofits around the country, supporting efforts to create and expand free financial planning programs like the one that helped Angela achieve financial independence.

Join the network of planners powering pro bono financial planning for people in crisis or need. Become a volunteer or make a tax-deductible contribution at **FoundationForFinancialPlanning.org**.



**FOUNDATION FOR  
FINANCIAL  
PLANNING**

*Powering Pro Bono Financial Planning*

# BENCHMARK

DATA-BASED INSIGHT FROM *FINANCIAL PLANNING* AND SOURCEMEDIA RESEARCH

## RETIREMENT ADVISER CONFIDENCE INDEX

# Advisers' Optimism Dampened

As the Department of Labor's fiduciary rule takes effect, some planners express fear that fees may drop and compliance costs may rise.

### ADVISERS AND CLIENTS ALIKE ARE GROWING

increasingly apprehensive about the economic outlook, despite stock market gains. The aging of the bull market and political uncertainties are contributing to the anxiety, according to this month's Retirement Adviser Confidence Index — *Financial Planning's* monthly barometer of business conditions for wealth managers.

Advisers were also concerned about the implementation of the Department of Labor's fiduciary rule, which went into effect June 9. The adviser confidence index was down 2.3 points from the previous month to 54.1.

"Nobody knows for sure how to handle the new rule, and every company is different," one adviser said.

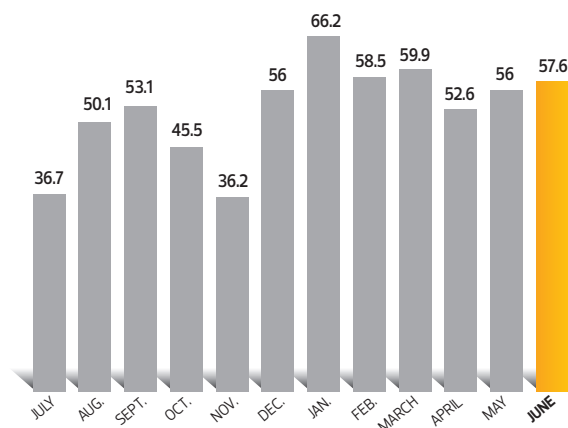
The looming regulation and tough pricing competition have generally lowered fees for retirement plans, advisers said. The rule could lead to higher fees in the long term, however, according to some planners.

"We are concerned about the increased regulations with DoL, since that may affect commission business, broker-dealer rules, class-action lawsuits and our overall cost of compliance and monitoring," one adviser wrote. "This may require us to raise fees or drop small accounts, if necessary."

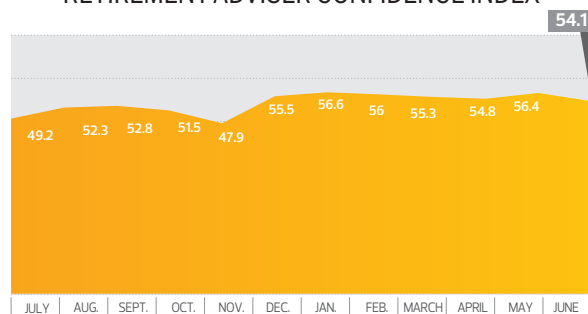
Retirement business dropped, as it has over the past four years in the month after Tax Day, advisers noted. The dollar amount of all contributions into retirement plans and total retirement products sold to clients both fell by double digits.

The turbulent political environment is also causing some jitters, one adviser said, noting that "international

RISK-TOLERANCE LEVEL



RETIREMENT ADVISER CONFIDENCE INDEX



The Retirement Adviser Confidence Index, published in partnership with ADP®, is created by the editors of *Financial Planning* and is based on a monthly survey of about 300 advisers. Visit [financial-planning.com](http://financial-planning.com) for more results.

ADP and the ADP logo are registered trademarks of ADP, Inc. ADP does not provide tax, financial, investment or legal advice, or recommendations for any particular situation or type of retirement plan.





## 401(k) Plan Solutions

# #hellowork

*Retirement benefits to meet the workplace needs of your clients.*

No two clients are alike. That's why you need a retirement plan provider that has the flexibility to fit the demands of your clients. ADP has a legacy of delivering successful retirement plans that create long-term value, are easy to manage and provide a wide range of investment choices.

To learn how ADP can help you build better retirement plans for your clients, contact us at 1-844-ADP-ELITE, or visit [www.adp.com/partners/financial-advisors.aspx](http://www.adp.com/partners/financial-advisors.aspx)

Unless otherwise agreed in writing with a client, ADP, LLC and its affiliates do not offer investment, financial, tax or legal advice or management services. For its retirement plan recordkeeping customers, ADP agrees to act as a nondiscretionary recordkeeper performing ministerial functions at the direction of the plan sponsor and/or plan administrator. Accordingly, unless otherwise agreed in writing, ADP does not serve in a fiduciary capacity nor act as an investment advisor or manager to any of the retirement plans for which it provides recordkeeping services. Nothing in these materials is intended to be, nor should be construed as, advice or a recommendation for a particular situation or plan. Please consult with your own advisors for such advice.

ADP and the ADP logo are registered trademarks of ADP, LLC. ADP A more human resource. is a service mark of ADP, LLC. All other trademarks and service marks are the property of their respective owners. 99-1893-A-0517-01 Copyright © 2015-2017 ADP, LLC. ALL RIGHTS RESERVED



A more human resource.™



# BENCHMARK

events give me the willies.”

Additionally, the aging of the bull market is putting some clients on edge. “They are concerned with the market, and believe that we could be headed for a correction soon,” one adviser wrote.

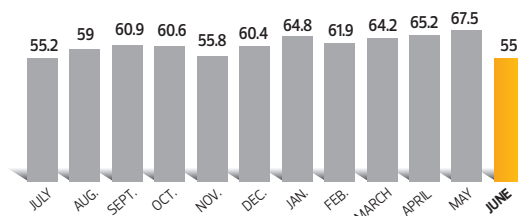
At the same time, the rise in equities has given some clients heightened performance expectations, which may account for the 1.6-point uptick in clients’ risk tolerance.

“People now have an expectation that the market will always go up, and expect to get at least the same returns as the major U.S. indices,” an adviser wrote. “This is actually causing us to want to be even more conservative, as valuations are stretched.”

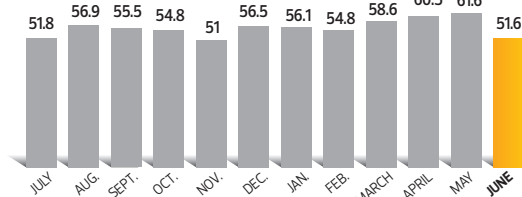
The Retirement Adviser Confidence Index is composed of 10 factors – including asset allocations, investment product recommendations, economic and risk factors, taxes and planning fees – to track trends in wealth management. RACI readings below 50 indicate deteriorating business conditions, while readings over 50 indicate improvements. — *Tobias Salinger*

FP

AMOUNT OF ALL CONTRIBUTIONS RECEIVED



TOTAL RETIREMENT PRODUCTS SOLD TO CLIENTS



SourceMedia | Research

## Financial Planning WHITE PAPERS

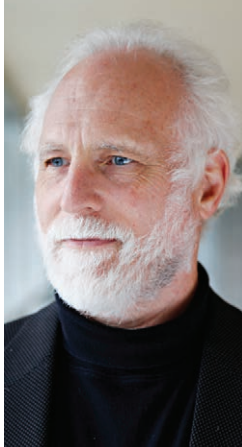
# INDUSTRY RESEARCH MADE SIMPLE

Browse a wide range of industry reports and white papers highlighting the latest market research and trends within the investment adviser community.



FOR FREE ACCESS, VISIT: [Financial-Planning.com/Resources](https://Financial-Planning.com/Resources)

Financial  
Planning



## INDUSTRY INSIGHT **VERES**

# Life Insurance Industry Evolution

The sector may catch up in the areas of trust, transparency and a fiduciary mindset, and a promising app may help, Bob Veres says.

**IN THE BATTLE BETWEEN THE** fiduciary sales model for mutual funds and the opaque, commission-driven model for the life insurance industry, guess who has been winning over the past three decades?

While total mutual fund assets have grown from \$495 billion to more than \$17 trillion over the past 31 years, the number of life policies sold annually has fallen by almost half, to fewer than 10 million from 17 million, according to data from the Investment Company Institute and LIMRA.

Of course, it's never too late to recognize the advantages of a fiduciary model. Whether it's the result of the Department of Labor's rule, the fact that insurance agents are aging out of the business or the fact that the industry is facing a skeptical millennial generation, it appears the industry is slowly rethinking its sales approach.

Quietly, no-commission variable annuities have been made available to fee-compensated advisers by, among others, Vanguard, Jefferson National, TIAA, Schwab (written through Nationwide), TD Ameritrade Institutional (written through Great West Life), Transamerica, Ameritas and, most recently, Lincoln Financial.

Progress has been slower for cash-value (aka permanent) life contracts, including whole, variable, universal and variable-universal. What these policies have in common, and where they differ from term life, is that they all include a cash account from which

the policyholder's annual term life premiums, known as the cost of insurance, are deducted to pay for the actual life insurance coverage.

The interaction between these two moving parts can be complicated. How much of the premium dollars are actually invested on behalf of the policyholder versus being paid to the sales agent? How fast is the investment account growing thereafter, and exactly what fees are being deducted?

The COI goes up incrementally every year as the policyholder gets older, but how fast does it rise, and does the COI remain consistent with the rates the company is offering on term policies?

Mutual insurance companies also offer dividends, which can be thought of as excess premium that was collected and is now being returned to the policyholder.

Even though they're called permanent policies, if the COI exceeds the cash value, the contract is canceled or the face amount is adjusted. When policies are overfunded, the face amount, and therefore the COI, automatically goes up to maintain a corridor between cash value and face amount.

### **A PROMISING NEW APP**

Fiduciary advisers are reluctant to recommend products that they themselves have a hard time deciphering, and until now there has been no Morningstar in the insurance world to help them. But I see the potential for

**“We’re trying to take a very complex product and make it more visual, which the insurance industry has never done,” says Assurance co-founder John Lefferts.**

greater transparency in the form of a new app called Assurance, which turns insurance policy illustrations into comparison charts that even a financial columnist can understand.

"We're trying to take a very complex product and make it more visual, which the insurance industry has never done," says company co-founder John Lefferts, who, in a previous life, was president of AXA Advisors and, following that, founding CEO of a broker-dealer called Lion Street.

Assurance pulls data for virtually any life product directly from WinFlex, the insurance industry's comprehensive database of life insurance policy data. You input a face amount and WinFlex provides the annual target premium policyholders are expected to pay – which, if paid, will guarantee that the policy will stay in force.

You can specify an assumed rate of return on the cash account, and Assurance calculates, from the policy illustration, the various costs that will be deducted from the investment account, including the annual COI based on the client's most likely underwriting risk class. Everything is visible in graphs, so you can do what you already do with mutual funds: run side-by-side comparisons of different contracts over different time periods.

## REPLACEMENT CALCULATING

Initially, I expect fiduciaries to use Assurance for replacement calculations – that is, to compare that variable-universal policy a new client purchased from his brother-in-law with a lean fiduciary-friendly contract from, say, TIAA, with an eye to possibly doing a 1035 exchange from the former into the latter. So you call up the current policy and look at the illustration at, say, a 7% rate of return, compared with the no-load policy.

In the most important graph, Assurance will show you the internal rate of return on the cash value in the policy, after fees and COIs, assuming the annual investment return specified. Obviously, the higher IRR will reflect a leaner, less-expensive policy, assuming everything else is equal.

What's interesting, in the illustration I

looked at, is that the difference in return can change over time. That is, an old policy might become more efficient and competitive at higher age brackets than it was initially.

You can also run an illustration that shows the death benefit rising as the cash values start to approach the original face amount, or simply look at the growth in aggregate premiums.

## NEW PRODUCTS TO COME?

Right now, there aren't a lot of fiduciary policies, but Lefferts says most life companies are looking at creating leaner commission-less products.

"As the demographics of the agency field force gets older," he says, "the insurance companies are looking at pricing their products for different markets and different distribution platforms. When they do, we'll be making it easier for the next generation of agents and advisers to show clients their options."

Assurance is not a perfect window into the life world, in part because it doesn't give the historical investment performance of the different contracts it deconstructs. You can find that elsewhere for variable life and variable-universal life policies, which mostly use mutual funds as their investment choices.

Assurance won't model dividends, which are returned to policyholders at the discretion of the mutual company.

Also, be warned that insurance companies have the option of raising their COIs for policyholders in later years.

In other words, the expense data in the policy illustration may not reflect future policyholder experience.

But Assurance is the first tool I've seen that provides output comparable to what Morningstar offers in the fund world – a new level of clarity and transparency into the most complicated, hard-to-understand area of our financial landscape.

For the first time in my 30-year career, I am beginning to have some hope that the insurance industry might eventually catch up in the key areas of trust, transparency and a fiduciary mindset.

FP

**Assurance is the first tool I've seen that provides output comparable to what Morningstar offers in the fund world.**

**Bob Veres**, a *Financial Planning* columnist in San Diego, is publisher of Inside Information, an information service for financial advisers. Visit [financial-planning.com](http://financial-planning.com) to post comments on his columns or email them to [bob@bobveres.com](mailto:bob@bobveres.com). Follow him on Twitter at @BobVeres.





## NEW GENERATION GRANT

# Get a Confidence Boost

It's not uncommon to feel unsure, but there are many things you can do — and people you can lean on, Dave Grant says.

**A LACK OF CONFIDENCE ISN'T LIMITED** to the first few years in the planning business. Even the most seasoned professionals occasionally have the wind taken out of their sails.

But for many new planners, questions like “How do I get to that place of complete confidence?” or “Will I ever feel so strong that if I hear ‘No’ from colleagues and clients, it won’t faze me?” are especially acute.

These are just two of the common themes I found when I spoke with members of the XY Planning Network who had less than 10 years of experience.

### STAY TRUE TO WHAT YOU BELIEVE

Even before I reached out to those newbies, I reflected on what has made me more self-assured over the years. Obviously, it has taken years to build up enough confidence to be unfazed when a prospect says no. I’m now secure enough in my philosophies, price structure and abilities that I know the right clients will be attracted to me.

Serendipitously, since I have adopted that mindset, my client numbers have grown and new business relationships have formed naturally.

But confidence came only after I had worked for a number of years with a variety of clients at my own practice.

When I worked at other firms, there were some things that I wasn’t completely on board with. It didn’t allow me to be as con-

fident as I am now. Whether it was investment philosophy, use of technology or the planning process itself, this lack of congruence caused me to doubt we were the right choice for some clients. But I couldn’t turn them down when they wanted to work with us because it wasn’t my company.

Additionally, if I didn’t fully believe that the firm was serving clients to its fullest potential, I couldn’t bring the best service to my clients. Confidence seems to come easier now that I’m on my own. I now believe I am providing the best value to my clients.

### IT STARTS AT HOME

One thing I heard from many planners is that confidence starts at home. If you have a supportive family who agrees with your career choice, it makes it so much easier to show up to work every day. The planners also said that having a spouse, parent or other loved one believe in them provided enough fuel to make it through the roughest days.

The notion that a supportive spouse made a big difference was championed by new RIA owners more than those who were employees. In starting a new venture, many planners needed a lot of support and encouragement to keep going.

The encouragement of friends can give a boost to new planners, whether these acquaintances are patting you on the back or hiring you as their adviser.

When I spoke with less-experienced pro-

**Many new planners feel their success is not due to their own abilities. This feeling is commonly known as the impostor syndrome.**

professionals, I learned that those who were just coming out of a college program second-guessed themselves more frequently. They had book knowledge, but a lack of client-facing experience.

Some advisers I spoke to were career changers from other industries who earned their master's degrees in financial planning. Surprisingly, one said she was more knowledgeable than other members at local FPA and other affiliate group meetings. As a result, she felt more confident in her abilities and went back to growing her roster of clients, knowing she could compete with seasoned advisers.

## FEAR OF BEING OUTED

Many new planners believe their success is not due to their own abilities. This feeling is commonly known as impostor syndrome.

These young planners say their concerns are amplified because they found themselves providing advice on retirement income strategies while still renting their first apartment and paying off student loans. Many were not far removed from college. While their advice was accurate, there was no congruence between their own financial situation and their clients'.

This feeling goes away only with time — I felt the same way and I have no college background in finance. By continually studying and working on various client situations, the fear of being outed as a fraud disappears as confidence takes over. It gets easier to feel confident in giving advice when you realize that it has worked for other clients.

When I founded NAPFA Genesis, I realized that new planners had many questions that would be best answered by peers. Seeking peer advice can build a sense of camaraderie. By establishing the group, I found that in addition to providing a space to brainstorm ideas, the energy from that camaraderie fuels planners' confidence. Advisers in the group receive validation for their good ideas — and if an idea needs tweaking, they are glad for the input of others before presenting it to a client.

As planners progress in their careers, having a small mastermind group of peers is priceless. This intimacy can foster supportive relationships without any feelings of competition or one-upmanship.

## AVOID A SCARCITY MINDSET

It's common to feel that you need to be closing every prospect into a paying client when you're starting out. You may feel you need to prove something to yourself or you may be worried about keeping your doors open.

That said, when the wrong type of client signs on, the relationship often requires far more work and effort than an appropriate adviser-client connection.

Changing my own mindset regarding this issue has worked as a confidence booster. It helps to remember there are plenty of clients in the world that you can work with — and they will find you.

In you act from a scarcity mindset and assume every client could be your last, you are influencing not only how you feel, but also how you run your practice.

I have succumbed to a scarcity outlook at various points of my career and it's draining. But in conversations with advisers and clients, I realized that my long-term problem wasn't finding clients to work with. The real struggle is finding the right type of clients.

By offering fee-only services on a variety of models, the main problem an adviser will face is getting the word out. Assuming that job is well done, you may end up having to turn away prospective clients.

Thinking that there will be too much business to handle is not easy when you are starting out or when a slow period hits, but that mindset is crucial to prevent building the wrong type of business.

For fiduciary advisers, it should be natural to assume there's a wealth of clients out there because it lends itself to an attractive business model. Instead of acting as if each client is your last, be sure to accept only those clients whom you can envision working with in 20 years. Then, confidence will come naturally.

FP

**If you act from a scarcity mindset and assume every client could be your last, you are influencing not only how you feel, but also how you run your practice.**

---

**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.



## HUMAN CAPITAL **CRUZ**

# A Road Map for Hiring Top Talent

Your current superstar employees hold the secrets to making future crucial hires, Kelli Cruz says.

**JUST AS ADVISERS ARE ALWAYS ON** the lookout for their next great client, they should also be keeping an eye out for the best and brightest people to join their team.

But how can you know which hires are best for you – and your clients?

You can start by thinking about your current team and the superstars you already have in place. Then start a list of which traits separate them from the rest of your team.

Next, sit down with these employees and think about the answers to the questions below. Finally, create a profile and plan for finding the best candidates to fit your firm.

**Where did they come from?** Where was the employee working before? Did they work for a competitor, or did they change careers? Were they a less-experienced hire, such as a college recruit or a summer intern?

In other words, what background and experience seems to be the best fit for a successful hire in your firm?

Recently I went through this process with a client who was recruiting for an adviser position. He determined the most successful hire was a career changer – specifically, someone who had been a CPA. The hire had a CPA background, and had completed the CFP exam prior to joining the firm.

**How did they get here?** How did your star employees connect with the firm (e.g., job posting, recruiter or client's referral)? Which social media sites do they visit most frequently? This will help you to determine

where to target candidates online.

**Why did they come here?** What attracted them most to the company and/or to the role? This will help you to identify how best to position the firm and job openings to candidates.

**What are their values?** Which characteristics and traits do they have in common? What are two or three core values or beliefs that they all share?

The last two questions get to the most important part of the criteria for making a great hire. By determining the qualities and attributes of your most successful hires, you will be able to screen for what is not trainable – values, work ethic and attitude.

A new hire can learn the industry and the responsibilities of the position over time. However, it is difficult to train someone how to be trustworthy, dependable and ethical.

### IDENTIFY CORE COMPETENCIES

Identify the core competencies for each role in the firm and your firmwide core competencies to ensure you are getting the right DNA match for a successful hire.

Firmwide core competencies are a firm's main strengths and strategic advantages. These can include the combination of pooled knowledge and technical capacities that allow an advisory to be competitive.

I like to think of organizationwide competencies as what makes up the firm culture. Ask what are the values and characteristics

**Firmwide core competencies are a firm's main strengths or strategic advantages.**



of the people who fit well within the firm?

The following are examples of firmwide core competencies:

- **High standards:** Expects personal performance and team performance to be nothing short of the best.
- **Work ethic:** Possesses a strong willingness to work hard – and sometimes long – hours to get the job done.
- **Integrity and honesty:** Does not cut corners ethically. Earns trust and maintains confidences. Does what is right, not just what is politically expedient.
- **Follows through:** Lives up to verbal and written commitments, regardless of personal cost.
- **Understands teamwork:** Reaches out to peers and cooperates with their manager to establish an overall collaborative working relationship.
- **Entrepreneurial attitude:** Demonstrates ability to work successfully in a small company environment.

Role-specific core competencies are the attributes that employees need to carry out their work effectively. Here are some:

- **Organization and planning:** Plans, organizes, schedules and budgets in an efficient and productive manner.
- **Analytical skills:** Able to structure and process qualitative or quantitative data and draw insightful conclusions.
- **Attention to detail:** Does not let important details slip through the cracks or derail a project or process.
- **Persistence:** Demonstrates tenacity and willingness to go the distance to get something done.
- **Communication:** Speaks and writes clearly and articulately without being overly verbose. Maintains this standard in all forms of written communication, including email.
- **Flexibility/adaptability:** Able to adjust quickly to changing priorities. Copes effectively with complexity and change.

Once you have established the strengths and characteristics of your most successful employees, I suggest using behavioral-based interview questions to screen for what you

cannot train them to do.

The theory behind behavioral interviewing is that “the most accurate predictor of future performance is past performance in a similar situation.”

## SCREENING FOR THE RIGHT MATCH

This method of structuring the interview questions will help you begin to see if there is a real match with the job and, most important, the culture of your firm. For instance, the following questions to ask your star employees help probe deeper into following through on commitments, teamwork and displaying a fit with the role:

- Tell me about a time you agreed to do something for a client when you weren’t sure you would have the time. Why did you tell them you would help them and what was the outcome?
- How do you keep coworkers, your manager and clients reassured that you will meet a determined deadline?
- What from your past professional or personal experiences indicates you will have success in the role of an adviser?
- What hobbies and/or activities are you involved in outside of work? This helps to determine how the candidate balances their work and personal life, and if their work ethic is a match with the environment of your firm.

To ensure you are hiring candidates who match your ideal employee profile, you can use personality assessments to predict how an employee will perform in the role.

Third-party assessment tools such as Kolbe, DISC and StrengthsFinder are useful indicators of how well-suited a candidate is for the job in question. Many advisers use a financial planning case study or a mock client meeting to gauge a candidate’s skill at managing client relationships.

Ultimately, having a strong interview process will ensure the highest level of success in selecting a new employee. Profiling your top talent and then using those criteria to define qualified candidates means you will maximize the fit between the person, the job and your organization.

**FP**

**To ensure you are hiring candidates who match your ideal employee profile, you can use personality assessments to predict how an employee will perform in the role.**

## Serving Military Clients

A retired Air Force pilot turned CFP says advisers should take a closer look at armed services personnel and be aware of their unique needs.

BY CHARLES PAIKERT

**MILITARY MEMBERS CAN BE TERRIFIC CLIENTS. THEY** are often disciplined savers, and midcareer personnel can make well into the six figures. Some planners, however, hesitate to add military clients to their rosters.

"There's a misconception that members of the military can't balance their checkbooks and don't need a financial adviser," says Curt Sheldon, a retired Air Force fighter pilot who is now a CFP with his own firm in Alexandria, Virginia.

Speaking at a session on what fiduciaries need to know to serve military members at the annual Fi360 conference, Sheldon said that, among other advantages, armed services retirees often "move into high-paying civilian positions and have significant investment portfolios."

What's more, military members, accustomed to a disciplined lifestyle, bring that self-control to their savings, he told the audience.

But, cautioned Sheldon, a colonel who served in Operation Desert Storm, men and women who are or have been in the military "speak a different language," may have dealt with highly stressful situations and have very particular financial planning needs.

### PLANNING PAIN POINTS

For example, those in the armed forces who are nearing retirement age will face a major "planning pain point" on Jan. 1, according to Sheldon.

That's when a new so-called blended retirement system for the U.S. military kicks in. Upon reaching retirement age, individuals will be able to receive a lump sum portion of their pension's future cash flow at a discount rate, currently predicted to be 7%. The problem, Sheldon says, is that, with interest rates currently around 2%, that future payout may not be the best deal for retirees.

"It's tempting to take the cash," he said, "but an adviser really has to sit down and ask the client what their needs are,



what else they have and why they really want to do it."

Those in the armed forces also have to decide what to do with their thrift savings plan, known as TSP, the government's version of a 401(k).

Many military members have substantial savings that are tax-exempt, Sheldon said. For example, military members do not have to pay any taxes on pay they receive while in a combat zone. Funds from IRAs and 401(k)s can be rolled into TSPs, but contributions and distributions are pro rata. As a result, "you can't maximize tax efficiency and you can't control taxes on distributions," Sheldon said.

What's more, distributions, whether in the form of a partial withdrawal, monthly payments or a life annuity, are "cumbersome at best ... and there may be possible estate planning surprises," Sheldon added.

TSPs represent a "material decision" for advisers working with military members, according to Sheldon.

"They're great for accumulation, not so good for distribution plans," he said.

**FP**

Charles Paikert is a senior editor of *Financial Planning*. Follow him on Twitter at @paikert.

## Focus Beefs Up With \$16.5B RIA

A partnership with SCS Capital Management is the second deal for the aggregator since Stone Point Capital and KKR bought a majority stake.

BY TOBIAS SALINGER

**FOCUS FINANCIAL PARTNERS HAS ADDED AN RIA** with \$16.5 billion in assets under management, its largest partner firm ever, weeks after securing an infusion of cash from two private equity companies.

The RIA aggregator has inked partnership deals with 10 firms this year and 48 since it launched 11 years ago. In the latest deal, the New York-based firm is set to acquire a majority stake in the revenues of Boston-based SCS Capital Management, according to an announcement in May by Focus.

The deal is the second one unveiled by Focus after Stone Point Capital and KKR agreed in mid-April to purchase a majority stake in the firm. The private equity firms set Focus' value at \$2 billion, up from a valuation of \$750 million in its last major equity sell-off four years ago.

SCS Capital, Focus' newest partner, usually requires its clients to have a minimum of \$25 million in assets under management, according to its latest Form ADV brochure.

Most clients invest in one or more of 14 pooled products, including funds of funds and offshore corporations, managed by SCS.

### \$74 MILLION PER CLIENT ACCOUNT AVERAGE

SCS averages \$74 million per client account. The wealth manager signed on with Focus at a "perfect moment" for the firm, its CEO and co-founder, Pete Mattoon, said in a statement. "We have been looking for a permanent capital partner that protects our commitment to clients and strong culture," Mattoon said.

The firms did not disclose the terms of the deal, which is subject to closing conditions.

SCS manages more than \$16.5 billion across 224 accounts, according to its Form ADV. HNW individuals make up more than 75% of the firm's clients, while less wealthy individuals represent another 10%. Founded in 2002, SCS has 77 employees, including 37 who serve in advisory roles.

The firm disclosed this year that it advises three new private equity investment funds, two of which are based in the Cayman Islands. Three other investment vehicles linked to hedge funds and advised by SCS deregistered in March ahead of selling their remaining assets.

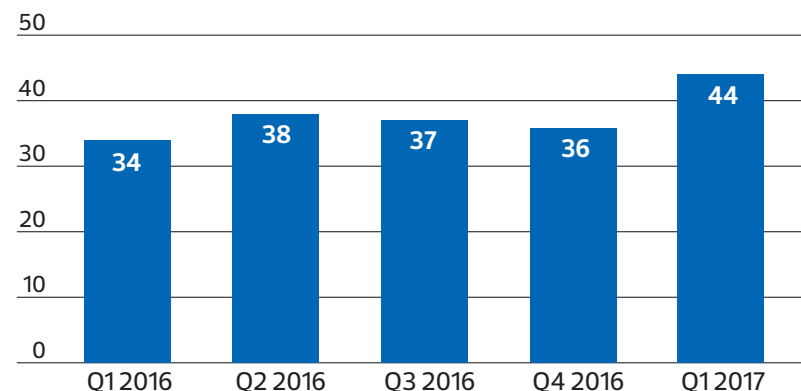
Focus has been one of the industry's most active aggregators this year. Led by CEO Rudy Adolf, Focus added Bordeaux Wealth Advisors, a Silicon Valley firm with \$1.9 billion in AUM, earlier in May.

In early April, the firm agreed to a partnership deal with Lake Street Advisors, a Boston-based firm with \$2.7 billion in AUM.

FP

### A Surge in Deals in the 1st Quarter

RIA M&A transactions hit a record high



Source: DeVoe & Co.

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



## The Beauty of Irrevocable Trusts

For ultrawealthy clients in the property business, an adviser's starting point should be an irrevocable trust. But you can't stop there.

BY MARTIN M. SHENKMAN

### A STARTING POINT FOR HIGH-NET-WORTH CLIENTS

— especially those exploring real estate investments — is to emphasize that irrevocable trusts are an essential part of estate planning.

This is not affected by the recent discussion of the possible elimination of all federal estate taxes. Even if irrevocable trusts are no longer created for tax reasons, they should still be created.

Having appreciating real estate owned by flexible irrevocable trusts gives clients more tax planning options, whatever the tax laws happen to be. The more flexible buckets in which clients' assets are stored, the more opportunities to plan.

Regardless of the potential tax benefits, building wealth in irrevocable trusts provides assets with protection benefits from lawsuits and claims.

Nothing Washington does is likely to reduce the litigious nature of our society. Just one example of the possible benefits of irrevocable trusts is that they can insulate assets from the divorce claims of heirs.

Below are some other details of estate planning that are worth considering for clients with significant real estate holdings:

### TRUST-FRIENDLY STATES

It has become common in modern estate planning to have trusts administered within states that have tax and legal environments that are favorable.

Four states — Alaska, Delaware, Nevada and South Dakota — have been the leaders in the trust game for years, but other states continue

to join the fray by enacting more favorable rules.

There is much at stake. The general concept of “irrevocable” in an irrevocable trust is that it cannot be changed. In recent years, however, the notion of merging — or, in estate planning parlance, decanting — an existing trust into a new trust has become more widely accepted.

This can provide a great deal of flexibility to modernize administrative provisions in an old irrevocable trust. But not all states permit decanting.

### QUIET TRUSTS

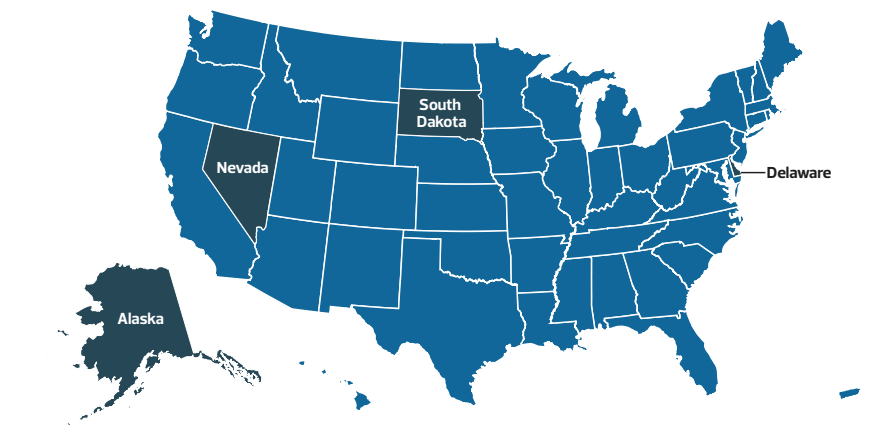
An even newer construct is nonjudicial modification. This occurs when a living grantor, all fiduciaries and all beneficiaries agree to change an irrevocable trust. Delaware enacted a law permitting this move last year.

This is an incredibly robust provision, but only one example of the kind of favorable laws that Delaware and other

---

### 4 States With Tax Environments Conducive to Trusts

Alaska, Delaware, Nevada and South Dakota have favorable legal environments.



## HIGH NET WORTH

---

trust-friendly jurisdictions can provide.

Another favorable option that might have considerable importance for some real estate investors is the ability to have a quiet trust. The general rule in many states is that most adult beneficiaries (sometimes referred to as qualified beneficiaries) must receive information about the trust. This would typically include a copy of the trust document and annual reports.

If a trust is administered in a state whose laws permit the trustee to forgo such communications and the trust document provides that no communication be given, however, then the beneficiaries may not have to be informed.

For some real estate clients, this may be an important goal.

If profits are to be reinvested in the properties, the client may prefer to have a quiet trust so the heirs do not clamor for distributions when the money is needed for improvements or expansions.

### MINIMIZING TAX IMPACT

Many clients use trust-friendly states to minimize state income taxes. While this may also be feasible for real estate investors, it is more difficult and limited because income generated by a property in a particular state is likely to be taxed in that state no matter where the trust owning the property is located.

Nevertheless, other types of income – such as investment earnings on cash accumulated from distributions and reinvested – may avoid state income taxation with this type of planning.

### DIRECTED TRUSTS

Real estate clients should consider structuring their irrevocable trusts as a directed trust. This is a trust for which the trustee function is bifurcated into at least two parts.

The first role is an investment adviser or trustee, responsible for all investment decisions. Hence, this person can determine

**Many clients use trust-friendly states to minimize state income taxes.**

**We built our IOVA on  
transparency, simplicity  
and unlimited tax deferral.**

**RIAs and fee-based  
advisors think we're really  
onto something.**

whether the trust will hold or sell any real estate interests.

The second trustee role is as a general trustee, who holds all other trust powers. This can be a crucial component of the succession plan for an investor with significant real estate holdings. The client herself can serve as the initial investment trustee (and this should not affect the removal of the real estate interests from her estate).

If one child or heir will ultimately succeed to managing the business, but all the heirs will be beneficiaries of the trust, this structure permits passing the baton to the designated heir to manage, while leaving the trustee with the flexibility to allocate the financial assets however desired.

To take advantage of this flexible structure, the trust will have to be formed in a jurisdiction that has laws permitting directed trusts.

Otherwise, the general trustee will have

liability for real estate decisions that they are not actually controlling.

#### **MASTER LLC**

The common approach to structuring real estate investments is to create separate limited liability company for each property.

If complex estate planning techniques will be used to shift some of these interests to irrevocable trusts, it will often be helpful to create a master limited liability company to own interests in the many properties and in other LLCs.

This can greatly simplify the legal documentation and financial transactions that are required.

Consider the prospect of gifting and selling interests in 20 different property LLCs to a trust, versus forming a single master LLC to own those underlying interests so that the transfer of just one LLC's interests to the trust are necessary.

**It is often helpful to create a master LLC to own interests in properties and in other LLCs.**

Delivering RIAs and fee-based advisors client value isn't an afterthought. It's JeffNat's guiding thought. A deliberate combination of purpose, product and commitment to RIAs, fee-based advisors and the clients they serve.

We work 100% transparently. Because that's how business should be done. No hidden fees. No hidden commissions. These principles have saved clients like yours over \$174 million in unnecessary insurance fees since 2006<sup>1</sup>.

Simplicity has its advantages, too. Our flat-fee IOVA, Monument Advisor, is a remarkable solution for all fee-based advisors. Easy to grasp. Easy to explain. Easy to manage.

Then there's the accumulating power of unlimited tax deferral that anchors our industry-changing Monument Advisor IOVA.

If you've been looking for a way to build your business into a powerhouse, try joining one. More than 4,000 advisors are already on board with the simple brilliance of JeffNat's Monument Advisor.

Jefferson National<sup>®</sup>  
is now



**Nationwide<sup>®</sup>**

TO LEARN MORE, VISIT:

**[jeffnat.com/clientvalue](http://jeffnat.com/clientvalue)**

OR CALL:

**1.866.667.0564**

<sup>1</sup>Total client savings derived from annual average Monument Advisor contract size multiplied by MORNINGSTAR<sup>®</sup> average M&E of 1.35%, minus the \$240 flat-insurance fee of Monument Advisor, and then multiplied by the number of policies in force. Data spans May, 2005 through December, 2016.

Variable annuities are subject to market fluctuation and risk. Principal value and investment returns will fluctuate and you may have a gain or loss when money is withdrawn.

Variable annuities are long-term investments to help you meet retirement and other long-range goals. Withdrawals of tax-deferred accumulations are subject to ordinary income tax. Withdrawals made prior to age 59 1/2 may incur a 10% IRS tax penalty. Variable Annuities are issued by Jefferson National Life Insurance Company, (Dallas, TX), or Jefferson National Life Insurance Company of New York (New York, NY) and distributed by Jefferson National Securities Corporation, FINRA member. Policy series JNL-2300-1, JNL-2300-2, JNL-2300-3, JNL-2300-1-NY, JNL-2300-2-NY. All companies are members of Nationwide. JNL201704-A042

Nationwide, the Nationwide N and Eagle and Nationwide is on your side are service marks of Nationwide Mutual Insurance Company. ©2017 Nationwide

**FOR FINANCIAL PROFESSIONAL USE ONLY. NOT FOR PUBLIC USE.**



Many institutional trustees charge an incremental fee for each limited liability company interest they have to hold because of the administrative burdens. For most clients, that is not an issue.

But for many real estate investors, given the tendency to use separate LLCs for each property, it can become a significant annual cost. Using a master LLC might be a way to avoid that.

## TRUST ADVISER LLC

Real estate interests, even if held in LLC format, will create a tie to the state where they are located.

If the client creates a trust in a different state to own those interests, issues might arise as a result of the connections to the states where the properties are located.

One way to minimize those connections might be to create an limited liability company in the state where the trust is to be administered and have that LLC hold the powers of trust investment adviser and trust protector.

The people providing this service would then do so through that LLC, thus possibly reducing the trust's connections to the state where property is actually located.

tax) can be vital to the succession of the real estate business.

When planning that insurance, advisers should consider using irrevocable trusts that are flexible enough to hold real estate LLC interests and life insurance.

Having both real estate and insurance in the same trust can enable distributions from real estate properties to be used to fund insurance premiums, avoiding the need to deal with annual gifts and the requisite notices (Crummey powers) traditionally used with such gifts.

Taking this action might require the appointment of a separate trustee for insurance matters.

**Having permanent life insurance coverage to provide liquidity may be invaluable.**

Articles of Organization Professional Limited-Liability Company (PURSUANT TO NRS CHAPTERS 86 AND 89)	
USE BLACK INK ONLY - DO NOT HIGHLIGHT	
ABOVE SPACE IS FOR OFFICE USE ONLY	
1. Name of Professional Limited-Liability Company: (see instructions)	
2. Registered Agent for Service of Process: (check only one box)	<input type="checkbox"/> Commercial Registered Agent: Name _____ <input type="checkbox"/> Noncommercial Registered Agent (name and address below) <b>OR</b> <input type="checkbox"/> Office or Position with Entity (name and address below) Name of Noncommercial Registered Agent <b>OR</b> Name of Title or Office or Other Position with Entity _____ Street Address _____ City _____ State <u>Nevada</u> Zip Code _____ Mailing Address (if different from street address) _____ City _____ State <u>Nevada</u> Zip Code _____
3. Name and Address of the Original Members and Managers: (see instructions)	
1) Name _____ Street Address _____ City _____ State _____ Zip Code _____	
2) Name _____ Street Address _____ City _____ State _____ Zip Code _____	
3) Name _____ Street Address _____ City _____ State _____ Zip Code _____	
4. Management: (required)	Company shall be managed by: <input type="checkbox"/> Manager(s) <b>OR</b> <input type="checkbox"/> Member(s) (check only one box)
5. Profession to be Practiced: (see instructions)	
6. Name, Address and Signature of Organizer: (attach additional page if more than 1 organizer)	I declare, to the best of my knowledge under penalty of perjury, that the information contained herein is correct and acknowledge that pursuant to NRS 239.330, it is a category C felony to knowingly offer any false or forged instrument for filing in the Office of the Secretary of State. Name _____ Organizer Signature <b>X</b> _____

The document used to file a professional LLC in Nevada.

## LIFE INSURANCE

Life insurance is likely to remain an important feature of the estate plan for major real estate investors. Having permanent life insurance coverage to provide liquidity may be invaluable to avoid a forced sale of properties during a market downturn. Some type of tax is likely to be due.

Using insurance to defray some portion of that tax (whether capital gains or estate

## SUCCESSION PLANNING

Succession planning is a vital issue to address for clients with extensive real estate holdings. Advisers should make sure that the attorneys involved are coordinating both the provisions and planning in the governing entity documents and the trust and estate planning. In many cases, this work is handled by different lawyers, and if it is not coordinated, costly problems can result. **FP**

**Martin M. Shenkman**, CPA, PFS, JD, is a *Financial Planning* contributing writer and an estate planner in Fort Lee, New Jersey. He runs laweasy.com, a free legal website.



# DISRUPT

a d v i c e

SEPTEMBER 12 - 13, 2017 | NYC

SIGN UP TODAY,  
EARLY BIRD RATES  
EXPIRE ON 7/14

## These Disrupt|Advice 2017 speakers are embracing the future...



**MARK BERG, CFP®**

Senior Advisor  
and Founding Principal  
TIMOTHY FINANCIAL  
COUNSEL



**BETH JONES,  
RLP®, AIF®, CEFT®**

President, Third Eye  
Associates, Ltd.  
CERTIFIED FINANCIAL  
TRANSITIONIST



**STEVEN D. LOCKSHIN**

Principal  
ADVICEPERIOD



**CAROLYN MCCLANAHAN  
M.D., CFP®**

Founder  
LIFE PLANNING PARTNERS, INC.

## The most successful advisers adapt to change. **WILL YOU?**

Disrupt|Advice will be the one forum that brings together independent, wirehouse and bank advisers to help them get ahead of the forces changing their businesses.

Sign up today, early bird rates expire on 7/14.

To register visit us online or contact Paul Himberger at 212-803-6091.

Group discounts are available.

Presented by  
**Financial  
Planning**

**LEARN MORE**

[www.financial-planning.com/events](http://www.financial-planning.com/events)

# AWAY FROM H

There's a lot more to real estate investing

BY CHARLES PAIKERT

**W**hen it comes to discussing real estate with clients, adviser Michael Martin is able to draw on his own hard-earned experience.

In 2001, Martin, principal and founder of Marius Wealth Management in New York, left a career at Smith Barney to spend what became a decade as a real estate investor, buying, rehabbing and selling prop-

erties in New York and Florida.

"I learned some valuable lessons, I can tell you that," Martin says. Fortunately for his clients, they are lessons he is now able to impart to them.

The native New Yorker had some home runs renting, buying and selling properties in the Hamptons, the fashionable beach towns on Long Island.

"I knew what renters and buyers wanted in a Hamptons house, and where they wanted to be," he says. "I knew how far a house could be from the train track, for example. And after seeing a house for the first time during the day and being initially sold on it, I would always go back at night or weekends to uncover any negative surprises, such as crazy neighbors, loud noises or unpleasant odors from, say, a nearby duck farm."

But Martin didn't fare as well in Florida.

In 2005, he overpaid for what appeared to be desirable vacant lots fronting



# OME

than thinking locally



Being caught at the wrong end of an economic cycle is a major risk in real estate, says Derek Newcomer, director of investment research at Beacon Pointe Advisors.

a canal in Coral Gables, Florida. What Martin now owes on his mortgages is more than the fair market value of the lots. His waterfront properties are, in real estate lingo, now underwater.

Martin learned the hard way that “vacant lots do not produce rental income if the numbers turn against you at market highs, especially if you need to derive income while you wait for the market to improve.”

### REAL ESTATE LESSONS

Don’t mortgage vacant lots,” Martin says, “which I did. Don’t have your wife on the mortgage, too, which I did.”

Martin also warns against replicating two other mistakes he says he made: succumbing to FOMO – a fear of missing out – and being “persuaded and influenced by a commission-hungry salesman.”

Martin returned to the advisory business in 2012.

“I realized I liked being an adviser better,” he says. “Real estate was ultra-competitive, and it’s easier to differentiate yourself as an adviser.”

After two years at Wells Fargo Advisors, he started his own firm in 2014. When high-net-worth clients say they want to invest in real estate, excluding their primary residence, Martin doesn’t mince words.

**“REAL ESTATE IS NOT FOR THE FAINT OF HEART,” MICHAEL MARTIN SAYS. “YOU CAN’T BE EMOTIONALLY ATTACHED. AND THE LACK OF LIQUIDITY IS A HUGE ISSUE.”**

“Real estate is not for the faint of heart,” he advises them. “It’s a very fickle market. You can’t be emotionally attached. And the lack of liquidity is a huge issue. You’re married to a property until you’re able to sell it, and the options for liquidity are far less than any other investment.”

## Key Terms for Real Estate Investments

**Capitalization rate:** Often just called the cap rate, this is the rate of return on a real estate investment property based on the income that the property is expected to generate. The cap rate is used to estimate the investor’s potential return on his or her investment.

$$\text{Capitalization Rate} = \frac{\text{annual net operating income}}{\text{cost (or value)}}$$

**Cash-on-cash return:** This measures the annual before-tax cash flow divided by total cash invested.

The cash-on-cash return is used to evaluate the cash flow from income-producing assets. It is also sometimes used to determine if a property is underpriced. The initial equity investment is the total purchase price minus any loan proceeds.

$$\text{cash-on-cash return} = \frac{\text{annual before-tax cash flow}}{\text{total cash invested}}$$

Martin and other wealth managers stress the need for a detailed and candid conversation covering asset allocation, risk, tax liability, income needs and the consequences of owning an illiquid asset.

Advisers generally recommend that high- and ultrahigh-net-worth clients allocate anywhere from 5% to 30% of a portfolio to real estate as an asset class, with many caveats, of course.

Age and income needs are primary considerations. For older clients who

of assets into real estate investments outside their primary residence. For anything exceeding 15%, clients should “have an affinity with the space” – that is, be real estate professionals themselves.

Being caught at the wrong end of an economic cycle is a major risk, cautions Derek Newcomer, director of investment research at Beacon Pointe Advisors in Newport Beach, California.

Property location is another critical variable. “If you have a real estate asset in Houston, and the energy business takes a dive, you’re left very exposed,” Newcomer explains. One way to mitigate the risk, he advises clients, is to diversify their holdings with multiple assets in different geographic areas.

### SCRUTINIZE COSTS

Clients should closely scrutinize maintenance costs, Fox notes. They must analyze tax obligations. And while real estate investments can provide tax relief in some cases, Fox and other advisers say this should not be a primary reason to buy property.

will need income, Ross Fox, founding partner at Cardan Capital Partners in Denver, puts “a higher emphasis on cash flow versus total return. We want to have serial liquidity events in investments that mature over time.”

For HNW clients, Fox recommends allocating approximately 5% to 15%



Position Your Clients for Real Estate **SUCCESS**.  
Your Clients Deserve an Exclusive Buyer Agent.

## **naeba** members:

- provide fiduciary representation to real estate buyers, including market value comparisons, expert advice, and skilled negotiation
- never represent sellers or accept property listings, which protects your clients against the inherent conflict of interest that exists in typical real estate brokerages
- can show your client any property on the market and because they don't have listings, will never steer your client toward a property that is not in your client's interest
- must adhere to the strictest Code of Ethics and Standards of Practice in the real estate industry



*These advantages and more are available to your clients without any extra cost in their real estate transaction.*



For more information, visit **[www.naeba.org](http://www.naeba.org)** or call 800-986-2322.



"You can certainly receive favorable tax treatment for some investments, but clients can get too cute by half by trying to [minimize] their taxes," Fox says.

Lois Basil, principal of the Basil Financial Group in Chicago, says her real estate advice doesn't vary much, no matter what her client's tax bracket. "I think there's a place for real estate in every portfolio, whether mass affluent or high net worth," Basil says. "Leveraged real estate is an excellent hedge against inflation, and tax efficient. Our goal is to have our clients' net worth divided one-third interest-earning, one-third equities and one-third real estate."

Only after risks have been discussed and understood can the potential benefits of real estate investments be presented to clients, advisers say. Indeed, it's imperative.

For wealthy clients, real estate is simply "too big to ignore," says Alex Stimpson, founding partner and co-CIO of Corient Capital Partners

in Newport Beach, California. "Real estate plays an important role as part of overall asset allocation in their portfolios," he says. "It provides risk diversification because it has a low correlation to the stock market."

Real estate is also a good source of income diversification, he adds. While corporate bonds are yielding around 3%, real estate investors should be rewarded with a higher yield—an additional 2% to 5%, Stimpson says—in exchange for taking on lower liquidity.

### THE ILLIQUIDITY PREMIUM

This "illiquidity premium" is a key concept when discussing real estate with clients, says Marty Bicknell, chief executive of Leawood, Kansas-based Mariner Wealth Advisors.

Just as clients need to know the risks associated with an investment that isn't publicly traded, clients "with the patience to ride out economic cycles" can also benefit from illiquidity, Bicknell says, although the premium he seeks is less generous

than Stimpson's.

"The illiquidity premium should be around a 2% to 3% increase over more liquid alternatives," he says. "If not, it wouldn't make sense to tie up the capital."

A leading way clients can invest in real estate is through publicly traded REITs. But with yields at historic lows (the Vanguard REIT Index Fund yields a little over 4%), advisers interviewed did not recommend REITs as an optimal real estate strategy.

Direct investments or investments in a private fund were preferred real estate vehicles, and investors can benefit greatly from the capitalization rate [see sidebar], say Stimpson and other wealth managers.

"The cap rate is a powerful predictor of future return and future risks," Stimpson says. "What you see is usually what you get."

What are some of the common and not so common real estate strategies wealth managers are employing for clients? See examples below.

## AIRBNB

**How it works:** One of Michael Martin's clients in Denver bought two luxury recreational vehicles to rent to Airbnb customers. They're in a trailer park just outside



the city, and the client is a model host; he leaves maps of the city, puts in fresh flowers and makes himself available by phone or text.

In the winter, the client moves the vehicles to Vail, Colorado, home of the popular ski resort.

The client bought two Grand Design Solitude Fifth Wheel vehicles for \$70,000 each. He is financing 80% of the purchase at 4% simple interest (a type of interest

applied to automobile and short-term loans).

**Upside:** Denver is booming, and demand for accommodations is high.

After adding the \$14,000 down payment to the annual financing costs per unit and dividing that number by the net annual income of approximately \$37,000, the client achieved a return on his investment of about 48%, according to Martin.

**Risks:** The RVs are not appreciable assets, and if there is a market downturn, there is no guarantee of rental income. What's more, the client's business depends on Airbnb, which could mandate a reduction in rates. "His fate is in someone else's hands," Martin says.

## UNLOCKING HOME EQUITY

**How it works:** “We analyze the equity in a client’s home,” says Lois Basil of Basil Financial Group. “If it is less than 50% leveraged, we recommend thinking of ways to unlock that real estate equity.”



This approach is markedly different than what is in the financial press, where the advice often is to prioritize paying off your mortgage.

“While not having a mortgage may make sense for some people, we have found that always having a mortgage is a sound and tax efficient strategy,” Basil says.

“Our goal when working with clients is to minimize their tax liability. People often misunderstand that much of their income in retirement is taxed at ordinary income rates. We want to work to make sure our clients are taking advantage of every available deduction to reduce their taxable income.”

For example, Basil Financial Group will even

recommend 30-year mortgages for 80-year-old clients. “Their retirement income is still being taxed at ordinary income rates, and we want them to keep more of their money,” Basil says.

**Upside:** The strategy reduces taxable income. For most clients, their home is their largest asset. “Having your house illiquid does not pay for health care, does not fund education and doesn’t buy groceries,” Basil says.

What’s more, mortgage interest rates are declining after a postelection spike.

**Risks:** There might not be enough income to pay the mortgage. It’s also possible the value of the real estate will go down, property taxes will rise and unexpectedly large home-improvement repairs will be needed. “The biggest problem we have with this strategy is overcoming clients’ objections based on the psychological freedom they have that comes from not having a mortgage,” Basil says. “Sometimes, emotions can’t trump a sound financial rationale.”

## CHARTER SCHOOLS

**How it works:** Summit Trail Advisors, a wealth management firm in San Francisco, has partnered with American Infrastructure MLP Funds to buy around 50 buildings housing charter schools in 13 states over the past two years.



Clients from other independent firms can also invest. American Infrastructure is a private equity fund that charges a 2% management fee

and 20% of profits above and beyond an 8% preferred return to investors.

The fund hopes to take the portfolio of schools public in an IPO, says Tom Palecek, a Summit Trail founding partner. “To get there, we need to acquire enough schools to where the aggregate of the portfolio income

is in excess of around \$100 million,” Palecek says.

**Upside:** Investors were collecting an 11% yield in June while the partnership continued to add schools.

If an IPO proceeds and the stock rose in value, investors could “stand to make a substantial amount” from share price appreciation, Palecek says. If the stock did indeed gain, he estimates the yield could drop to 6% to 8%.

**Risks:** Charter schools in the portfolio need to keep seats full for years to come, have high test scores and demonstrate “really great management and operations,” Palecek says. Anything less could mean problems. A regulatory change in charter school funding at the federal or state level could also spell big trouble.

## PRIVATE PARTNERSHIPS

**How it works:** While there are thousands of real estate fund managers whom advisers can work with, “it takes time and a dedicated effort to find managers whose strategies are most suitable to meet clients’ needs and goals,” Derek Newcomer says. “The adviser needs to ensure that a client [is qualified and willing] to invest in an illiquid investment strategy such as private real estate.



“Some managers have very high minimums,” Newcomer explains. “We have been successful in negotiating minimum investment sizes for our clients so that we can obtain greater adoption from a wider universe of clients.”

Newcomer’s firm, Beacon Pointe Advisors, places clients in partnerships with such firms as Kairos Investment Management, Southwest Value Partners and Buchanan Street Partners, which invest in a wide variety of properties, including office buildings, multifamily properties, industrial properties and retail assets.

An internal committee at Beacon Pointe determines a client’s appropriate asset allocation, usually no more than 10%, before investing in a partnership, Newcomer says.

Investment managers typically charge a 1% to 2% management fee on either committed or invested dollars, as well as a performance fee of 15% to 20% after investors have received their original dollars invested and an 8% to 9% preferred return.

“Some funds are structured differently,” Newcomer says, “so it is extremely important to understand how fees are generated and what the fund pays out to the manager as fee income.”

**Upside:** Distribution of income: Beacon Pointe targets approximate total return combining income and profit to around 12% to 15% over the life of the fund.

**Risks:** Investments could be illiquid for up to 12 years.

“Fractured management teams can lead to trouble, particularly when you are in a long-duration life fund that can last 10-plus years,” Newcomer says. “Poorly managed assets can lead to increasing costs and decreasing income-generating capabilities.”

The manager may also utilize too much debt when acquiring a property, become too reliant on one tenant or concentrate holdings in one geographic region. What’s more, a partnership may collapse as a result of fraud, disagreements within management or other reasons.

“Advisers should thoroughly review the fund offering documents to fully understand what the consequences of such an incident would have on underlying investors,” Newcomer says. “Certain clauses within the offering documents will outline what would happen should such an event take place.

“There may be arbitration clauses, mediation, or assets may be placed into a liquidating trust,” he says.

“Investing with the right management team that has a long history of working together successfully can help to minimize such an event.”



It is extremely important to understand how fees are generated in private partnerships, says Beacon Pointe’s Derek Newcomer.

FP

# A Profitable Sale Without Taxes

Section 1031 of the IRS Code may seem arcane, but using it can be highly beneficial to certain clients as real estate prices climb.

BY MIRIAM ROZEN

Section 1031 of the IRS Code may seem like an arcane — and perhaps even unnecessary — subject for an adviser to be expert in. But now that property prices have climbed to pre-2008 levels in most parts of the nation, it is essential to know about 1031 exchanges, according to Steve Dudash, president of Chicago-based IHT Wealth Management.

"If you are not able to hold conversations about like 1031 strategies with your clients, you are obsolete," Dudash says. "You won't have a job in five or 10 years."

Knowing about 1031 exchanges is especially valuable for an adviser with clients who own rental real estate. Under this section of the tax code, clients can defer the federal government's recognition of capital gains on the sale of a property if they buy a comparable property — one rental home for another, for instance — within a prescribed time period.

Only recently, as real estate prices have risen nationwide, have 1031 exchanges re-emerged as an extremely useful tool, Dudash says. When clients had properties that were underwater, capital gains taxes were not even a hint on the horizon, he says.

The attractiveness of 1031 exchanges may be amplified if proposals for a flat tax become serious. If such a proposal were to be enacted, clients' capital gains might no longer be taxed at preferential rates but rather would fall into ordinary income



brackets, according to Chad Smith, a wealth management strategist at HD Vest investment Services in Irving, Texas. "It could be changing very much over the next year, and capital gains could be taxed at ordinary income rates," Smith says.

## OFFSETTING HANDSOME GAINS

But even under current tax laws, 1031 exchanges are an attractive tool for advisers in an economic environment in which clients are realizing significant capital gains. "It's always handy," says Lisa Detanna, a senior vice president and managing director for Raymond James' Global Wealth Solutions Group in Beverly Hills, California.

According to Detanna, a client will call and say, "Oh, by the way, I've sold a property."

In some cases, this can lead to a scramble to find a place to exchange.

For just such situations, Detanna turns to a banker whose institution has been designated to act as a qualified intermediary in 1031 exchanges.

Under a typical 1031 exchange scenario, a client who owns rental real estate sells the property but the proceeds initially go to such a bank, which is prepared to serve as a qualified intermediary or, as it is sometimes called, an accommodator.

Under the IRS rules, the seller of the rental property then has 45 days to identify a "like" property and 180 days to purchase it, using the proceeds that have been kept with the qualified intermediary.

Although a qualified intermediary adds an expense, the tax savings may be much greater.

The exchange can help postpone taxes on highly appreciated properties that clients want to sell but don't want



to add to their tax bill.

"Some will charge a flat fee, and some charge a percentage of the sale price," Detanna says. But, either way, "it's nominal when you consider how much you are saving by delaying the taxes." Indeed, the tax saving put her clients in "a whole different arena" in terms of their purchasing power for a new rental property. "The delay of taxes lets you build wealth," she says.

### DEFINING 'LIKE'

The exchanges are possible in a variety of circumstances because of how broadly the tax law defines a "like" property. There is tremendous flexibility in the term. "It doesn't have to be apartment to apartment," Detanna says. "You can switch to a duplex or exchange to a strip mall. It doesn't have to be residential."

For Smith, 1031 exchange strategies have enabled him to help clients who are "tired of being landlords." For such clients, Smith has frequently recommended that they consider limited partnerships that own rental real estate. These partnerships aim at providing turnkey solutions for investors who don't want to look for another sole-ownership property or haven't been able to find one yet.

But when evaluating limited partnerships — sometimes structured as tenancies in common — advisers should approach the proposals with skepticism, Smith says.

"Our firm works with only two vendors" of such vehicles, he says, in order to limit its business to firms in which it has confidence. Even then, his firm hires an outside counsel to review any new investment packages the vendors offer. "We are very, very cautious," Smith says.

"That turnkey option is not right for everybody," he adds. "It needs to

fit into their overall plan and their income needs."

For her part, Detanna generally steers clients away from turnkey 1031 investment vehicles. "There are lots of negatives associated with these," she says. "You have no control; general

an adult child or an elderly parent who then pays rent. This can be an attractive option because no one has to pay capital gains taxes.

But, Dudash cautions, often the family dynamics overwhelm whatever rental payment structure is

THE TAX SAVINGS FROM A 1031 EXCHANGE CAN PUT CLIENTS IN "A WHOLE DIFFERENT ARENA" IN PURCHASING POWER. "THE DELAY OF TAXES LETS YOU BUILD WEALTH," LISA DETANNA SAYS.

partner fees are usually high. You are in a partnership maybe with 35 other partners, and you get very little information about them or the management of the assets."

### ESTATE PLANNING

On the other hand, one-to-one 1031 exchanges are valuable for clients' financial planning and, in particular, estate planning, Detanna says. "If the patriarch and matriarch have multiple rental properties and the adult kids don't have the bandwidth to be in the property management business, 1031 options are something we would generally discuss," she says.

Sometimes, since the heirs will get the step-up in property values when they inherit rental real estate, the best option is to wait and allow them to sell it and avoid more expensive strategies, Detanna and other advisers says.

At IHT Wealth, Dudash says, he asks clients considering a 1031 exchange, "What is your purpose?" By knowing their endgame, he can help them figure out if such an exchange makes sense in their circumstances.

Sometimes, a 1031 exchange strategy can help with multigenerational planning. A rental property owner can make an exchange to buy a home for

devised and relationships turn sour. "It doesn't always work out," he says.

Another scenario in which a 1031 strategy might be helpful, as long as the clients have two years of lead time, is in financing a summer home or a future residence.

If the clients have a rental property, they can sell that and exchange it for a home in a vacation spot of their choice and then rent out that vacation property for two years, so they satisfy the IRS' requirements for the 1031 exchange. After that, the place is theirs to enjoy forever — no capital gains tax payments required.

But the devil is in the details. According to Alan Soltman, a CPA with Merlis, Soltman, Green & Associates in Los Angeles, who works with Detanna, the IRS will not challenge that the dwelling qualifies as a like exchange under 1031 if it is leased at least 14 days at a fair rental in each of the first two years after the exchange.

But if the clients use the home during the two-year holding period, limitations apply. For a 1031 exchange, the property owners' personal use cannot exceed the greater of 14 days or 10% of the total number of days the property was rented at a fair market price, Soltman says.

**FP**

---

Miriam Rozen, a *Financial Planning* contributing writer, is a national reporter for Law.com in Dallas. Follow her on Twitter at @MiriamRozen.

## A 'Grave' Threat for Advisories

Pershing Advisor Solutions' CEO challenges advisers to diversify their staff — or become irrelevant.

BY TOBIAS SALINGER

**LACK OF DIVERSITY WITHIN THE ADVISORY INDUSTRY** represents a "grave" threat, according to Pershing Advisor Solutions CEO Mark Tibergien.

"Our talent doesn't reflect the face of our community, nor does it reflect what I think is important for the continuation of the independent financial adviser movement to address as a crisis," Tibergien said in a speech at the May NAPFA conference near Seattle.

"To the extent that we do not address what our future is going to look like, what you have created here with NAPFA will become irrelevant in 10 or 15 years. It's a call to action."

Tibergien, who runs one of the country's largest custodians, admitted that a 65-year-old white man is an ironic speaker for this message. He and other presenters at the conference, however, pointed out the sheer numbers highlighting the problem. They also proposed a series of changes they hope will lead to more advisers who are minorities or women.

"We as a society have overcome a lot of the overt sexism that is out there in the workplace. But I do believe that there's still unconscious bias and gender-role expectations that still exist, most of the time unintentionally," said Gretchen Halpin, principal of Hewins Financial Advisors in Chicago.

"In the financial services industry, a lot of the leaders of the firms are still from that past generation of thinking," she said. "And so that unconscious bias comes into play when young women are moving into the workforce."

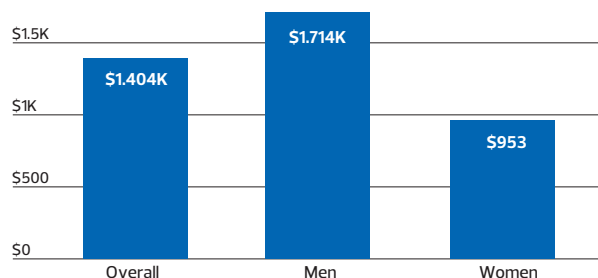
### STARK DISPARITIES

Data display stark gender and racial disparities. Only 8% of advisers at 18 large financial services firms are people of color, according to a SIFMA demographics study.

And just 48,631 advisers out of 310,504 overall — about 16% — are women, according to a study earlier this year by Cerulli Associates. Female advisers earned 80% less in weekly median pay in 2016 than their male colleagues,

### Massive Gender Compensation Gap

Male advisers earn 80% more than women in weekly median pay.



Source: U.S. Bureau of Labor Statistics

according to the U.S. Bureau of Labor Statistics.

Forward-looking firms create career paths toward leadership roles for their advisers, Tibergien said. They also need to alter the tone of their recruiting pitches, specifically to correct the idea that advisers are just salespeople, to appeal to millennials and other young people, he argued.

Yet a common misperception among hiring executives remains that not enough women are qualified or want to be advisers, according to Manisha Thakor, the Houston-based director of wealth strategies for women at Buckingham Strategic Wealth and the BAM Alliance.

The growing wealth of women worldwide could force changes at all firms, however. Firms should take a close look at their leadership teams, said Eileen O'Connor, CEO of Hemington Wealth Management in Falls Church, Virginia.

"There are not enough women in leadership positions," O'Connor said. "You can do a lot of talking about culture, but I think having women in those positions is what's going to attract women to the firm."

FP

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

## Should I ... Do a Client Survey?

It's a good source for an honest critique, especially when a client might be hesitant to complete one in person, but it does take time and money.

BY INGRID CASE

**ADVISER JASON KIRSCH LEARNED SOME** uncomfortable facts when he surveyed his clients last year. The founder of the holistic planning firm Grow heard that he sometimes talks too fast, and too much, without really listening. Clients also said that the documents he sends them can be hard to understand.

It wasn't all negative. Kirsch found out that he generally communicates well, but he was chagrined to hear that his initial contact with clients at times seems too automatic.

In all, it was a good experience and Kirsch says he was especially grateful for comments that suggested improvements. "I know my strengths and weaknesses, but I don't know all my strengths and all my weaknesses," he says.

The knowledge led to change. Kirsch has re-evaluated the documents he gives clients and tries to talk less and listen more. Impersonal email templates, however, aren't going away. "If I did spend more time crafting personal emails, I would have to transfer that cost to the clients," he says.

### CONFIDENTIALLY CRITIQUING

Surveys can be a great way to find out what clients really think. Kirsch's firm, based in Los Angeles, sends surveys every six months. Clients who leave the practice get a survey within a month after the relationship ends.

It takes Kirsch about a day to create and review each survey. He uses Survey Monkey software and says he gets a nearly 100% response rate from short-term clients. He hears back from about 40% of ongoing clients.

That response rate is similar to what Evelyn Zohlen has had from two client surveys in the past two years. Zohlen, founder and president of Inspired Financial in Huntington Beach, California, tried to make asking for feedback part of client meetings, she says, "but some people are uncomfortable giving negative feedback face to face."

Zohlen uses a vendor that handles every aspect of the



surveys: writing the questions (Zohlen chooses the topics), sending them out and analyzing responses. The process costs about \$500. "It was interesting to see how many people said that they would like particular services, such as insurance reviews and college savings advice, but didn't realize that we provide them," Zohlen says.

Zohlen and her staff then created a single-page summary of services they offer. "It's like a menu."

Diane Woodward, president of Oak Tree Wealth in San Ramon, California, "wanted to know how I'm doing."

"I've had a women's health and money event that involved a nutritionist and a personal coach ... and I'm doing an event on cybersecurity," she says. "I want to know if clients like these events." They do like the events, she notes.

Her clients would also like more financial education. "I've added a quarterly webinar on various topics," she says.

The questions were approved by Woodward's compliance department and the survey took 15 or 16 hours. Woodward paid \$500 to \$800 to the vendor.

**FP**

---

Ingrid Case, a *Financial Planning* contributing writer in Minneapolis, is a former senior editor for *Bloomberg Markets* magazine. Follow her on Twitter at @CaseIngrid.

## Deducting in Reverse

Reverse mortgages present a number of appealing features for borrowers — and a number of confounding tax implications.

BY MICHAEL KITCES

**THE APPEAL OF A REVERSE MORTGAGE IS THAT** it allows homeowners to borrow against their primary residence's value without making ongoing payments. Interest simply accrues on top of the principal and most commonly is not repaid until either the homeowner moves and sells the home, or it is sold by heirs after the owner dies.

However, borrowers (and their advisers) often overlook the tax implications of reverse mortgages. If not planned for, subsequent mortgage interest tax deductions may be lost for the borrower or his or her heirs. Consequently, it's essential to coordinate a reverse mortgage with the rest of a client's tax- and estate-planning strategies.

### MORTGAGE TAXABILITY

The only reverse mortgage insured by the federal government is called a Home Equity Conversion Mortgage and is available only through an FHA-approved lender. One of the most popular selling points of an HECM is that the money received is tax-free.

This is because a reverse mortgage is nothing more than a loan against an existing asset — regardless of whether the reverse mortgage is an upfront lump sum, a line of credit that's periodically drawn against or structured as tenure payments for life.

It is no more taxable as income than a loan to buy a car or pay for college, a home equity line of credit or a loan against a life insurance policy.

While it might be called income for household cash

flow purposes, it's really just a loan — albeit one subject to special terms and borrowing requirements.

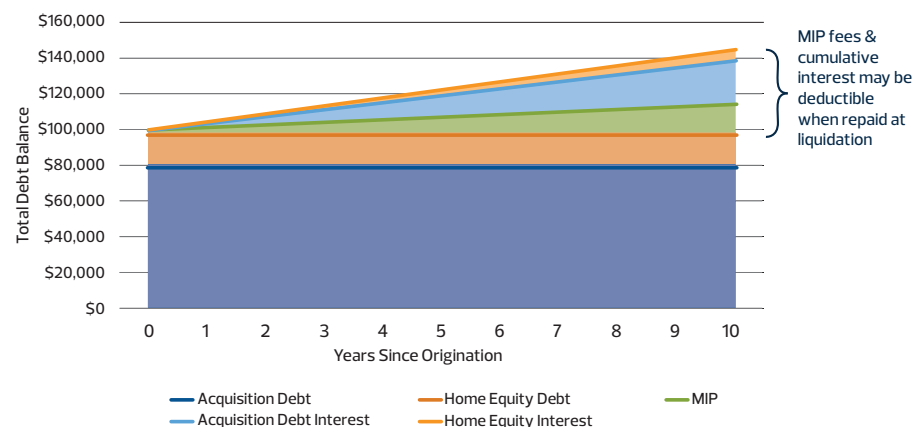
### DEDUCTIBILITY OF INTEREST

Determining the deductibility of reverse mortgage interest is far more complex, however.

The standard rules under IRC Section 163(h) state that personal interest is not tax-deductible. But there is an exception under IRC Section 163(h)(3) that allows a deduction for payments of "qualified residence interest" — that is, mortgage interest that is classified as either "acquisition indebtedness" or "home equity indebtedness."

Acquisition indebtedness is a mortgage debt incurred to acquire, build or substantially improve either a primary residence or a designed second home. Home equity indebtedness describes any mortgage debt against a primary resi-

### How Reverse Mortgage Interest and MIP Compound



Key Points: ● \$450,000 Residence ● \$80,000 Existing Mortgage ● \$10,000 Credit Card Debt ● \$8,000 Closing Costs followed by 3% Interest ● MIP of 0.5% Upfront ● 1.25%/year Ongoing

Source: Michael Kitces



dence or second home that doesn't qualify as acquisition indebtedness.

The classifications of mortgage debt are significant. Interest on the first \$1 million of acquisition debt principal is deductible, but taxpayers can deduct the interest on only the first \$100,000 of home equity indebtedness. Additionally, interest on home equity indebtedness is an alternative-minimum-tax adjustment, which means the deduction is lost entirely for those already paying AMT.

## HOW THE PROCEEDS ARE USED

Notably, the rules classifying mortgage debt are based not on what the lender calls the mortgage, but how the loan proceeds are used. Thus, a home equity line of credit to expand the home is acquisition debt, but a cash-out refinancing of a 30-year mortgage that is used to consolidate and repay credit card debt is home equity indebtedness — at least for the additional cash-out portion of the loan.

Meanwhile, a mortgage taken out when a primary residence is purchased is acquisition debt. But if the owner buys the property with cash and later does a cash-out refinance for the same mortgage amount and terms, he or she will have the interest treated as home equity indebtedness because the loan proceeds weren't used to acquire the residence.

Furthermore, under Treasury Regulation 1.163-10T(c)(1), mortgage interest deductibility is further limited to a debt balance that doesn't exceed the original purchase price of the home. Thus, if the original purchase price was \$300,000 and a home expansion increased the adjusted purchase price to \$350,000, the owner can never deduct mortgage interest on more than \$350,000 of mortgage debt. In most typical traditional mortgage situations, this is a non-issue, as the mortgage would typically start at \$300,000 or less and amortize downward.

Issues arise if the house appreciates and a subsequent cash-out refinance increases the mortgage balance above the original purchase price, plus improvements. And it can also be a limiting factor for negative amortization loans, where the interest compounds against the loan balance over time.

A reverse mortgage is still indebtedness against a primary residence, which means the same rules apply to deduct reverse mortgage interest. This includes the determination of whether the loan balance will be classified as acquisition debt or home equity indebtedness. However, there's an important caveat: Under IRC Section 163(h), mortgage interest is deductible only when it's actually paid.

That's a big deal for a reverse mortgage, because the borrower is typically not making any interest (or other) payments on an ongoing basis. Yet if the mortgage merely accrues and compounds, there can be no interest deduction on a year-by-year basis.

Instead, the cumulative loan interest is often repaid when the reverse mortgage finally terminates.

## RECOVERING LOST DEDUCTIONS

The problem with the typical lump-sum repayment of a reverse mortgage is that when the cumulative loan interest is repaid all at once — and thus claimed as a deduction all at once — the accrued debt might exceed the adjusted purchase price of the property.

Furthermore, if the taxpayer does not have enough income to be offset in that particular tax year, much of the deduction could be lost entirely.

In their *Journal of Taxation* article "Recovering a Lost Deduction," Stephen R. Sacks, et al., explore how to avoid losing the tax benefits of the reverse mortgage interest deduction in lump-sum repayment scenarios.

The most straightforward is, in the tax year the reverse mortgage will be repaid, the owner should create taxable income that can then be absorbed by the mortgage interest deduction. This might be accomplished with an IRA distribution or a partial Roth conversion or simply by ensuring the owner's total income from other sources is sufficient to fully offset the available deduction.

If the primary residence has appreciated such that there's a capital gain, even after the up-to-\$500,000 capital gain exclusion for the sale of a primary residence, the excess gains can also potentially be offset by the mortgage interest deduction. And while

**In the tax year the reverse mortgage will be repaid, the owner should create taxable income that can then be absorbed by the mortgage interest deduction.**

the deduction is less valuable when applied against a capital gain instead of ordinary income, it's still better than being lost altogether for lack of sufficient income.

If the original homeowner dies, a question arises: Who gets to claim the interest? It is not the deceased homeowner anymore. Instead, it is now a tax issue for the estate or heirs.

Fortunately, Treasury Regulation 1.691(b)-1 allows a decedent's prospective deductible items not paid at death to be deducted when paid by beneficiaries.

However, in many cases, the beneficiaries themselves lack sufficient income to be offset by the mortgage interest, especially when most assets get a step-up in basis. The estate inherits the house to liquidate, but doesn't inherit pretax retirement accounts that might have created taxable income.

Accordingly, one must consider who will inherit a property subject to a reverse mortgage that might be repaid after death, and whether he or she will have sufficient income to offset or absorb the available deduction. Alternatively, the borrower can avoid the potential clustering of the reverse mortgage's interest deduction payment at death by voluntarily paying the interest annually (though notably, payments are first applied against accrued mortgage insurance premiums and aggregate servicing fees).

And such ongoing repayments might not be manageable, either, depending on the retiree's cash flow.

#### **ITEMIZING DEDUCTIONS**

Mortgage interest payments are deductible only when the borrower actually itemizes deductions – which isn't always the case for retirees. It is even less likely if the standard deduction is increased in 2017 and beyond as proposed in President Trump's and the House Republicans' tax reform plans.

Thus, if the standard deduction is high enough that itemized deductions are indirectly curtailed for many retirees, it might be more desirable to simply allow the mortgage interest to accrue – though, again, it's still necessary to ensure sufficient income in that liquidation/repayment year to actually

absorb the full deduction.

Aside from the potential deduction for a reverse mortgage's interest payments, taxpayers can also potentially deduct mortgage insurance premiums as mortgage interest under IRC Section 163(h)(3)(E).

However, to claim the MIP deduction, it's necessary that the mortgage itself has been issued since Jan. 1, 2007, and that the reverse mortgage debt be classified as acquisition indebtedness and not home equity indebtedness. This means the deductibility of the MIP depends on how the proceeds of the reverse mortgage are actually being used. And the impact can be substantial, given that reverse mortgages have both an upfront MIP of 0.5% to 2.5% and an ongoing MIP of 1.25%.

Again though, payments – whether for mortgage interest or mortgage insurance premiums – are deductible only when actually paid, meaning that when the upfront MIP is rolled into the reverse mortgage balance and the annual MIP accrues on top, payments haven't been made and the MIP cost can't be deducted.

Instead, if the payments aren't made until the property is liquidated and the mortgage is paid off in full, the MIP will be deductible at that time, all at once, and face the same threshold issue regarding sufficient income to absorb the deduction.

The MIP deductibility situation is further complicated by an income phase-out, which kicks in as income goes above \$100,000 of adjusted gross income (for both individuals and married couples filing jointly), with a full phase-out above \$109,000.

Thus, if the MIP deduction comes due all at once, from a big liquidation that triggers a big capital gain, it may create income against which the deduction would be offset – pushing the taxpayer over the line where none of the MIP is deductible.

In practice, these constraints may prove moot, as the deduction for mortgage insurance premiums was extended last under the PATH Act of 2015 through the end of 2016, and lapsed as of Dec. 31, 2016.

Of course, it may be reinstated later in 2017; it has already been reinstated retroactively after lapsing more than once in the

**Taxpayers can also potentially deduct mortgage insurance premiums as mortgage interest.**

past decade. Alternatively, it could become a matter of permanent tax law under income tax reform.

Still, as it stands now, MIP payments aren't even deductible in 2017, much less in a distant future year when the property is finally sold and the reverse mortgage is liquidated. And even if the deduction gets reinstated and sticks around, it may be a hassle to calculate how much of the (cumulative) payments are deductible, as unfortunately the relative balances of mortgage insurance premiums, interest and principal are not directly tracked in the current Form 1098 reporting from the lender. At best, balances would have to be determined, or reconstructed retrospectively, from monthly reverse mortgage statements.

## REAL ESTATE TAX IMPLICATIONS

One final point of complexity with a reverse mortgage is how to handle real estate taxes.

In general, the deductibility follows the normal rules under IRC Section 164: The taxes are deductible when actually paid. Thus, regular payments for real estate taxes through a mortgage servicer – as part of the full PITI monthly payment – are still deductible because they were actually paid, even if through the servicer's escrow arrangement. And a direct payment of real estate taxes is also deductible when paid.

The favorable treatment stands when using a reverse mortgage to generate cash to make a real estate tax payment – whether by drawing against the home equity line of credit, using the lump-sum proceeds of a cash-out reverse mortgage, or via the ongoing tenure payments structure. From the tax code's perspective, it's irrelevant how the taxpayer got the money; all that matters is that the payment occurred and a real estate tax obligation was paid.

The situation is somewhat more ambiguous for real estate taxes paid directly from the HECM reverse mortgage, which can happen when taxpayers fail to meet underwriting requirements and have a Life Expectancy

Set Aside.

The LESA rules are intended to ensure that reverse mortgage borrowers don't unwittingly default on the loan by failing to make property tax and homeowner's insurance payments. Instead, those amounts are drawn directly from the mortgage and are then held in escrow. Payments for taxes and insurance are then remitted.

The LESA rules ensure that the borrower doesn't max out the reverse mortgage borrowing limit for other purposes and then leave himself unable to pay property taxes (and homeowner's insurance), which could trigger a default.

Instead, the reverse mortgage borrowing capacity is carved out to pay the taxes and insurance, and the homeowner remains responsible for the rest of his bills – albeit without property taxes and homeowner's insurance looming.

The problem, though, is that in the LESA scenario, the taxpayer never actually makes a personal payment for property taxes, which raises questions about its deductibility. Nonetheless, some argue that given the legal tax obligation is satisfied and the taxpayer incurs an actual debt – that is, an increase in the reverse mortgage balance – it should still be constructively treated as a payment for tax purposes at the time the property taxes are paid via the reverse mortgage, even if it wasn't a personal cash outflow for the homeowner.

But there is no definitive tax guidance to clarify the treatment, or clearly distinguish why an increase in reverse mortgage debt balance for interest is not deductible, while a similar increase in the balance for a payment of real estate taxes might be deductible.

The bottom line: it's important to be aware of the potential pitfalls on the tax deductibility associated with reverse mortgages.

While the standard rules for deductibility of mortgage interest, insurance premiums and real estate taxes remain, a reverse mortgage necessitates more in-depth tax planning and coordination.

FP

**From the tax code's perspective, it's irrelevant how the taxpayer got the money; all that matters is the payment.**

**CEQUIZ**

GO TO [FPCEQUIZ.COM](http://FPCEQUIZ.COM)  
TO TAKE THE CE QUIZ ONLINE

---

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

## Vacation Property Angst

Certain planning techniques allow estate owners to distribute this valuable asset without triggering hard feelings and large expenses.

BY DONALD JAY KORN

**WHEN A WIDOWED MOTHER PLANS TO SPLIT HER** mutual fund portfolio equally among all of her children, this may be acceptable to everyone in the family. However, passing on a vacation home in the same way can have unintended consequences.

"A bequest that was well-intentioned by the parents could end up destroying family relationships," says Brent Brodeski, CEO of Savant Capital Management in Rockford, Illinois. "Ironically, that's exactly the opposite of what the parents desired when they imagined family reunions each year at the lake."

The challenge, according to Brooke Salvini, principal at Salvini Financial Planning in Avila Beach, California, is that some children might want to cash in their share of this valuable asset, while others may disagree.

### HARD FEELINGS

"Some of the siblings may have a sentimental attachment to the family vacation house and want to keep it for ongoing generations," she says.

"When there is the wherewithal, the easy solution is a buyout among the siblings. It's harder when that isn't possible and the sentimental siblings are forced to sell. That has left hard feelings in the family," Salvini says.

A need for cash isn't the only obstacle that can arise. Brodeski has seen situations where one heir lives too far away to visit frequently, or one child has bad memories of being dragged to the vacation home.

He has also seen situations in which one heir has a spouse who doesn't want to use the vacation home, or one heir who is unmarried and without children has no use for a large vacation home.

"When such a home passes to the children," he says, "most often there is some combination of one kid who loves it and uses it while at least one other does not. Then the siblings who want to get rid of it are frustrated."

If advisers get involved while original vacation home-



owners are still alive and healthy, quite a bit of frustration can be avoided.

"It's difficult for the heirs to make decisions after the death of the parents," says Erika Safran, founder of Safran Wealth Advisors in New York. "That's partially because of likely unequal financial lives, and partially because of emotional attachment to the property that represented their parents and their youth. Problems can be avoided by some thoughtful conversations and forward planning."

### RENT IT OUT

Safran is currently working with a couple who has a vacation home that the family enjoyed for years while the children were young.

"Now their college-age kids have no desire to use the home, so the parents wonder if they should keep it for future generations or if they should sell the house, which has appreciated substantially," Safran says. "This couple can afford to hold onto the home, so selling to raise cash is not necessary."

Safran advised the parents to hold onto the house, continue to use it periodically and perhaps rent it out when it is



not in use.

"Years from now, when the kids are established in their careers, the family can revisit the keep-or-sell decision," Safran says. "Selling the property would create a sizable tax liability on the gain."

## TRIPLE TAXING

A vacation home sale does not qualify for the \$250,000 capital gain exclusion (\$500,000 for married couples filing jointly) that may apply to sales of a principal residence. "Instead, a large gain on a vacation home might be taxed at the top 20% rate on long-term capital gains, plus the 3.8% surtax on net investment income and perhaps the state income tax as well.

However, "maintaining the vacation property and leaving it to the heirs does not create an income tax bill," Safran says. Indeed, current law provides a basis step-up to the date-of-death value, eliminating capital gain tax on prior appreciation.

"Once the kids are older, family communication while both parents are alive is a key to making decisions everyone is happy with," Safran says.

"The kids might want to share the house and maintain it. If one child is not as financially secure as the other, he may want to

inherit cash instead of the property," she says. "If that decision is honored by the parents, they can put into their estate-planning documents that one child will get the house and the other will get an equivalent value of other assets, based on an appraisal at the time of death. That would be fair."

According to Brodeski, it is "very typical" that one child buys the family home from the estate or the parents and one or more siblings buy their own vacation home, perhaps with an inheritance from the parents.

"Then the siblings can maintain a great relationship," Brodeski says, "because they don't need to pick up each other's stuff at the house and arm-wrestle over who uses it when."

## DECANTING

In some cases, Brodeski suggests, estate planning documents could call for a 10%-to-20% discount from appraised value on an intrafamily sale, if the deal avoids a sales commission and the presale fix-up costs that might occur on a sale to an outsider.

Another possible tactic is to move the vacation home into a trust, which can provide ongoing management, control and operating funds.

"I've had some clients put the vacation house into an irrevocable trust to remove it from their estate," Salvini says. "However, this has created capital gains tax challenges for the children later on, as they will lose the basis step-up."

"I've suggested they discuss with their attorney the pros and cons of decanting the trust [moving the assets to a new trust, with different terms]," Salvini adds.

## SUCCESSFUL SHARING

Less-formal arrangements can be built into a client's estate plan, including ideas on how to handle the inherited home.

Such suggestions also can help advisers who have clients in the next generation of a family.

"One of my clients does the bookkeeping for the family home," Salvini says. "As a group, they keep one checking account to pay all the related bills. Once a year, they

**Estate planning documents could call for a 10%-to-20% discount from appraised value on an intrafamily sale.**

## Home Away from Home

Vacation homes' distance in miles from primary residences.

5 or less	*
6 to 10	*
11 to 15	*
16 to 20	3%
21 to 50	10%
51 to 100	18%
101 to 250	22%
251 to 500	12%
501 to 1,000	14%
1,001 or more	21%
Median (miles)	200

\* Less than 1%

Source: National Association of Realtors

calculate the annual daily cost for the previous 12 months and divide the amount accordingly, per usage among the siblings, to replenish the account, plus a surplus for major repairs and maintenance."

"Thus, the costs are prorated by days of use. The costs of unused days are divided equally among the siblings," Salvini says.

#### TAKING TURNS

Brodeski tells of another operating method, devised by two siblings who share a family lake house.

"They both wanted to keep it," Brodeski says, "but sharing it was not working. Instead, both siblings get exclusive use of the home for 12 months at a time.

"Then they trade. When their turn comes, they actually take down the other's pictures and remove many of the furnishings, putting

up their own pictures and installing other things," he says.

#### PRUDENT PLANNING

Other plans for dealing with, or disposing of, a family vacation home may emerge from prudent planning.

"With my clients," Salvini says, "I push for getting the family together for a series of conversations about finances, well in advance of any health problems that could force a quick decision.

"A financial adviser can be very helpful, acting as a neutral meeting facilitator, Salvini says.

"For complicated family wealth situations, including estate planning for a vacation home, a professional facilitator can bring valuable soft skills to the table," Salvini adds.

**"A financial adviser can be very helpful, acting as a neutral meeting facilitator," says Brooke Salvini of Salvini Financial.**

**CEQUIZ**

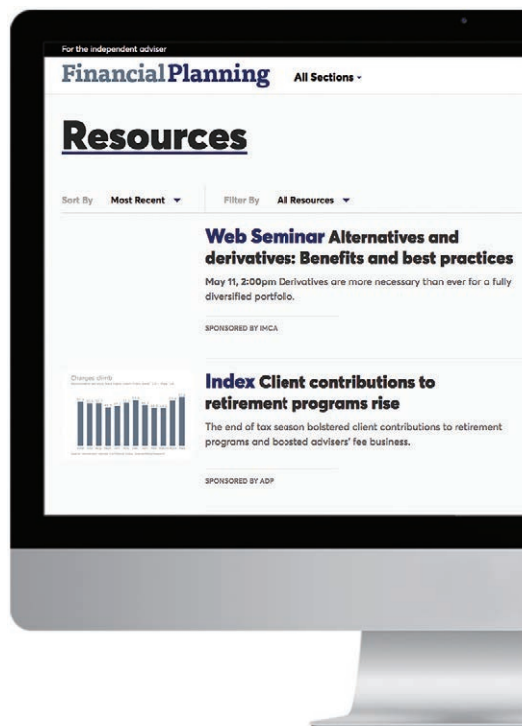
GO TO [FPCEQUIZ.COM](http://FPCEQUIZ.COM)  
TO TAKE THE CE QUIZ ONLINE

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

## Financial Planning RESOURCES

### A CENTRALIZED HUB FOR ALL YOUR INFORMATION NEEDS:

- ✓ CE QUIZ
- ✓ DATA/RESEARCH
- ✓ INDEXES (RACI/GAAT)
- ✓ WEB SEMINARS
- ✓ WHITE PAPERS
- ✓ VIDEOS



**FOR FREE ACCESS, VISIT:** [Financial-Planning.com/Resources](http://Financial-Planning.com/Resources)

## The Best Fit for a Trusteed IRA

Here's what advisers should know about this increasingly available option so they can help clients make the most suitable choice.

BY ED SLOTT

**A TRUSTEED IRA OFFERS PROVISIONS BEYOND A** custodial plan, but is it a good strategy for clients? That answer depends on several factors, including how much control – or not – clients want their beneficiaries to have.

Under the tax code, an IRA can be established as a trust or custodial account. With a trusteed IRA, a financial organization adds trust terms and language to the plan. Thus, the IRA itself becomes a trust, with the financial organization acting as the trustee.

The account is then administered under the trust provisions both before and after the IRA owner's death. In general, this will mean greater control for the IRA owner and less for the beneficiaries.

As a trusteed IRA is, in essence, a conduit trust; the trustee must pay out the annual required minimum distributions to beneficiaries. In addition to ensuring the stretch IRA for beneficiaries, some trusteed IRAs allow distributions beyond the RMDs for health, education and other support. However, because trusteed IRAs are standardized documents, there will likely be some limits on the post-death control options.

### THE COST OF CONTROL

Clients who have large IRAs as well as other extensive assets will probably already be using trusts as part of their overall estate planning strategy. For those clients, costs are not a concern and they would likely be best-served by naming a trust as their IRA beneficiary.

For other clients, whose IRA is their largest asset by far, a trusteed IRA may make sense. A trusteed IRA will generally cost less than hiring an attorney to draft a trust. However, there will still be a set-up fee, as well as ongoing fees.

One advantage of a trusteed IRA is that, if the IRA owner becomes incapacitated, trusteed IRAs often have a provision that allows the trustee to take the RMD on their behalf.

This would not be possible with a trust or an individual named on the IRA's beneficiary designation form. In those



cases, a power of attorney would likely be needed to get the RMD paid out. A trusteed IRA eliminates this complication. The trustee can also make lifetime investment decisions, as well as pay any IRA-related fees or expenses.

### ENSURING THE STRETCH FOR BENEFICIARIES

Trusteed IRAs usually include provisions limiting how much freedom a beneficiary has regarding how much they can take from the inherited IRA.

A trusteed IRA may be a good strategy for clients whose primary concern is preserving the stretch for their beneficiaries. The trusteed IRA may limit yearly distributions to the amount of the RMD, preserving the stretch IRA.

If, instead, a trust is named as the beneficiary of an IRA and the trust meets the look-through rules, the beneficiary of the trust can use the stretch and take RMDs over the life expectancy of the oldest trust beneficiary.

However, there is a risk that requirements of the look-through rules may not be met by a particular trust. An attorney drafting a trust may make an error that causes the trust to not meet these requirements, with the resulting loss of

the stretch for beneficiaries. Going with a trustee IRA mitigates this risk.

### **MULTIPLE BENEFICIARIES**

Even if a trust is drafted in such a way as to meet the requirements of the look-through rules, there can still be problems with achieving the maximum stretch if there are multiple trust beneficiaries.

The separate account rules for multiple beneficiaries do not apply to trusts. This means that all trust beneficiaries must honor the beneficiary with the shortest life expectancy.

This may not matter so much if the beneficiaries are close in age. However, if beneficiaries include a surviving spouse as well as children, this severely limits the stretch available for the children.

The work-around for this problem is to create and name sub-trusts for each beneficiary directly on the IRA beneficiary designation form. This format allows each trust beneficiary to use their own life expectancy.

Using a trustee IRA eliminates this complication, because they are generally drafted in such a way as to ensure each beneficiary may use their own life expectancy.

### **SUCCESSOR BENEFICIARIES**

When an IRA owner names a beneficiary outright, the owner will have no say in what happens to the funds after the death of the beneficiary. A beneficiary may choose their own successor beneficiary.

A trustee IRA would give the IRA owner the ability to name successor beneficiaries.

This may be helpful in second-marriage situations in which the IRA owner would like to provide for a spouse during their lifetime but then ensure that the IRA funds go to children from a prior marriage.

This could also be achieved by naming a trust as the IRA beneficiary, although at greater expense.

### **SPOUSAL ROLLOVER**

In many cases, after the death of the IRA owner, a surviving spouse will want to do a spousal rollover. This option is available if the spouse is named directly as the sole beneficiary on the beneficiary designation form.

Frequently, when a trust is named as the IRA beneficiary, this option becomes more complicated, and sometimes requires the time and expense of requesting a private-letter ruling from the IRS. There have been many PLRs allowing a spousal rollover when the spouse is the trustee of the trust, is the sole beneficiary and has complete control over the trust assets.

A spousal rollover would likely not be possible with a trustee IRA, however. Clients who are looking for the ability of a surviving spouse to do a spousal rollover should strongly consider simply naming that spouse on the beneficiary designation form. They would not be well-served by either a trust as beneficiary or a trustee IRA.

Some clients may have concerns about creditor protection of IRA assets for their heirs. For example, a parent might be concerned that, if a child is having financial

**A trustee IRA would give an IRA owner the ability to name successor beneficiaries.**

## **Rules for common types of trusts as the beneficiary of an IRA**

Here's how it breaks down

Type of Trust	Primary Advantages	Primary Disadvantages
Bypass	Shelter future growth from federal or state estate tax; potential asset protection benefits as well	Loss of spousal rollover; potential for compressed trust tax brackets
Marital	Planning for incapacity (consider alternative solutions?)	Loss of spousal rollover; costly PLR to fix if not truly intended or necessary
QTIP	Restrict spouse's access to IRA principal while preserving marital deduction	Loss of spousal rollover; coordination with QTIP requirements
Revocable Living/ Testamentary	Flexibility to allocate where IRA will go after death	Potential loss of stretch if trust not named properly

Source: Michael Kitces



trouble, creditors could access the inherited IRA funds.

There are good reasons for this concern. In *Clark vs. Rameker*, for example, the U.S. Supreme Court ruled that inherited IRAs are not protected in bankruptcy.

A trustee IRA would offer a higher level of protection from creditors than leaving assets outright to a beneficiary. However, the protection would be limited by the fact that the trustee IRA would be required to pay out the RMDs each year to the beneficiary.

individual may be a co-trustee with a financial organization.

This will not work with a trustee IRA because for two reasons:

- 1) The trustee will be the financial organization offering the trustee IRA.
- 2) The tax code does not permit an individual to be a trustee of an IRA.

One big downside for trustee IRAs is the lack of ability to move the inherited IRA assets. While there is no reason that a trustee IRA could not allow the movement of

**By naming a trust as an IRA beneficiary, a higher level of protection could be achieved because a trust could be drafted to give the trustee discretion to keep the RMDs in the trust.**

## Ins and outs of look-through trusts

A look-through trust is one that can qualify as a designated beneficiary by meeting IRS requirements. This allows RMDs to be paid out using the age of the oldest trust beneficiary's life expectancy—in other words, the trust beneficiary with the shortest life expectancy. In addition to the requirements below, all trust beneficiaries must be individuals or there could be no designated beneficiary on the IRA and the stretch option could be lost.

1. The trust is valid under state law or would be but for the fact that there is no corpus.
2. The trust is irrevocable or the trust contains language to the effect that it becomes irrevocable upon the death of the employee or IRA owner.
3. The beneficiaries of the trust who are beneficiaries with respect to the trust's interest in the employee's or IRA owner's benefit are identifiable.
4. The required documentation is provided by the trustee to the plan administrator no later than Oct. 31 of the year following the year of the IRA owner's death.

There would be no way to protect those RMD funds.

By naming a trust as the IRA beneficiary, a higher level of protection could be achieved, because a trust could be drafted to give the trustee discretion to keep the RMDs in the trust instead of paying them out to the trust beneficiaries.

Of course, there is a downside to using a trust to protect the RMDs from creditors. RMD funds held in the trust will be taxed at trust tax rates, which quickly reach the top 39.6% income tax bracket. A Roth IRA left to a trust could eliminate this trust tax problem.

Clients who are considering trusts often want to appoint an individual, usually a family member, as a trustee. Frequently, the

inherited IRA funds after the death of the IRA owner, these documents are generally drafted in such a way that, if not outright prohibited, it is certainly not guaranteed.

This would be something for clients to seriously consider, because these accounts will be in existence for many years. Even if the institution is sound, if beneficiaries feel they are getting poor service or would prefer different investment choices, they may not be able to vote with their feet.

Trustee IRAs are not for everyone. Consider the alternatives of simply naming a beneficiary directly on the IRA beneficiary form or naming a trust that has been drafted specifically for the client by a knowledgeable attorney.

**FP**

---

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

# PORTFOLIO

ALSO IN PORTFOLIO: P. 50: Smart Beta vs. Active Managers

## Destructive Impact of Fund Fees

A retiree living off her portfolio may lose hundreds of dollars a year in income for each added basis point of fund expense ratio — or adviser fee.

BY CRAIG L. ISRAELSEN

**FEES DIRECTLY REDUCE PORTFOLIO RETURNS ... AND** that comes directly out of the pocket of the investor. There is no way to say that gently.

Understandably, fund companies have to charge something. Money management isn't free. Additionally, many advisers charge clients an AUM-based fee.

But what is the impact of different fee levels in a retirement portfolio over a period of 25 years from age 70 to 95? To put it bluntly, it's huge.

To evaluate the impact of fees (the expenses of the funds in the portfolio and the advisory fee if applicable), we need to have a low-cost retirement portfolio to act as a baseline for comparison. The baseline portfolio in this analysis consisted of seven indexes.

For this index portfolio, a baseline fee level of 50 basis points was assumed, but no advisory fee was assumed. The 50 bps simply covered the collective expense ratio of the underlying funds. This portfolio simulates what an individual investor would pay as a do-it-yourselfer or if using a robo advisory service. The example further assumes that the

investor is in his or her retirement years.

The retirement portfolio consisted of the following indexes: S&P 500, Russell 2000 Index, MSCI EAFE Index, Dow Jones REIT Index, S&P GSCI, Barclays Aggregate Bond Index and 90-day U.S. Treasury bills.

These indexes cover the major asset classes that portfolios typically contain: large-cap U.S. stocks, small-cap U.S. stocks, non-U.S. stocks, real estate, commodities, U.S. bonds and cash. Each asset class was equally weighted at 14.29%, and the portfolio was rebalanced at the end of each year.

The analysis of the impact of fees assumed a retirement portfolio that began with \$1 million and evaluated the ending account balance over rolling 25-year periods. The 25-year period represents a retirement lasting from age 70 to age 95.

In real life, of course, some retirement periods are shorter and some are longer, but 25 years seemed a reasonable estimate. The first 25-year period was from 1970 to 1994. The second was from 1971 to 1995, and so on.

There were 23 rolling periods of 25 years in this study. The amount of money withdrawn from the portfolio each

### The Impact of Fees

How fund expenses and advisory fees impact a retirement portfolio over an average 25-year period, based on 23 rolling periods from 1970 to 2016.

\$1 million starting balance in a diversified seven-index portfolio	Total Portfolio Fees (Combination of mutual fund expenses and adviser fee)					
	50 bps (baseline)	100 bps	150 bps	200 bps	250 bps	300 bps
Annual withdrawals determined by the required minimum distribution						
Average ending account balance after 25 years	\$2,739,515	\$2,428,629	\$2,151,765	\$1,905,338	\$1,686,128	\$1,491,240
Average annual withdrawal during each 25-year period	\$158,407	\$146,853	\$136,218	\$126,426	\$117,409	\$109,104
Average total amount withdrawn over each 25-year period	\$3,960,176	\$3,671,335	\$3,405,443	\$3,160,640	\$2,935,214	\$2,727,594

Source: Steele Systems Mutual Fund Expert, calculations by author

year was determined by the required minimum distribution specified by the IRS for tax-deferred retirement accounts. The annual performance of the portfolio was calculated using the actual historical returns of the stated indexes.

From a starting portfolio size of \$1 million, the ending account balance in the first 25-year period (1970-1994) was \$3,491,175.

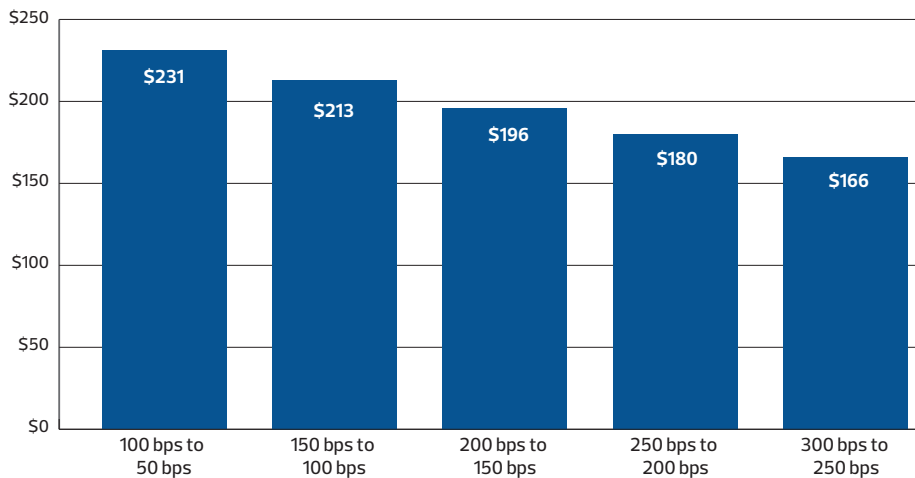
bps. At this fee level, the average ending balance drops by \$310,886, to \$2,428,629 – a decline of 11.3%. The average annual withdrawal declined by \$11,554, to \$146,853 – a 7.3% drop. Finally, the average total withdrawal declined by \$288,841, to \$3,671,335 – also a 7.3% drop.

The relative declines in the ending balance and the average annual withdrawal

**Reducing costs in clients' retirement accounts is vital for an adviser who plans to stick around.**

## Give Me a Raise!

Relationship between a portfolio fee reduction of 1 basis point and the corresponding increase in annual retirement income (based on RMD withdrawals)



Source: Steele Systems Mutual Fund Expert, calculations by author.

The total amount withdrawn using the RMD during this particular 25-year period was \$4,421,584; this equaled an average annual withdrawal of \$176,863, assuming a total portfolio cost of 50 basis points. All of these figures are in nominal terms, meaning that inflation has not been accounted for.

Of course, that is only one particular 25-year period. There were 23 rolling 25-year periods between 1970 and 2016.

A summary of the results for all 23 periods is shown in the table "The Impact of Fees." The average ending account balance was \$2,739,515, assuming total fees of 50 bps. The average annual withdrawal based on the RMD was \$158,407, and the average total amount withdrawn over each of the rolling 25-year periods was \$3,960,176.

Next, we introduce a total fee level of 100

tended to hold all the way across the table. For each additional 50 bps of cost, the average ending balance of the retirement portfolio declines by roughly 11.5% and the average annual withdrawal from the portfolio declines by roughly 7.2%.

Think of it this way: if a portfolio had a total cost of 100 bps and by using lower cost products or reducing the advisory fee the total portfolio cost could be halved to 50 bps, the retiree could withdraw \$11,554 more from the portfolio each year and her ending account balance would be higher by roughly \$288,850 after 25 years.

The increase in annual withdrawal of \$11,554 was associated with a 50 bps reduction in cost; therefore each basis point of cost reduction increased the annual portfolio withdrawal by \$231. As shown in the

## Low-Cost Diversified Retirement Portfolios

12-Asset Class 7Twelve model	12 Actively Managed Mutual Funds	12 ETFs from Various Fund Families	12 Vanguard Mutual Funds	12 Vanguard ETFs	12 Fidelity Mutual Funds	12 ETFs Available at Schwab
Portfolio aggregate annual expense ratio	54 bps	16 bps	22 bps	10 bps	40 bps	18 bps
15-year average annualized return (2002–2016)	7.71%	7.51%	7.88%	8.10%	8.09%	7.68%

Source: Author's calculations

chart “Give Me a Raise!” when reducing the total portfolio cost from 100 bps to a lower fee level, each basis point of cost reduction added \$231 to the retiree's income each year (based on RMD-based annual withdrawals).

For a portfolio that starts at 150 bps each basis point of cost reduction equals \$213 more for the retiree each year. For a portfolio that starts at 200 bps, each basis point of cost reduction translates to \$196 more for the retiree each year.

The payoff of cost reduction to the end user is huge and vital for advisers who plan to stick around. Cost reduction is the new sheriff in town. Said differently, advisers need to create the same cost-effectiveness for their clients that they would want for themselves. That's what a fiduciary would do.

Clearly, the importance of keeping portfolio costs down has never been greater. But there is good news: building a multi-asset retirement portfolio need not be expensive. To illustrate this, I have calculated the aggregate expense ratio of a 12-asset class model known as the 7Twelve Portfolio across several different fund providers. (Disclosure: I am the designer of the 7Twelve Portfolio.)

As shown in the table “Low-Cost Diversified Retirement Portfolios,” such a retirement portfolio can be built in a variety of ways for under 55 bps – often well under that. If using actively managed mutual funds from various fund families, the cost is around 54 bps. If using various ETFs, it can be built for 16 bps. If using Vanguard ETFs, the aggregate portfolio cost is 10 bps.

Cost is clearly not what would stop an

adviser from building a multi-asset portfolio. Adopting a low-cost approach is easily accomplished by using any of a number of large mutual fund families. Moreover, where you purchase the portfolio “ingredients” matters less than the asset-allocation model that is employed.

This is demonstrated by the similarity in the 15-year performance across the various 7Twelve models built using different fund families. Again, the asset-allocation model has the biggest impact on performance, not where you purchase the ingredients.

### WHAT IF?

If you are currently using mutual funds in your client's retirement portfolios that have an average expense ratio of 100 bps and you are also charging 100 bps advisory fee, your clients face a total cost of 200 bps.

If you moved to low-cost ETFs, you could drop the expense ratio cost component down to 10 bps and if you lowered the advisory fee to 90 bps, your clients are all in at 100 bps.

What does that do for your client? It increases their retirement account balance 25 years later by more than \$520,000, and it increases their annual portfolio withdrawal by over \$20,000 each year for 25 years. In short, it changes their financial situation dramatically.

The era of high-cost funds is over. Lower advisory fees and lower-cost investment products – whether index funds, actively managed funds or ETFs – is the right path. In fact, it is the only viable path in a competitive and cost-centric world.

**An adviser who decides to adopt a low-cost approach can use any of a number of large mutual fund companies. Moreover, where you buy the ‘ingredients’ matters less than the asset-allocation model that is used.**

**CEQUIZ**

GO TO [FPCEQUIZ.COM](http://FPCEQUIZ.COM)  
TO TAKE THE CE QUIZ ONLINE

FP

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



## Smart Beta vs. Active Managers

Smart beta ETFs beat benchmarks more than funds with human drivers, studies show, but some advisers doubt they can do it across the board.

BY BRYAN BORZYKOWSKI

**SPENCER BETTS HAS ALWAYS BEEN AN ACTIVE** management guy.

He didn't like benchmark-hugging ETFs because passive products hold the bad companies with the good. If a big player on the S&P 500 were to sink and drag down the index, then the ETF would fall in tandem. Stock picking, he said, made more sense.

About two years ago, Betts started hearing about smart beta products – ETFs that go slightly beyond mere indexing to incorporate investment characteristics like value, momentum and high yield and are designed to beat a benchmark. His stance on passive investments began to soften.

"ETFs have gotten more interesting," concedes Betts, a Lexington, Massachusetts-based adviser with Bickling Financial Services. "We used to have a 'Dogs of the Dow' mutual fund, but now we can get an ETF and pay 20 basis points instead of 65."

About 10% of his firm's \$200 million in assets under management are in smart beta ETFs, but he says he could envision a more even split between active management and ETFs in the future.

### BLURRING LINES

Until recently, the choice between exchange-traded funds and active management was clear. Advisers who wanted to hold inexpensive index-like products would buy ETFs, while those who preferred stock-picking managers would buy mutual funds and pay higher fees.

With the advent of benchmark-beating ETFs, the lines between active and passive have blurred. That has advisers wondering what's better for their clients – smart beta securities or actively managed funds?

If you look at the data, factor-based investing does exceed its benchmark more often than mutual funds.

According to ETF Trends, between December 2013 and April 2017, only 19% of active managers outperformed their respective style benchmarks compared with 40% of smart beta ETFs.

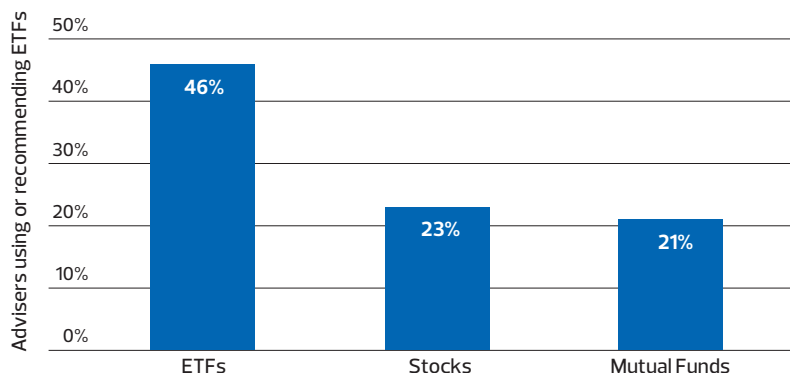
### 'BEST INVESTMENT EVER'

In historical research from Bloomberg, Peter Lynch's legendary Fidelity Magellan Fund was pitted against a quantitative value strategy that invested in the cheapest 30% of U.S. stocks by price-to-book ratio and weighted them equally across the fund.

Between May 1977 and May 1990, covering the years that Lynch managed his fund, the Magellan portfolio returned 29.1% annually with a 21.1% standard deviation. The smart beta strategy, meanwhile, returned 23% annually with a 17% standard deviation. One problem with much of the smart

## ETFs Dominate Adviser Plans

Nearly half of advisers say they plan to recommend the investment vehicle more frequently over the next 12 months.



Sources: *Journal of Financial Planning* and FPA Research and Practice Institute

beta data is that many of these funds were created only recently, so the historical data is sparse.

The lack of a track record is why Betts isn't more heavily invested in these products. There are back-tested numbers, but "every back test shows that this is the best investment ever," he says.

Still, these funds have taken off — assets under management rose 33% to \$560 billion in globally listed smart beta products in February — largely because they come cheap. For instance, the most popular smart beta fund by AUM, the iShares Russell 1000 Value ETF, has a 0.2% expense ratio. The largest value-focused mutual fund, American Funds Washington Mutual, has an expense ratio of 0.58%.

"Cost is the primary factor," says Jacob Wolkowitz, a managing director of the Minneapolis-based Accredited Investors Wealth Management.

"If you want a stock picker who is valuation conscious and can pay 0.09% for that versus 0.25%, then why wouldn't you go with the cheaper option? You can get the same returns or better from factor investing, but at a lower cost."

### COMBINATION OF PRODUCTS

Despite the fee gap — ETFs' tax-efficient structure gives it another advantage over mutual funds — many advisers continue to embrace active management, including Wolkowitz, whose firm has about 20% of its assets in smart beta strategies, 25% in more traditional passive ETFs and the rest in actively managed funds.

His company, which oversees \$1.7 billion from high-net-worth clients, started using smart beta strategies in 2006 and has replaced most of its United States-focused mutual funds with factor ETFs. But its international investments are mainly overseen by fund managers.

In the United States, active managers do not add as much value, he says, noting that most have been able to generate only

minuscule returns or have even produced negative returns.

Wolkowitz readily acknowledges his unfamiliarity with international markets and points to the fact that many of the products do not yet have a track record. With that, he says he would rather entrust his client's assets to real people.

"We have a better understanding of corporate governance in the U.S., and we know that what's worked in the past is likely to work in the future," he says. "Emerging markets are still figuring things out and value companies may not recover as consistently as they have in the U.S."

Ben Johnson, Morningstar's director of global ETF research, says most advisers use a combination of smart beta and active management, in part because smart beta ETFs cannot adjust their asset allocation in a pinch in the way that fund managers can.

"These are active bets employed in a passive, rules-based systematic fashion," he says. "Once the playbook has been written, no one's going to call an audible."

### PORTFOLIO REALITY

Different advisers also have different styles. Some might use a manager with a strong track record and employ smart beta only to fill in some gaps.

Others, like Wolkowitz, might want to use managers in areas in which the adviser is less comfortable.

"There can be a case that these investments can be used together, and that's the reality of what we're seeing," Johnson says. "If you look at the makeup of a client's portfolio, they're using all things active, passive and everything in between."

That is the approach that Betts takes. He might be an ETF convert, but he still likes his active managers. "I'm happy with the active beta stuff because I agree with it," he says. "But they complement each other. We believe in long-term asset allocation so we just want to have the clients in the right buckets over time."

**"These are active bets employed in a passive, rules-based systematic fashion. Once the playbook has been written, no one's going to call an audible," says Ben Johnson of Morningstar.**

**CEQUIZ**

GO TO [FPCEQUIZ.COM](http://FPCEQUIZ.COM)  
TO TAKE THE CE QUIZ ONLINE

**Bryan Borzykowski** is a freelance financial writer and editor based in Toronto. He has written three personal finance books and appears regularly on Canada's CTV News. Follow him on Twitter at @bborzyko.

## Broker/Dealer

### Home of the Independent Financial Adviser

Adviser Focused - Technology Leaders - Values Driven  
Serving Advisers Since 1990



- Midwest Based
- Weekly Payouts
- Fidelity Clearing & Custody Solutions
- RBC CS Platforms
- RIA Services
- Personal Service You Deserve

Contact: Brent Owens  
[www.joinCFD.com](http://www.joinCFD.com)  
Call: 800.745.7776

Email: [brent@joincfid.com](mailto:brent@joincfid.com) OR [brent.owens@cfdinvestments.com](mailto:brent.owens@cfdinvestments.com)



### 1 Easy Way to Bring in More Clients

- Keep your name in front of your current and prospective clients
- Offer the educational information your clients want
- Ensure your position as an expert in financial services

**Integrated Concepts Group, Inc.**  
*Print and Internet newsletters to help you bring in new clients*

FOR 10% OFF YOUR 1st ORDER,  
visit [www.ICGNews.com/FP](http://www.ICGNews.com/FP)  
or call 1-800-338-4329



877-688-2369 | [joincambridge.com](http://joincambridge.com)

Member FINRA/SIPC

**Start Planning!**  
**Reach the largest audience of**  
**Independent Advisors with**  
**SourceMedia Recruitment & Classified**

**Please contact:**  
**Christina Melomo**  
**at 212-803-8586**

Considering a new broker dealer partner?  
You owe it to yourself to get all the facts.



"The Sure Way To Miss Success Is To Miss The Opportunity."

(561) 472-2000  
[opportunity@moneyconcepts.com](mailto:opportunity@moneyconcepts.com)  
[www.moneyconcepts.com](http://www.moneyconcepts.com)

The Intangibles make all the difference.

Excellence Matters



## Lost in the fog of regulatory complexity?

Let Securities Service Network be your guide.

- Comprehensive Education Plans
- Robust Capital Structure
- Cutting Edge Technology
- Flexible Fee-Based Advisory Platforms
- Industry Leading Resources of Ladenburg Thalmann (NYSE: LTS)

**joinssn.com**  
Securities Service Network  
Member FINRA/SIPC  
(866) 218-7908

Don't Miss The **August**  
**issue** of **Financial**  
**Planning's Broker/**  
**Dealer Guide**  
**Space Close 7/6**

**Start Planning! Reach the largest audience  
of Independent Advisors Today with SourceMedia**  
**Recruitment & Classified Please contact:**  
**Christina Melomo at 212-803-8586**

# Financial Planning

INVESTED IN ADVISORS



Visit today to get the essential information you need  
to grow your business and stay ahead of the competition.

[www.Financial-Planning.com](http://www.Financial-Planning.com)

Available on your iPhone®, iPad® or Android™





## Marketing Opportunities



**OLD LIFE MAGAZINES**  
LIFE MAGAZINE ISSUES FROM 1936-2000

Give your client an original, vintage issue of **LIFE Magazine** from the week they were born.

*Gift wrapped and delivered direct to your client with your personal note!*

Join the many advisors already using this service

**APPRECIATION!**  
SHOW IT WITH THE VERY UNIQUE GIFT OF A VINTAGE LIFE MAGAZINE!

VISIT OR CALL  
**OLMags.com | 800-923-6433**

## Software



**Everyone**  
*is switching to Quik! - don't you want to find out why?*

**13 of the top 25 B/Ds use Quik!**  
**See why for yourself today.**

**Call 877-456-7845 x962**  
**quikforms.com/compare**

## Marketing Opportunities

Always Looking for  
“RETIRED”  
Investment Advisors



“TIRED” of losing  
monthly income!

Contact **Jonas C. Everett**, Radio  
Show Host with over 10 years of  
experience in Mergers and  
Acquisitions for:

- “Book of Business” Purchases
- Lump-Sum Opportunities
- Branch Office Opportunities
- Complimentary Appointment Scheduling
- Succession Planning

**(800) 383-6590**

jonas.everett@premieriowa.com  
premierinvestmentsofiowa.com

Free Succession Planning  
System for Retiring Advisors  
lightedtunnel.com

Tune into the  
Premier Financial Hour  
Tuesdays at 4pm on  
WMT 600 AM

Securities offered through Registered Representatives of Cambridge Investment Research, Inc., a Broker/Dealer, Member FINRA/SIPC. Advisory services offered through Cambridge Investment Research Advisors Inc., a Registered Investment Advisor. Cambridge and Premier Investments of Iowa, Inc. are not affiliated.

# CE QUIZ

JULY 2017

VISIT [FPCEQUIZ.COM](http://FPCEQUIZ.COM) TO TAKE *FINANCIAL PLANNING'S* CE QUIZ.

## FROM: DEDUCTING IN REVERSE

1. Taxpayers can deduct the interest on what amount of home equity indebtedness?

1. The first \$1 million
2. The first \$300,000
3. The first \$100,000
4. The first \$50,000

2. What is the minimum upfront insurance premium on a reverse mortgage?

1. 0.5%
2. 2.5%
3. 1.5%
4. 0.75%

## FROM: DESTRUCTIVE IMPACT OF FUND FEES

3. For each additional 50 basis points of fees, the average ending balance of a retirement portfolio consisting of the S&P 500, Russell 2000, MSCI EAFE, Dow Jones REIT Index, S&P GSCI, Barclays Aggregate Bond Index and 90-day U.S. Treasury bills declined by about what percentage over 23 25-year rolling periods between 1970 and 2016?

1. 10.5%
2. 11.5%
3. 9.5%
4. 12.5%

4. In the same scenario, average withdrawal levels decline by roughly what percentage?

1. 6.2%
2. 8.5%
3. 5.7%
4. 7.2%

## FROM: SMART BETA VS. ACTIVE MANAGERS

5. From December 2013 to April 2017, what percentage of active managers outperformed their respective style benchmarks, according to ETF trends?

1. 30%
2. 25%
3. 19%
4. 10%

## FROM: VACATION PROPERTY ANGST

6. How much is the capital gain exclusion on a primary residence for a single tax filer?

1. \$500,000
2. \$250,000
3. \$300,000
4. \$150,000

7. What is the surtax on net investment income?

1. 4%
2. 2.8%
3. 3.8%
4. 5%

## FROM: USE BEHAVIORAL FINANCE TO PUT WORRIED CLIENTS AT EASE (online only)

8. What percentage of clients are looking 10 or more years forward in their finances, according to a Morningstar study?

1. 30%
2. 45%
3. 8%
4. 15%

## FROM: THE RIGHT — AND WRONG — WAY TO CALCULATE AUM (online only)

9. Firms must register with the SEC within 90 days of regulatory AUM exceeding how much?

1. \$100 million
2. \$150 million
3. \$110 million
4. \$200 million

10. Firms must file Form ADV-W and revert back to state registration within 180 days if regulatory AUM falls below what amount?

1. \$100 million
2. \$95 million
3. \$80 million
4. \$90 million

*Financial Planning* offers its Continuing Education Quiz exclusively online at [FPCEQuiz.com](http://FPCEQuiz.com).

To earn one hour of continuing education credit from the CFP Board of Standards, please visit our website and answer the questions above. Planners must answer eight out of 10 questions correctly to pass. Credit will count under CFP Board subject A: financial planning process/general principles. The deadline for participation is July 31, 2018.

In addition, the Investment Management Consultants Association has accepted this quiz for CIMA, CIMC and CPWA continuing education credit. Planners must answer eight out of 10 questions correctly to pass. The deadline is July 31, 2018.

If you need assistance, please contact SourceMedia customer service at [help@sourcemedia.com](mailto:help@sourcemedia.com) or (212) 803-8500.

# Financial Planning

# SELFIE

## A Teachable Moment for All

Not providing guidance on budgeting and cash flow management is a disservice to clients.

BY SCOTT SCHUTTE



**YEARS AGO, I WAS APPROACHED BY AN INVESTMENT** adviser seeking to retire and transition his practice. After six months of communication, negotiations and meetings, he decided to transition his business to my firm.

I asked him why he had chosen me from among all the qualified advisers he had interviewed. His answer came as a surprise to me.

He said that I was the only adviser who was “militant about cash flow management and budgeting,” adding that I “walked the walk” with my personal finances.

### A SAD REALITY

I learned from talking with other advisers that it’s a sad reality that many live beyond their means. I find it worrisome that budgeting and cash flow are challenging for many. It means they may not be providing guidance on these topics to their clients.

In my opinion, a planner who is not providing guidance on budgeting and cash flow management is doing a disservice to clients. Why? Because these are among the main factors impacting the success of a financial plan.

Many advisers feel there are other ways for clients to learn about budgeting. But, think about it. You can’t major in financial responsibility in college. Therefore, it’s up to the adviser to teach clients this skill to ensure they don’t amass bad debt or make poor spending decisions.

### TEACHING CLIENTS TO HELP THEMSELVES

Here’s what I’ve learned from working with every client and their children on how to budget:

**Focus on philosophy, not line items.** You want to edu-

cate your clients on the why and the how of budgeting, but not be an arbiter of their spending.

You definitely don’t want to be in the middle of a debate between a husband who wants to buy a boat and a wife who disagrees. That isn’t productive for your relationship with your clients and doesn’t help them on their path to better decision making.

**Have rule of thumb conversations.** Rather than sending your clients an expense worksheet, educate them on guideposts they can leverage. I also refer to these as rules of thumb.

Even clients who are great at managing their budget can learn something from these tried-and-true principals. I often suggest they use them to educate their children. The teacher can become a student when they talk to their kids about spending and realize their own habits may not be as ideal as they believed.

Some rule-of-thumb topics to discuss include: 1) the 50-30-20 budgeting rule; 2) the 20/4/10 rule when purchasing a car; and 3) save 10% of your income for retirement.

We know rules of thumb are not a substitute for customized financial advice, but I have used them to change budgeting behaviors for multiple generations of my family and my clients.

**Offer to educate clients’ children.** I usually do this when the children are first entering the job market. It helps them get on the right track and our firm captures younger investors who will grow assets over time.

Let’s face it, budgeting is not particularly fun or exciting. But it is a critical element of financial planning that advisers need to teach and practice.

My passion for this topic has helped my clients and my business. Win-win.

**FP**

---

Scott Schutte is a managing director and adviser at Lightship Wealth Strategies in Newton, Massachusetts.

To submit a Selfie commentary, email [fpeditor@sourcemedia.com](mailto:fpeditor@sourcemedia.com). Post your comments online at [financial-planning.com](http://financial-planning.com).



## FSI COVEREDADVISOR BENEFITS PROGRAM

As an independent advisor, costs of running your business can add up. Members of the Financial Services Institute have exclusive access to the **FSI CoveredAdvisor Benefits Program** which includes discounts on a number of products and services for you and your business.

### CoveredAdvisor Affinity Benefits

Get discounts on dozens of products and services for you and your business, including:

- Document Storage
- VoIP
- Website Creation
- Data Aggregation
- Email Marketing
- And DOZENS More!

### CoveredAdvisor Insurance Benefits:

- Long-Term Disability
- Term Life
- Critical Illness & Accident Insurance
- Plans for your non-advisor staff members

*\*Plan provisions and premium rates are unavailable on the open market.*



For more information, please visit  
**[financialservices.org/benefits](http://financialservices.org/benefits)**

This program is exclusively  
for FSI members.

Not yet a member? Join today:  
**[financialservices.org/membership](http://financialservices.org/membership)**



# For your clients' look after my better half side.



## Only Nationwide® variable annuities offer a spousal death benefit on qualified money, at no additional cost.<sup>1</sup>

- Benefit paid no matter which spouse passes away first
- Surrender charges are waived
- Contract value is adjusted to equal the death benefit value<sup>2</sup>

See how it works at [NationwideFinancial.com/Spousal](https://NationwideFinancial.com/Spousal)

**For your clients' many sides, there's Nationwide.**  
mutual funds | annuities | life insurance | retirement plans



**Nationwide®**  
is on your side

<sup>1</sup>VARDS, 2017. Nationwide can offer this benefit because we have annuitant-driven contracts. Nationwide's Spousal Protection Death Benefit Feature is available at no additional cost on Nationwide Destination<sup>SM</sup> 2.0 products.

<sup>2</sup>For example, with a Return of Premium Death Benefit, if the contract value is lower than the premium amount, upon the passing of the first spouse, the surviving spouse would receive the higher amount, being the original premium as the death benefit value with surrender charges waived. This assumes no withdrawals were taken.

Variable products are sold by prospectus. Both the product prospectus and underlying fund prospectuses can be obtained by visiting [nationwide.com](https://nationwide.com) or by calling 800-321-6064. Before investing, carefully consider the fund's investment objectives, risks, charges and expenses. The product prospectus and underlying fund prospectuses contain this and other important information. Read the prospectus carefully before investing.

Variable annuities are long-term, tax-deferred investments designed for retirement that will fluctuate in value. They allow for a fixed or variable stream of income through a process called annuitization and also provide a variable rate of return based on the performance of the underlying investments, which are subject to investment risk, including possible loss of principal. A variable annuity is a contract between the owner and an insurance company and has fees and limitations that include mortality and expense, administrative fees, contract fees and the expense of the underlying investment options. Riders may not be available on all variable annuities and not in all states.

Some death benefits may be available at an additional cost, and the cost of an option may exceed the benefit paid under the option. Any early withdrawals will decrease the death benefit and contract value. If withdrawals are taken before age 59 1/2, a 10% early withdrawal federal tax, in addition to ordinary income taxes, may apply. Guarantees are subject to the claims-paying ability of the issuing insurance company.

Variable products are issued by Nationwide Life Insurance Company. The general distributor is Nationwide Investment Services Corporation, member FINRA.

Nationwide, the Nationwide N and Eagle, and Nationwide is on your side are service marks of Nationwide Mutual Insurance Company. © 2017 Nationwide.