



Policy-Based Financial Planning[©]

Elissa Buie, CFP[®] and David B. Yeske, CFP[®]

FPA San Francisco

September 12, 2006

[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

[What Policies Are Not]

- Procedures
- Action Items/To Do's
- Implementation
- Goals and Aspirations
- Targets
- Beliefs and Values

[What Policies Are]

- Decision rules
- A bridge between
 - “why” (personal values and goals)
and
 - “how” (external circumstances, resources)
to get to
 - “what” (action items)
- Best when explicit

[From Values to Action ...]

Values and Beliefs

Goals and Targets

Policies

Data and Analysis

Recommendations and Action Items

Policies and the Six-Step Financial Planning Process*

- 1. Establish and define the Client-Planner relationship.
- 2. Gather client data, including goals.
 - And values and money beliefs, etc., etc.!
- 3. Analyze and evaluate financial status.
- 4. Develop and present financial planning recommendations.
 - And policies!
- 5. Implement the recommendations.
- 6. Monitor the recommendations.

* CFP Board Process

Characteristics of a “Good” Policy

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

[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.

Policy for Prioritizing Savings

[Values-Goals-Policies-Analysis-Action]

- **Values/Beliefs:** Client values self-sufficiency. Client believes in providing children with at least the basic tools for success. Client doesn't want to be a burden on children in retirement.
- **Goal:** Fund 4-years of public education for each child; retire at 60 at current lifestyle.
- **Policy:** We will fund the cost of a **public** education as a priority over saving for retirement but the additional cost of a **private** education will only be funded after retirement savings targets have been met.

Policy for Prioritizing Savings

[Values-Goals-Policies-Analysis-Action]

■ ***Data and Analysis:***

- Children are 5 and 8
- Public education costs \$15,000/year in 2006 \$
- 7% inflation, 9% earnings assumptions

■ ***Action items:***

- Save \$1,200/month toward education
- Fully fund 401k
- Save additional \$1,000/month toward retirement
- Invest according to IPS

Policy regarding legacy or estate planning [Values-Goals-Policies-Analysis-Action]

Values/Beliefs:

Client believes children and grandchildren should be given the tools to live productive and happy lives, but also believes that inherited wealth blunts ambition and too often results in lives that do not serve larger societal needs.

Policy regarding legacy or estate planning [Values-Goals-Policies-Analysis-Action]

■ ***Goals:***

- To pay for the education of our children and grandchildren.
- To make the down payment on a first home for each of our children and grandchildren.
- To leave no other assets to our heirs.

Policy regarding legacy or estate planning [Values-Goals-Policies-Analysis-Action]

■ ***Policies:***

- Each child/grandchild will be gifted 4 x the annual gift exclusion when they are ready to purchase their first home.
- Each child/grandchild will be provided up to 4 years of college tuition/room/board/books/spending money.
- All of our remaining assets will be left to charity.
- We will review our desires and estate plan at each annual financial planning update.

Policy regarding legacy or estate planning [Values-Goals-Policies-Analysis-Action]

■ ***Data and Analysis:***

- Review of estate documents revealed these wishes were not reflected therein.
- John and Susie (son and daughter-in-law) are ready to buy their first house.
- The current gift tax exclusion is \$12,000.
- Cindy and Matt (daughter and son-in-law), who already own a house, have asked for help in buying a second home.

Policy regarding legacy or estate planning [Values-Goals-Policies-Analysis-Action]

■ ***Action Items:***

- Meet with attorney and modify estate documents to:
 - establish a trust for education and home down payment for each remaining child/grandchild at our death;
 - leave the balance of our estate to charity.
- Gift \$48,000 to John and Susie this year for a down payment on their first home.
- Explain to Cindy and Matt that we will not be able to help them with their second home.

Policy from Implicit (Financial Hygiene) Values and Goals

■ ***Debt Management Policy:***

- We will use credit cards for convenience only, for purchases we can pay off each month.
- For purchases representing 10% or less of annual income, we will save monthly until the purchase amount is accumulated.
- For purchases costing more than 10% of annual income, we will use amortized debt, not to exceed total debt service of 30% of gross income.

[A Personal Example]



(c) Financial Planning Group, Inc.
(c) Yeske & Company, Inc.

[A Personal Example]

- (Some of) Dave's and Elissa's Values
 - Elissa being with Lauren and Alisson as much as possible.
 - Dave building a relationship with Lauren and Alisson.
 - Dave and Elissa continuing to evolve ourselves and our relationship.
 - Financially supporting our lifestyle.
 - Participating in the financial planning profession.

[A Personal Example, cont.]

- Dave's and Elissa's Environment
 - 2,419 mile separation
 - Ultimate desire to live in San Francisco
 - Joint custody of Lauren and Alisson
 - Two firms – clients and staff - merger
 - United Airlines frequent flier program
 - Finances

[Dave's and Elissa's Policies]

- Our family energy is focused on NoVa and the growth and evolution of the girls
- Dave's finite number of travel days will maximize his time with the girls
- Dave takes on parental duties
- Elissa travels to SF whenever girls are not available to her in NoVa
- Dave and Elissa actively discuss all opportunities to participate in profession

Dave's and Elissa's Action Items

- Dave travels to NoVa Friday night – Wednesday a.m.
- Dave is responsible for getting the girls to school in the a.m. when he's in NoVa
- Dave helps with homework
- Dave takes responsibility for Mother's Day celebration, etc.
- Elissa spent 2006 Spring Break in California
- Dave is taking riding lessons with Elissa and the girls
-

What has this meant?

- Managing client and staff expectations
- Being able to plan well in advance for holidays, vacations, and invitations
- Being able to schedule events with the girls (birthday parties, trips, etc.)
- Being able to schedule flights well in advance
- Ask us a question ...
 - Can you speak at FPAXyz?
 - How will you react to the next UAL bankruptcy?
 - How are you going to fit in the goal of taking the girls on safari?
 - How are you operating your businesses in light of these issues?
 - What date is preferable for Lauren's Sweet 16 party?

[Integral Framework]

	Interior	Exterior
Individual	I	It
Collective	We	Its

Integral Framework

<p><u>Individual / Interior</u> Who you are, who matters to you, and how you feel about things, including attitudes toward spending & saving, personal risk tolerance, and your vision of “the good life.”</p>	<p><u>Individual / Exterior</u> What you own, what you owe, all the objective facts about your life, including personal resources and constraints like education, occupation, income, expenses, assets, liabilities.</p>
<p><u>Collective / Interior</u> Relationships; religious/spiritual beliefs; family, ethnic, cultural history and beliefs, including collective attitudes toward spending, debting, investing, charitable giving, education, legacy, etc.</p>	<p><u>Collective / Exterior</u> Objective facts about the external environment, including tax laws, financial market structure, state of the economy, interest rates, inflation rates, available financial instruments, etc.</p>

Integral Framework: Policy Bridge

WHY

Goals

Objectives

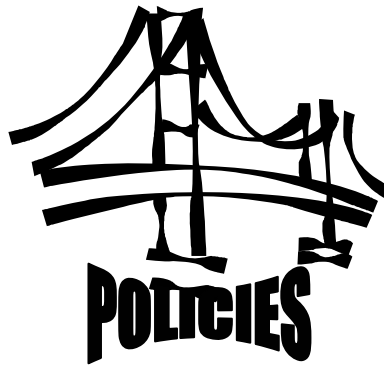
Values

Beliefs

Money Issues

Relationships

Culture



HOW

Strategies

Laws

Regulations

Best Practices

Resources

Economy

Societal Norms

Financial Planning Policies

- Financial Planning Policies bridge the four 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.

[Interesting Policies]

- ***Policy:*** We will not succumb to keeping up with the Joneses.
- ***How this helped:*** Clients moved away where they could start anew and made decisions in their new life specifically aimed at keeping them away from the Joneses.

Interesting Policies

- ***Policy:*** We will not purposely create a financial legacy for our children.
- ***How this helped:*** Clients were able to accurately evaluate their need for the permanent insurance their newly-insurance-licensed family member recommended to them.

Interesting Policies

- ***Policy:*** We will provide emotional support for family freely. We will provide financial support only as it does not infringe on other goals.
- ***How this helped:*** Client referred sibling in debt crisis to Credit Counseling Service, and paid for initial consultation. Client did not bail sibling out of debt crisis.

Financial Planning Policies

Six-Step Process

- Step 1: Discovery
 - Beliefs and Values
 - Goals and Desires
 - Attitudes and Cultural Issues
 - Data
- What do they want to have and do?
- What really matters to them?
- What do they have to work with?
- What areas will the policies need to encompass?

Financial Planning Policies

Six-Step Process

- Step 2: Identify Planning Area and Related Principles
 - What Planning Area(s) are we addressing?
 - What are the Best Practices in that/those Planning Area(s)?

Financial Planning Policies

Six-Step Process

- Step 3: Combine Client Goals/Attitudes with Planning Principles
 - Draft statements that 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
 - Scenario Planning
 - General enough to encompass wildly divergent circumstances, and
 - Specific enough to leave one in no doubt as to the actions to be taken

Financial Planning Policies

Six-Step Process

- Step 4:
 - Example:
 - What if housing inflation doubles?
 - What if each child has 6 children?
 - What if client's job and benefits change?
 - What if client's monthly income or expenses change?
 - What if United Airlines eliminates its frequent flier program?

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
 - An interior shift that has changed all the exterior goals
 - NOT market moves, insurance costs, changes in income/expenses/employee benefits, emotions in reaction to exterior cyclical events

[Example, cont.]

CASH FLOW AND DEBT MANAGEMENT

We will use credit cards for convenience only, for purchases we can pay off each month.

For purchases representing 10% or less of annual income, we will save monthly until the purchase amount is accumulated.

For purchases costing more than 10% of annual income, we will use amortized debt, not to exceed total debt service of 30% of gross income.

We will maintain an emergency fund equal to our monthly spending times the number of months of waiting period on Bob's disability policy (minimum 3 months).

We will set savings targets, save first and then spend the rest.

Action Items:

- 1. Maintain an emergency fund of \$27,000.**
- 2. Accumulate \$3,000/month in a "Fun To account" towards future non-retirement/education needs (e.g. construction, new car, homes: Tahoe, London and Meribel) and other items that arise.**
- 3. Spend Bob's bonus to the extent it exceeds \$37,000 gross/\$22,000 net, or accumulate these amounts in the "Fun To account".**

[Example, cont.]

TAX MANAGEMENT

We will choose tax saving strategies to maximize after-tax wealth over a multi-year span, not to minimize current year taxes.

We will establish withholdings to generate neither large liabilities nor large refunds.

Maintain mortgage debt outstanding with an interest rate of 7% or less.

Action Items:

- 1. Set Bob's withholdings to Married 10 (show EB first paystub after this change takes effect).**
- 2. Have Bob's bonus withheld at 33% Federal.**
- 3. Allocate surplus cash flow to Schwab account, not to paying down mortgage.**

RISK MANAGEMENT

We will maintain the largest deductibles consistent with our emergency fund.

We will insure against risk based on our ability to absorb the loss.

We will secure as much disability insurance as we can qualify for.

Action Items:

- 1. Raise your auto insurance deductible to \$1,000.**
- 2. Raise your medical insurance deductible to \$1,500.**
- 3. Purchase \$2,300,000 20-year term insurance on Bob.**
- 4. Purchase \$250,000 15- to 20-year term insurance on Sue.**

Example, cont.

INVESTMENT MANAGEMENT

We will keep short-term money (money needed within the next twelve months) liquid.

We will manage our portfolio according to our Investment Policy Statement

Action Items:

- 1. Provide Elissa with a complete list of ABC Co. 401k alternatives.**
- 2. Open a Schwab account for your non-qualified retirement/education savings.**
- 3. Establish moneylink for \$3,200 per month.**

RETIREMENT AND EDUCATION

We will allocate savings first to pre-tax vehicles to the degree possible.

We will not allocate savings to tax-deferral vehicles that do not provide a tax deduction.

We will fund the cost of a public education as a priority over saving for retirement but the additional cost of a private education will only be funded after retirement savings targets have been met.

We will live a life that balances work and play over our entire life expectancy.

Action Items:

- 1. Save the following toward Retirement and Education:**
 - \$15,000 per year to Bob's 401k (with \$7,500 per year match; vesting applies).**
 - \$16,000 per year, representing your current tax overwithholding.**
 - \$22,000 per year, representing Bob's minimum after-tax bonus.**

[Example, cont.]

ESTATE PLANNING

Action Items:

1. Provide copies/have drafted the following estate documents:

Wills

Advanced Medical Directives

Medical Powers of Attorney

Revocable Living Trusts

2. Establish an Irrevocable Life Insurance Trust for the additional insurance being recommended.

3. Discuss Estate wishes.

Sample Estate Planning policies:

We will minimize estate taxes at all costs.

We will maximize our access to our assets during our lifetime without regard to estate taxes.

We will leave assets to our heirs in a way that impacts their future behavior.

We will gift as much money as possible during our lifetime in order to reap the rewards of our gifts.

Through lifetime gifting or inheritance we will provide our children with funds sufficient for education and a down payment on a house with all other assets going to charity.

We will leave our children enough money to do anything but not enough money to do nothing.

We will leave our children enough money to be financially independent and never have to work.

We will coordinate our gifting and our estate plan with our wishes to "give back".

[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.