

[Policy-Based Financial Planning]

**Financial Planning Association
Northern Virginia Chapter**

**Elissa Buie, CFP®
YESKE BUIE INC. ... *Live Big*®**

Elissa@YeBu.com

+1 703-538-2116

www.goodfinancialplanning.com

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Overview

- Uncertainty
- Chaotic World
- Financial Planning
 - Well crafted financial planning policies can serve both planners and their clients by acting as a powerful touchstone in the midst of a rapidly changing world.

Policy

*A tool for making decisions
in the face of uncertainty*

Examples

{Financial Planning Profession}

- Investment Policies
 - Boone, Lubitz 1992, 2004
- Safe Withdrawal Rates
 - Bengen 1994, 1996, 1997, 2001
 - Guyton 2004, 2006
- CFP® Code of Ethics
- CFP® Practice Standards

Examples {Other Professions}

- Law
 - Ethics policies, e.g. what constitutes conflicts of interest
- Medicine
 - “First, do no harm.”
- Accounting
 - FASB/GAAP
- Military
 - Chain of Command

[Examples from Life]

- I will give 10% of my gross income to charity.
- I will only drive American cars.
- I will only do work that I love.

What Policies Are Not

- Beliefs or Values
- Action Items
- Implementation
- Observations
- Goals and Aspirations

Policies vs. Values, Beliefs, Observations, Goals, Action Items

- **Value**: A college education is imperative for a good life.
- **Goal**: To ensure my son's education is covered even if I die prematurely.
- **Policy**: I will maintain sufficient life insurance to cover my son's education costs.
- **Action Item**: I will buy \$250,000 of 20-year term life insurance.

Policies vs. Values, Beliefs, Observations, Goals, Action Items

- **Observation**: Our extended family looks to us to help support them.
- **Goal**: To encourage them to support themselves.
- **Policy**: We will provide financial literacy support but will not give them money.
- **Action Item**: Arrange for and pay for brother John's consumer credit counseling services.

Policies vs. Values, Beliefs, Observations, Goals, Action Items

- **Belief**: Too much inheritance blunts ambition.
- **Goal**: To provide for spouse without leaving too much money to our grown kids.
- **Policy**: We will own life insurance for our survivor needs only, establishing charities as contingent beneficiaries.
- **Action Item**: Buy term insurance based on capital needs analysis; coordinate beneficiary designations; monitor regularly.

Characteristics of a “Good” Policy

- Broad enough to encompass any novel event that might arise.
- Specific enough so that we are never in doubt as to what actions are required.

Identifying a “ Policy

- Are there external circumstances that will change and affect the decisions encompassed by this policy?
- Does this policy enable us to make decisions as things change?

Goals **policies** Decisions

Policies vs. Values, Beliefs, Observations, Goals, Action Items

- **Value**: A college education is imperative for a good life.
- **Goal**: To ensure my son's education is covered even if I die prematurely.
- **Policy**: I will maintain sufficient life insurance to cover my son's education costs.
- **Action Item**: *I will buy \$250,000 of 20-year term life insurance.*

Policies vs. Values, Beliefs, Observations, Goals, Action Items

- **Value**: A college education is imperative for a good life.
- **Goal**: To ensure my son's education is covered even if I die prematurely.
- **Policy**: I will maintain sufficient life insurance to cover my son's education costs.
- **Action Item**: *I will buy an **additional** \$100,000 of 20-year term life insurance.*

Policies vs. Values, Beliefs, Observations, Goals, Action Items

- **Observation**: Our extended family looks to us to help support them.
- **Goal**: To encourage them to support themselves.
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- **Action Item**: *Arrange for and pay for brother John's consumer credit counseling services.*

Policies vs. Values, Beliefs, Observations, Goals, Action Items

- **Observation**: Our extended family looks to us to help support them.
- **Goal**: To encourage them to support themselves.
- **Policy**: We will provide financial literacy support but will not give them money.
- **Action Item**: *Teach Susan how to balance her checkbook and how to use Quicken to establish and follow a budget.*

Policies vs. Values, Beliefs, Observations, Goals, Action Items

- **Belief**: Too much inheritance blunts ambition.
- **Goal**: To provide for spouse without leaving too much money to our grown kids.
- **Policy**: We will own life insurance for our survivor needs only, establishing charities as contingent beneficiaries.
- **Action Item**: *Buy term insurance based on capital needs analysis; coordinate beneficiary designations; monitor regularly.*

Policies vs. Values, Beliefs, Observations, Goals, Action Items

- **Belief**: Too much inheritance blunts ambition.
- **Goal**: To provide for spouse without leaving too much money to our grown kids.
- **Policy**: We will own life insurance for our survivor needs only, establishing charities as contingent beneficiaries.
- **Action Item**: *Cancel insurance.*

[Financial Planning]

Client Values
and Goals

Best Practices



Recommendations
and

Implementation

[Policies: A Bridge]

Client Values
and Goals

Best Practices



Recommendations
and

Implementation

Financial Planning Policies

- Financial Planning Policies transcend the current situation by expressing in general terms what clients plan to do and how they are willing to do it in terms not limited to the current circumstances.

[Implicit vs. Explicit]

- We are not suggesting that financial planning policies are not implicitly present in most financial plans. We are simply suggesting that these policies made explicit can create better tools for guiding clients.

Integral Framework

	Interior	Exterior
Individual	I	It
Collective	We	Its

[Being Integral]

	Interior	Exterior
Individual	I	It
	What and Who	Traditional Data
Collective	We	Its
	Matter, and Why	Markets, Economy, Laws, Society

[Being Integral]

	Interior	Exterior
Individual	<p>I</p> <p>What and Who</p>	<p>It</p> <p>Traditional Data</p>
Collective	<p>We</p> <p>Matter, and Why</p>	<p>Its</p> <p>Markets, Economy, Laws, Society</p>

The Integral Perspective

	Interior	Exterior
Individual	<p>I</p> <p>Personal Values Personal Beliefs Goals & Objectives</p>	<p>It</p> <p>Income & Expenses Assets & Liabilities Education & Skills</p>
Collective	<p>We</p> <p>Family History Social/Cultural Norms Social Networks</p>	<p>Its</p> <p>Tax Laws Financial System State of the Economy</p>

Policies Blend the Interior and the Exterior, the Individual and the Collective

WHY

Goals
Objectives
Values
Beliefs
Money Issues
Relationships
Culture

HOW

Strategies
Laws
Regulations
Best Practices
Resources
Economy
Societal Pressures

Financial Planning Policies

- Financial Planning Policies blend the integral quadrants by expressing in general terms what clients plan to do and how they are willing to do it in terms not limited to the current external circumstances.

Financial Planning Policies

Six-Step Process

- Step 1: Discovery
 - Goals
 - Desires
 - Values
 - Attitudes
 - Data
- What really matters to them?
- What do they want?
- What do they have to work with?

Financial Planning Policies

Six-Step Process

- Step 2: Identify Planning Area and Related Principles
 - What Planning Area(s) are the Policies going to need to address based on the client's circumstances?
 - What are the Best Practices in that/those Planning Area(s)?

Financial Planning Policies

Six-Step Process

- Step 2:
 - Different client *structural* circumstances will dictate different planning areas that may require policies.
 - Client resources
 - Kids/No kids
 - Marital status
 - Career path
 - Etc.

Financial Planning Policies

Six-Step Process

- Step 3: Combine Client Goals/Attitudes with Planning Principles
 - Draft statements that you believe reflect the client goals, values and attitudes, and the relevant planning principles.

Financial Planning Policies

Six-Step Process

- Step 4: Test Policies and Develop Specific Recommendations
 - Is it a policy?
 - Are there external circumstances that will change and affect the decisions encompassed by this policy?
 - Does this policy enable us to make decisions as things change?
 - Scenario Planning: Feed current and potential data through the policies to test how good they are.
 - General enough to encompass divergent circumstances.
 - Specific enough to leave one in no doubt as to the actions to be taken.

Financial Planning Policies

Six-Step Process

- Step 5: Test Policies with Client
 - Formalize for discussion with client.
 - Does the wording resonate with them?
 - Do clients see their goals and values reflected in the Policies?
 - Interactive Process

Financial Planning Policies

Six-Step Process

- Step 6: Periodic Review and Update
 - Policies change based on ***structural*** or ***fundamental*** triggers, ***not cyclical*** triggers
 - Laws and Regulations
 - Best Practices
 - Change in Client Values or Goals or Structural Circumstances
 - An interior shift that has changed the exterior goals
 - An exterior change that has changed the structural circumstances

[FP Policies - Applications]

- All comprehensive financial planning engagements
- Hourly or “one-time” financial planning engagements
- Young people and others with little income and few assets for whom planning issues will emerge over time

[Summary]

- A process for making financial planning policies explicit would aid both clients and advisors in making appropriate adjustments to changing circumstances without the necessity of starting from scratch.

[Some Examples]

[Debt Policy]

- We will use credit cards for convenience only for purchases that are part of the monthly budget.
- For purchases equal to 10% or less of annual after-tax earnings, we will set aside funds monthly until needed sum is accumulated.
- For purchases equal to more than 10% of annual after-tax earnings, we will use amortized debt.

DEVELOPING FINANCIAL PLANNING POLICIES

What really matters to the client (values, beliefs)?
For children/grandchildren to live productive, happy lives To not remove incentives to make their way in the world Helping family achieve Education Family
What does the client want (goals)?
Client wants estate distributed with care, without undue waste in taxes. Client wants to make sure children and grandchildren are provided a solid base for a productive and happy life. Client wants to leave a legacy that will support empowerment.
What Policy (Planning) Areas need to be addressed?
Estate planning Charitable giving Gifting during life
Draft Policies to be shared with the client
We will provide, by lifetime gifting or through our wills and trusts, funds sufficient to pay for up to 8 years of college education for our children and grandchildren. We will provide, through lifetime gifting or through our wills and trusts, funds to help make a 20% down payment on a first home. The balance of our estate will go to charity.

[An example where policies might have helped]

- Client who could not live on \$50,000 per month, wouldn't sell employer stock and started a business.
 - I will maintain a portfolio that supports a 5% safe withdrawal rate
 - I will invest in the new business by liquidating employer stock

[An example where policies did help]

- Same stock, \$110,000 cash flow goal
 - Maintain portfolio of at least \$2,200,000 (increasing with inflation)
 - Make other purchases/investments out of remaining employer stock
 - New first home
 - Business with partner and brother
 - Speculative real estate investment
 - New second home (and upgraded)

[More examples: The Horse Farm]

Clients spent money they couldn't afford helping their daughter and son-in-law buy the house next door, which the daughter and son-in-law couldn't afford, prompting the clients to spend even more money they couldn't afford to subsidize the daughter's monthly living expenses.

[The Horse Farm: policies]

- We will provide financial support to our children up to the point that it does not endanger our own financial security based on Guyton's safe withdrawal rate and "guardrails"
- We will not facilitate transactions by our children that they themselves cannot afford to sustain.

[The Money Anorexic]

- Husband retired from UCSF with a pension equal to 85% of prior earnings
- Couple have \$2mm in financial assets
- Wife spent her entire life as a diligent saver
- Wife told husband when he retired that they were going to have to tighten their belts because his pension was less than his salary had been.

[The Money Anorexic: policies]

- An amount equal to the sustainable withdrawal rate will be transferred quarterly to a separate “play” account.
- The play account will be kept liquid
- All travel, vacations, and other discretionary purchases will be made from the play account
- Suspend transfers when play account exceeds 150% of annual target