

# INSIDE INFORMATION

The newsletter for serious financial advisors. (www.bobveres.com)

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## EARLY WARNING

• In case you missed it, Vanguard has been offering free financial plans through its "Voyager" service, and promising that the consumer will get answers to their most crucial retirement questions: how much will they need at retirement, how much can they safely withdraw each year and what investment mix is best suited to their needs.

Call, and you're promised a fi-

## LIFE

## IN THE FAST LANE

*Here's a product--and the thinking behind it--that could change an industry. More importantly, it might help you provide better planning service.*

If you're looking for stunning new ideas and innovation, I don't recommend that you spend a lot of time on the life insurance industry. It is one of the few places in the financial services realm where sales have been essentially flat for more than two consecutive decades, and the level of trust in the consuming public--and among fiduciary advisors--is so low that whenever people talk about full disclosure and putting the customer first in the context of life insurance, you know immediately that they're telling a joke.

Yet there are signs that this may be changing. Readers of this newsletter know that the first M&E expense-less annuity has been recently introduced by Jefferson National Corp., which followed a not-always-successful effort by TIAA-CREF to offer commissionless life coverage products to the planning community. When I look at the reigning paradigm in life insurance--nondisclosure, stodgy product design, distribution that relies on sales tactics and commissions--I see a world where a new product or a new carrier could walk in and change the rules for the better,

and instantly become the dominant provider in the marketplace.

Jack Desemar, of Future Systems Advisors in Baton Rouge, LA, has come to the same conclusion from a different direction--and he's doing something about it. In fact, he appears to have created an entirely new life insurance product which addresses financial and estate planning issues in a way that should work much more

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ancial planner "who doesn't work on commissions." But more than a few advisors have noted that giving away free plans in hopes of capturing assets is a old and somewhat tiresome wirehouse strategy. Does the commissionless advisor recommend anything other than the in-house mutual funds? More to the point, is it possible that working on a salary represents a significant conflict of interest--equal to commission compensation?

## Life in the Fast Lane

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efficiently than anything currently on the market. The product is at least six months from coming to market as you read this, but I think it might be time to start preparing for a very significant shift in both the planning and insurance worlds.

What kind of shift? Desemar's new insurance product came from a financial planning system that he plans to license to the profession, but I don't think I'm giving too much away when I say that he divides all client assets into five different categories:

1. **Stuff** -- meaning, of course, your boat, car, plane, vacation home, furniture etc. The purposes of these assets are shelter and enjoyment; these are not assets that need to grow and/or produce income.

2. **Cash reserve** -- including checking account assets, savings, money market funds and CDs that the client can call on in emergencies or when an extraordinary opportunity presents itself. (Desemar believes that different people, under different circumstances, need different amounts, and has ways to calculate that, but that would be giving away too much of his thinking.)

3. **Spending or Consuming assets** -- which really means whatever assets you plan to consume in retirement. Desemar believes that these should all be tax-efficient assets; that is, you want to be able to control the timing and rate of taxation at or below long-

term capital gains rates. Examples would be tax-qualified, dividend-paying stocks, munis, closely-held companies, investment real estate, REITs and very tax-efficient mutual funds.

4. **Saving assets** -- which is a nontraditional asset category composed of tax INefficient assets; that is, assets where, when you liquidate them, you will pay ordinary income tax and you cannot always control the timing of distributions and/or realized gains. Here you have most mutual funds, corporate bonds, tax-unqualified dividend-paying securities, etc.

5. **Giving assets** -- whatever you plan to give to charity or your heirs.

What concerns us here is Category 4, which Desemar says is there for three purposes. The first, plausibly enough, is to provide a secondary source of retirement income should your clients somehow manage to spend their Category 3 assets before they've finished their retirement. The second is to serve as a reserve in case the client loses a lawsuit and has to give somebody else the Category 1, 2 and 3 assets. "If somebody is planning to retire on \$300,000 a year, we'd like to be able to have enough set aside in creditor-protected assets so that the client could fall back and live on \$200,000 a year in the unlikely case that they get sued and lose everything," says Desemar. "This is what you would have to start over with.

And, of course, the third purpose of Category 4 assets is to have money that will be left to heirs or charity at death in the most tax- and financially-efficient way possible.

What does all this have to do with life insurance? Under Desemar's system, the Category 4 ("Saving") assets should be placed inside tax-deferred vehicles where possible. So you max out on your qualified plans and IRAs--and then, in the likely event that a financial planning client has some Category 4 money left over, you have a problem. To get more tax-inefficient assets compounding tax-deferred, you have to recommend that the client buy an annuity or a cash value life insurance policy, and Desemar is very reluctant to make that recommendation given the product choices he has.

Plus there are some structural problems as well. "Annuities have the tax trap at death," he says, "and traditional life insurance is extremely inefficient for accumulation, because of the cost of the at-risk death benefit."

To explain this to the clueless journalist who is writing this article, Desemar created a little table which illustrates the efficiency of each of these alternatives as a future funding vehicle. The annuity receives the client's money, takes out whatever loads and fees the insurance company happens to be charging, and then invests the rest, which compounds with relative efficiency until the dreadful date when the client dies. At that point, the asset value takes a sharp nosedive, because the annuity

doesn't receive a step-up in basis like virtually every other asset. If you try to pull the money out in retirement, it is taxed at ordinary income rates, so that isn't an ideal solution either.

Alongside the annuity, Desemar graphs the accumulation within a life insurance contract. Here we have much slower compounding, and the rate of compounding gets slower as the client ages, but there is no dip at the end. Most of you already know why the compounding starts slow and peters out: the premiums are not just contributing to the investment account, but also toward the cost of life insurance protection. Problem is, a client who wants to stuff Category 4 assets into the policy probably doesn't need the protection. (We'll talk about estate planning issues in a minute.) If he/she did, then a term policy would be a more efficient solution.

The problem here is actually one of product design, as Desemar sees it. The coverage you are paying for is the difference between the cash value and the face amount of the policy--the amount the company is actually at risk for at any given time, an amount which changes daily. If you buy a \$1 million face amount and you've got a cash value of \$600,000 in the policy, then you are charged for \$400,000 of coverage--at your age, and of course the cost of each dollar of at-risk coverage goes up as you age and become actuarially more likely to die. If investment performance is lower than projected, or if the cash value in your account goes down, then the cost of insurance goes up and the policy risks going into that famous death spiral where the investments in the policy don't appreciate by an amount sufficient to pay the insurance costs, and each subsequent year there is less money in the account, more death benefits to pay for and the in-force ledger begins to look like the script of a horror movie.

Experienced insurance agents have devised some clever, tortuously complicated ways to get around this, basically overfunding the policy and dialing down their commissions by selling hybrid term/cash value coverage. (In the parlance of the trade, this is a modified endowment contract, and you've probably heard agents talk about "MECing.") But Desemar has other problems with the traditional products he sees recommended. "In many insurance policies, there is a current and a guaranteed maximum level of COIs

that can be charged," he says. "The insurance company is contractually able to dial up its profits on a policy without the client ever knowing."

Desemar has actually seen this in real life. "We'll call it Company A, which bought Company B, and the returns on the block of business turns out to be less than what Company A wants," he says. "So Company A gets the CFO and the actuary together and says, we have to increase the ROE on this business block. What do we do? Let's say they look at all the policyholders between 70 and 80 years old," Desemar continues. "And let's say they have \$10 billion of death benefit in that block. The actuary says, why don't we increase the annual COIs (cost of insurance) in that block by 5% a year? They do that with a little bit of reprogramming, so that when the consumer gets an annual statement, he knows the COIs go up every single year already, because he's older. What he doesn't know, what he has no way to know, is if they went up 5% more than they would have gone up for the person of that attained age."

In some policies, the COI rate can go up as much as 100% at the company's discretion. In the early years, when the policyholder is younger, the difference between the two levels may not be large; \$400 a year for a 45-year-old on \$1 million of death benefit. But in later years, watch out. "The same difference in premium at age 90 could be as much as \$200,000," Desemar explains. "So even a very small percentage change in the cost

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### **Inside formation**

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## Trendspotter

**D**on't look now, but the regional conferences are starting to outshine some of the national ones.

Case in point: the FPA NorCal Conference (formerly the Northern California Regional Planning Conference) at the Palace Hotel in San Francisco, April 3-4. In two days, the program will feature Peter Lindquist (one of the best speakers at the FPA National meeting in San Diego); Virtual Office News co-founder Joel Bruckenstein on technology issues; Jon Guyton reprising his article on sustainable withdrawal rates in retirement; planning coach Tracy Beckes on life-changing activities; Ted Klontz (one of the best speakers at the FPA Retreat last year) on novel life planning tools and applications for clients; Dennis Stearns on scenario learning (he has twice led group scenario learning activities at Retreat); David Goad on succession planning; Guy Cumbie on planning for real life changes; Jo Day on creating a paperless office; plus FPA president Dan Moisand, compliance attorney Tom Giachetti and Financial Planning magazine columnist Michael Kitces.

And those are just the *breakout* sessions. Keynoters will include international currency expert Bernard Lietaer on the potential consequences of a dramatic fall in the value of the dollar; popular IRA distribution planning expert Natalie Choate; John Rogers of Ariel Capital Management and one of the leaders in both value stock picking and socially-responsible investing; plus Nick Murray and George Valliere, chief political strategist of the Washington Research Group. (FPA members who sign up before February 22 pay \$399; you can check it out at <http://www.fpanorcal.org>.)

Increasingly, the regional meetings are able to cherry-pick the best sessions from the national conferences and supplement them with well-known local advisors (Paul Gire and Elfrena Foord are both on this year's agenda). In the larger metro areas like Greater Washington (FPA Mid-Atlantic) or regions (NAPFA North/Mid-Atlantic; NAPFA West; NAPFA South; NAPFA Midwest), there are enough advisors in the area to provide much of the economy of scale of a national event, with more attendee loyalty than the conferences that move around the country, plus exhibitors can receive special accommodations and some measure of exclusivity.

Does that mean that larger national conferences are in trouble? Probably not. Increased attendance at the local level, and exposure to nationally-recognized speakers, will probably help boost attendance at the larger conventions, where advisors will get to see some of next year's best local sessions a few months ahead of the pack. And the price differential (\$200) between members and nonmembers at the NorCal meeting will give Bay Area advisors an incentive to join the national association.

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of insurance at older ages can mean a lot of extra dollars out of your policy."

The result: that line on the graph which grew so slowly as the client gets older might halt or even backslide dramatically in later years. There is really no way to predict what the insurance company is going to do.

The insurance product which Desemar has helped design, which is now in the process of being developed by an insurance company to be named later, will address both of these issues. It will, first of all, pay the insurance company an asset-based fee for managing the contract. And secondly, it will buy as little at-risk death benefit as the law allows. "We asked ourselves: is it possible for a life insurance policy, even though it hasn't been done before, to not have an initial amount of death benefit?" he says. "The answer turns out to be yes."

In actual fact this is an exaggeration; under Section 7702 of the tax code, the policy must adhere to what are called the net single premium ratio rules, which defines the least amount of at-risk death benefit the policy can provide at any given client age. The actual chart has a different ratio each year of a person's life. The trick is that instead of having to pay for, say, \$1 million in coverage, you define the life insurance death benefit as a ratio to the cash value in the policy.

Fortunately, this ratio goes down as the policyholder ages--and as the death benefit premiums would be rising. At age 60, you

have roughly a 2:1 ratio, which means that if there is \$1 million in the account, the death benefit would have to be \$2 million. But at age 90, when the cost of at-risk insurance is likely to be high, the policy only has a teensy amount to pay for; based on the 1.1 to 1 ratio, on a \$1 million cash account, only about \$100,000 in additional coverage has to be added.

By dialing down the amount that the client would have to pay for death benefits, Desemar is able to draw a new line on his graph, which shows accumulation that tracks but never quite equals the annuity account's growth (there is, after all, SOME cost of insurance in the equation), but which doesn't have that nasty drop in value at the client's death. The client can create his/her own premium schedule, and the premiums are not mandatory in any given year. There are no commissions; only state and federal taxes (called DAC taxes; roughly 3.5%) so 96.5 cents on the dollar goes directly to the account value. The client can allocate these assets among the different subaccounts in any way that you recommend. And there will be no surrender charges, so the money is available if that aforementioned creditor lawsuit thing happens.

Interestingly, when Desemar went around to different life insurance companies with his product design proposal, he received two contradictory responses. In virtually every case, the insurance executive was uncomfortable with all the disclosure in the contract. "One of them even told me, you're giving all our secrets away!" says

Desemar. "It's way outside their comfort zone." On the other hand, most of these companies were willing to put the product onto their drawing boards. "The most consistent answer I got," Desemar adds, "is that this company doesn't want to be the first to come out with this product, but they want to be a quick second. They don't want to erode their existing product line or alienate their distribution network, but they see that there is a huge potential, so much that anybody who sticks with the traditional products too long could lose a lot of market share."

Obviously this new life insurance product can be used to fund the client's estate taxes--which brings up a couple of interesting issues that may only be interesting to the Inside Information audience. (Translation: what a bunch of technical nerds!)

The first is the relevance of the death benefit to the client's current estate tax liability. Desemar points out, convincingly, that this is a moving target. The client today has an estate worth \$10 million and, let's say, an estate tax liability of \$3 million. Does it make sense to buy a death benefit of \$3 million? Or should you aim for a future estate tax liability 10, 20 or 30 years down the road? More to the point: how could you? The new life insurance policy designed by Future Systems could grow in value as the client's net worth grows, effectively moving along with the moving target. Anything that has a fixed death benefit, by definition, isn't going to be as flexible.

Or as efficient. "The most

inefficient way possible to reach an increased future death benefit," says Desemar, "is to buy more at-risk death benefit at the beginning."

The second issue is even simpler: does it make sense to fund the estate taxes at all? This isn't merely an issue related to the vanishing estate tax--and whether or not it really WILL vanish. It's much more basic. "There is one question that is never asked during the traditional approach to estate planning," says Desemar. "You look at the net amount to the heirs after the estate and other taxes are paid, and then you look at the client and say, is that enough?" This is especially relevant, he says, if the estate will continue to grow in the future, making this amount you've calculated the LEAST the heirs will ever get.

"If the answer is yes, then no up-front death benefit is needed, and you'll have to find some other reason to justify recommending the Future Systems insurance policy. If the answer is no, but eventually the estate will grow to the point where the answer switches over to a yes, then buy term insurance between now and then. (This, of course, is an inelegant solution, since it imposes a fixed death benefit on a shrinking target. But at least it's cheap.)

I think this is one of those interviews where we get a lot of out-of-the-box thinking for the time invested. First, we get a fresh look at traditional cash value life insurance policies, which not only put you at the mercy of the carrier, but also have some logical flaws in

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the way they are designed compared with the need they are supposed to be addressing. Second, we get a fresh look at how, exactly, to make sense out of that need. Third, I think the categorization of assets is quite interesting, especially the idea of qualified investments as a last resort option for retirement income and as a judgment-proof reserve.

Finally, we get an early peek at a life insurance policy which could totally change the rules of the life insurance industry for the better. As most of you know, I think if somebody could force life companies to be as up-front about their expenses and fees and assumptions and COIs and all the rest of the things that are so obscure now, the world would finally have a private sector safety net worth boasting about. All they need is somebody to shake them out of their comfortable inertia, and the Future System product seems to have awakened at least the first stirrings of anxiety among senior executives.

Meanwhile, Desemar is web-izing the Future Systems methodology and software, and plans to set up a training facility for any advisors who want to take advantage of his ideas in actual client situations. You can get an early taste of some of what I think is original thinking in the planning world by visiting the web site at [www.fsadvisors.com](http://www.fsadvisors.com). Meanwhile, I'll follow the progress on the new insurance policy and let you know as soon as they get it on the market. ■

**Practice Management**

## Big Benefits for Little Firms

*Here's how to offer an employee benefits package that rivals the top Fortune 500 companies--even if you're not a multinational conglomerate.*

by Bob Veres

**G**reg Friedman, of Friedman & Associates (and CRM Software) in San Rafael, CA recently completed an interesting exercise in outsourcing. He reduced his employment rolls from seven to zero, and now leases his seven employees back from an outside organization called Administaff. "The same people still work here in the office," he says. "But technically they were hired by the outside firm. And so was I."

What's the point? Initially, the idea was to outsource the payroll function and human resources administration, essentially getting rid of one labor-intensive task and taking on expertise that few small firms will have in-house. But those benefits were quickly overshadowed by others. As a small company, Friedman & Associates struggled to afford to offer a competitive employee benefits package. "I always felt compelled to take care of my employees the way I advise my clients," Friedman explains. "But there was no way I could afford a lot of the stuff that we wanted to provide."

Take health insurance, for example. "I offered a top-of-the-line plan, and for my wife and me

and two kids, it was running around \$950 a month," Friedman explains. "For a single employee, it wound up costing us in the \$500 to \$600 range." By moving himself over to Administaff, Friedman was able to receive essentially the same package for \$123 a month--plus he now receives dental coverage and an expanded vision package. The single employee pays \$75 a month--and has the alternative of receiving HMO or PPO coverage instead. The package also includes employer-paid life insurance, disability coverage and employees are reimbursed to take classes up to \$1,500 a year.

"I asked them, how can you afford to do this?" says Friedman. "Their response to me was: we have 80,000 employees. We can negotiate national contracts."

This, of course, is in addition to having the payroll function outsourced, and significant perks like having all the employee benefits listed on a centralized web site. Plus Friedman, as the owner, gets to take advantage of employee training activities provided by Intellistaff, and the company helps him recruit and interview and test new hires--all built into the basic service fee. "I sat down and figured out that for what I save on my health insurance alone, for my employees," he says, "that

spread picks up the entire cost of the arrangement.”

When he first looked into the service, Friedman was looking for a way to reduce the cost of his employer practices liability insurance. “If I get sued by an employee, or an employee gets mad or whatever, I had some exposure,” he says. “I saw that it was part of the Intellistaff package.” Even so, it took him a while to get used to the idea of having his employees--and himself--working for somebody else. “I was resistant to it because I didn’t understand it,” Friedman explains. “I had this preconceived notion, whenever I heard the words ‘employee leasing,’ that you didn’t have control.”

In fact, the arrangement proved to be relatively unthreatening. “It works just like PayChex or any other payroll service,” says Friedman. “They end up having access to your checking account, kind of like a limited power of attorney. You process the payroll online, putting in hours or the salary each pay period, with most of the numbers already in there, and they kick back an e-mail saying this is the amount--with their service fee added--and you have to approve it before they actually issue the money. They take that amount from your business checking account, do automatic deposits to the employees’ bank accounts, and send them an e-mail with a link to a pay stub.”

Norm Boone, at Mosaic Financial Partners in San Francisco, CA, is doing something similar with his staff, working with an Intellistaff competitor called Gevity. Instead of employing his staff and leasing them back, Gevity acts as a co-employer--and with a total of

130,000 employees, the company is able to get health insurance and workers comp coverage at rates that are low enough to offset its administrative costs. “They’ve also allowed us to expand our menu of benefits to include vision, improved dental and incidental life insurance,” says Boone. “They’ve provided employer’s liability insurance, and they even had their ergonomics guy come through our offices to suggest ways to make our work environment more pleasant.” And like Friedman, Boone discovered that he could simplify some of his HR compliance issues. “If somebody has to be fired,” he says, “we get training and advice. Have we gone through all the right steps? There are things you shouldn’t do, and things you need to do, in an interview when you’re hiring somebody. Getting that kind of expertise is really very helpful.”

Gevity also assigned a personnel specialist to review his compensation policies. “For a small advisory firm,” says Boone, “this is a way to outsource payroll and get human resources consulting in the door, plus much better benefits.”

Interestingly, both Boone and Friedman ultimately decided to keep their own in-house 401(k) plans, rather than drop their plan and let their employees use the larger firm’s retirement plan services. “We felt like we had a better plan,” Boone shrugs. “And we had better long-term disability, so we kept that. But we ARE using their vision, their medical, dental, their payroll and worker’s comp.”

“In our case,” says Friedman, “we found that one thing these companies cannot do is discrimination testing across hundreds of companies, so they

make them just standard plans with no vesting or anything. So we decided to hang onto our 401(k).”

Boone reports no notable service problems with Gevity, but Friedman found that he had to struggle a bit with the payroll function. “We would add a new employee, and they would lose our fax, or lose our form,” he says. “There was a lot of little administrative stuff which I don’t think is typical. We have had three different payroll specialists in the year that I’ve used them, but when we complained, they put us with somebody else.”

My sense is that most advisors should at least be considering the possibility of outsourcing the payroll function, and if you decide to do that, then the employee leasing/co-employee arrangements begin to look interesting--especially for smaller firms with zero clout in the health insurance marketplace. Friedman and Boone both endorse the concept after having tried it in their shops, and Friedman is especially enthusiastic. “The bottom line is that this is by far the best thing I ever did,” he says. “My employees love it. Suddenly I have an IBM-quality benefits package, like I was an S&P 500 company.”

If you’re interested in shopping for one of these services on your own, you’ll find that there are a LOT of competitors, and they seem to offer a variety of different packages for different fees. The best web site for looking at all the different service providers side-by-side--including Gevity and Intellistaff--can be accessed through this link: [http://www.labor.state.nh.us/Leasing\\_Companies.asp](http://www.labor.state.nh.us/Leasing_Companies.asp). ■

# Farm Team Recruiting

*Finally! A workable system for using interns. Plus: how to recruit talented employees.*

by Bob Veres

There's a lot of talk around the planning profession about hiring interns, but the people who have done it are reporting a lot of problems. These new people require a lot of training (which diverts time and energy from you and your core staff), and by the time you get them accustomed to your systems and procedures, and get them productive, the summer is over and it's time for them to go back to school. You never know for sure whether they'll be workaholics or chronic complainers. And it takes time and energy to find things for them to do, tasks that you would trust to somebody whose work habits and ethics are not yet well-understood.

"You get them in, get them trained, and by that time, it is the second week of August, and they leave the third week in August," says Lou Stanasolovich, at Legend Financial Advisors in Pittsburgh. "In our minds, that's a pretty useless arrangement."

Instead of giving up, Stanasolovich has figured out a creative solution to the problem. His first insight is also the simplest: instead of hiring people over the last summer of their college years,

make a policy of hiring only sophomores who are willing to make a commitment over the next three years. That way, you can get them trained and still look forward to several years of part-time productivity. And there are benefits to staggering their terms (hire three sophomores this year, three next, three the following year). "The way we have it set up now, each new intern is primarily trained by senior interns," says Stanasolovich. "That way, the core staff is not distracted."

Currently, Legend has 14 core staff members and four part-time workers who were full-time employees at one time or another. If the company were hiring interns for the summer of their senior year, it might be able to support as many as two without seriously disrupting that size office. But with Stanasolovich's intern-trains-intern system, he currently has 16: 1 in the HR department, 6 in his marketing department writing and sending out press releases and story ideas to editors and writers around the country (the marketing department is run by an ex-intern), 8 in finance doing financial planning-related jobs and one high school student. Interestingly, all but the high school

student come from local colleges, none of which have formal financial planning programs.

When the program started, the first priority was to create a highly-detailed procedures manual on all the various tasks that had to be performed in the office, so the first interns spent a lot of time following the employees around, asking questions and writing down what they did and how they did it. This eventually grew into a substantial body of work in its own right, with details on such tasks as cleaning the computer mouse and where various office materials are stored.

As the staff acquired senior and junior interns, much of the training could be delegated, making it far less painful to bring in new people. The typical intern works all year long; they commit to be in the office for at least 250 hours per semester (15-17 hours a week is normal), work 40 hours a week on breaks and work full-time each summer. Pay starts at \$7 an hour and they get a \$1 an hour raise for every summer they work, plus bonuses if they work additional hours during the year. "By their senior year, they're typically earning in the range of \$10 to \$11 an hour," says Stanasolovich.

Hiring sophomores paid some unexpected dividends when the students went back to school and reported that they were receiving actual training, rather than simply being shunted off to menial tasks. "By the time they leave here," Stanasolovich reports, "they know how to work on programs like BNA Income Tax Planning, Morningstar, Centerpiece, Thompson Financial,

they know how to use Zachs, Bloomberg Professional Service, some know how to do financial planning retirement projections, they work routinely on financial planning updates, every one of them is very skilled in the investment area. They know how to prepare the cost basis, do tax-loss harvesting, prepare Centerpiece reports and things of that nature.”

As recruiting became easier, standards could go up; today, Legend won't look at anybody with under a 3.6 grade point average. “Last year, the lowest out of six people who applied had a 3.98 GPA,” says Stanasolovich.

A program like this can't be built overnight; Stanasolovich reports that it took 11 years of trial and error to get his internship system where it is today. Was it worth it? “I think there are two benefits that we've found. One is the usual thing where you have additional people to get things done. In our shop, we try to push everything we possibly can to the lowest-paid employee who can get the job done in a quality manner. A lot of times, that will be a very smart college student. These folks are real employees by the start of their senior years--if not before.”

In addition, a large internship program addresses the persistent problem that growing firms have, of identifying talented employees when they need them. “It's like the minor leagues in baseball,” says Stanasolovich. “Eventually we want somebody to graduate to the major league team, and generally we hire one every year out of our pool of interns, sometimes in marketing, sometimes in finance.

Of course, you don't have to hire interns in droves to get these benefits. Another firm that has done well in its internship program is Austin Capital Management, in Austin, TX. “The biggest challenge with hiring and recruiting these days,” says company founder John Henry McDonald, “is that there are two levels of people coming into our business; new people who are coming out of school wide-eyed and wanting to be fee-only, and older career changers who have been engineers and accountants. It's like a barbell,” he adds, “except that everybody is recruiting at the thin part of the barbell. They want people who have been in the business and are already trained.”

Austin's approach is to recruit in the fat parts of the barbell, by bringing in interns who have training in financial planning (Texas Tech University is currently the main source of interns for the firm), and to have an entry-level career slot where new employees can be watched in the heat of battle. “When an intern comes in here, her first job is as a part-time file clerk,” says McDonald; “ basically including responsibilities like scanning all new client information, some light data entry of that information, getting a handle on the difference between a will and an account statement and so on.” The goal is to give the new person a thorough understanding of the difference between the different documents and how they work in a financial plan.

Then the intern is watched to see if he/she is capable of moving on from there. “We want to see if they are able to investigate and

decipher that information,” says McDonald. “They're encouraged to be thinking about, what documents am I lacking? I notice I don't have wills here. If they come in with a foundation in financial planning, we want them to challenge the lead planner and say, I'm lacking some information; would you like me to provide you a follow up e-mail that you can edit and send on?”

Interns who blossom in the system may be offered a job as a resident, which--in Austin's career track--is a step below the paraplanner, who must have obtained the educational requirements of the CFP Board. Above that are full-fledged planners, which is the pool of candidates to become partners/owners in the firm.

At the resident level, promising candidates can be evaluated on a full-time basis--and discarded relatively painlessly if they don't seem to be working out. Meanwhile, if the company identifies an attractive career-changer candidate, this person can be inserted directly into the resident level without having to go through the internship. “If somebody has been working at a full-time job, it doesn't make sense to ask them to come in here as an intern,” says Greg Van Wyk, the planner who oversees the training and development of new hires.

At present, Austin has zero interns, one resident and two paraplanners on staff. The plan is to bring in somebody at the intern level every year and a half, with the hopes that this person will be hired at the end of the term. At the top end, says Van Wyk, the hope is that

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**Farm Team Recruiting***Continued from page 9*

this career track will allow Austin to promote somebody internally to planner status every 18 months as the company grows, and continue to leverage and build up the support department so that each planner can handle more clients. "The message we want them to receive is that this is a bona fide career track," says McDonald.

At a time when many planning firms are struggling to build capacity so they can handle all the new business coming in the door, there is an obvious attraction to growing talent from within. Stanasolovich's internal farm system offers a creative way to identify talented people and get some work done in the meantime--in a way that minimizes the staff commitment to training people who will not become part of the firm's long-term plans. The big attraction is the guarantee that the intern will get real training and build a resume upon graduation; a lesser hope is that the intern will get hired at Legend. McDonald's system is a more focused way to try out people the firm hopes to be able to keep. The attraction there is a clear, well-defined career path which, if you can handle the workload and develop quickly, can lead to partnership status.

In each case, the challenge of building capacity has been handled in a nontraditional--and ultimately more effective--way than scrambling for experienced employees in a scarce talent pool. I think these are models that the more ambitious planning firms can copy to their future benefit. ■

# Future Shocks

*A broad range of issues is about to hit the planning profession from directions both expected and unexpected.*

*by Bob Veres*

**A**re you ready for the future? You may not feel totally, completely prepared after watching a presentation by Neal Cutler, author of *Advising Mature Clients*, dean of the American Institute of Financial Gerontology. Cutler managed to break down the various complexities surrounding our aging society in a variety of ways that made them easier to grasp and more disturbing, but the gist of his talk is that planners are going to be offering a different menu of services in the future.

His talk begins with a look at the changing lifespan in the U.S., where life expectancies have risen from 47.7 years in 1900 to 77.2 in 2000. More dramatic is the change in expected years to live when people reach age 65; in 1900, the typical person was expected to live 11 more years if they made it that far. In 1930, they would live, on average, 12.4 more years. In 1960, this rose to 14.4, and by the year 2000, it was up to 18--and, as you can see, it's going up at an accelerating rate. When 83 is the AVERAGE expected age at death for today's 65-year-old retiree, then it makes sense to start preparing for the possibility of living to age 110. Cutler later said that 26% of all 65-year-olds today are expected to live past the age of 90.

Complicating this picture is the demographic dimension to aging--an area we're all familiar with, but which bears repeating. By the year 2030, the number of people in extreme old age, in old age, middle age, in their 20s, 30s, 40s and teens will all be roughly the same, creating a graph that Cutler described as a "population rectangle." There are many points to be made there, but Cutler focused on two: the fact that the aged and the merely elderly will become as numerous as 40-year-olds will put a strain on social services systems and raise consumption levels while diminishing the productive workforce, and the fact that people over the age of 70 will become a significant (and perhaps dominant) demographic for many planning practices.

Another dimension to the issue is aging within the family. In 1900, Cutler told the audience, 39% of persons age 50 had at least one parent still alive. Today, that figure is over 80%--and climbing. 12% still have both parents alive. By age 60, 44% still have at least one parent alive. This has changed the dynamics of how families operate, and requires people to plan for the day when their elderly parent or parents will move in with them.

For planners, these interesting changes are coming at a time when

people appear to be spending much less time in the accumulation phase of their lives. Cutler showed a slide which indicated that the typical person born in 1930 would formally end his/her schooling around age 20, work from age 20 to 65, and then might live another 20 years to age 85. Today, people graduate from college at age 25 (or later), retire at age 55 and live to age 95. The accumulation period falls from 45 years to 30, while the retirement period lengthens from 20 to 40 or more.

And there is evidence that they are experiencing healthier retirements--which means more activity. Cutler cited a few possible reasons for this--Medicare, more education about health issues, more social approval for an active lifestyle in old age. Whatever the reasons, he believes it points to more expenditures during retirement on hobbies, travel and sports. "I think the message here is that the profession is going to need better models for accumulation than the ones we inherited from the previous generation," said Cutler. "People are going to have to set aside a higher percentage of their income during the accumulation period, and the actual statistics show that they've been setting aside less.

The result of all this is a much more complicated financial life than any generation has experienced in the past. Cutler listed ten different complexities that advisors should be aware of in the near future. The first is the shifting balance between the accumulation and retirement stages. A second is people working in retirement--looking to you, the advisor, to help

them launch a second career as they're downshifting from the 9 to 5 routine. Statistics have showed that 21% of retirees plan to be actively working even though they describe themselves as retired. "I think the Baby Boomers are creating, on the fly, a new retirement model," Cutler said. "Their bottom line definition of retirement is choice; the ability to change careers in retirement and also to eliminate age-based mandatory retirement.

Of course, the finances of retirement are also growing more complex, as the pension system shifts from defined benefit to defined contribution plans, as working in retirement becomes more feasible and acceptable, and as the traditional 3-legged retirement stool (Social Security, pensions and savings) grows two more legs: work in retirement, and long-term care insurance, as a way to pay for the costs of ill-health in old age. "People are increasingly going to have to prepare for the costs of potentially not being able to function because of health issues," Cutler told the group. "For many people, the question is not if, but when."

Cutler returned to the LTC issue, noting that statistics show that more people age 54-75 are worried about spending all their money on long-term care costs than about the possibility of outliving their pensions, and the fear is consistent across the spectrum of ages. "Long-term care is the constant unknown in their lives," said Cutler. "As you age, you increasingly have a handle on costs and finances, but your health is much harder to anticipate."

Of course, Social Security decisions have become more complex (do I wait to collect full benefits, early benefits or wait and let the benefits go up?), and investing and saving seems to get more complicated with each passing year. Cutler also talked about "job lock," where people have to stay in their current job because they've experienced a significant, costly health issue, and they need to hang onto their health insurance benefits for as long as they can. "This can affect a 65-year-old with a younger, non-retired spouse who is not eligible yet for Medicare," Cutler said. "And as people look at retiring younger, there is increasingly a gap between when they retire and when Medicare coverage kicks in."

Another complexity comes from a growing number of what Cutler calls "dippies"--people who have Double Income, Plural Pensions. "You're finding people who have two different Social Security benefit packages, two or more defined contribution plans, two IRAs, double investments and they are not rich," he said. "Where does the money come out first, and how will they efficiently keep track of it all?"

When 60% of 50-year-olds have at least one living parent, there is a high chance that they will also have a child move back into the home, and the situation grows more complicated from there. "It's not unusual to see people having children at later ages, and then in their second marriages having blended families where they care for multiple parents and also young kids," said Cutler. "The financial

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**Future Shocks***Continued from page 11*

complexities of those situations can make retirement planning look simplistic.”

Finally, Cutler talked about the public’s use of financial planners and access to financial planning advice to help sort all of this out. He cited statistics that said that 47% of people in the late accumulation stage of their lives have worked with a financial planner, and seems to expect that figure to rise dramatically in the very near future. In the same studies, only 5% of those who have not yet worked with a planner are resistant to the idea; most say they simply don’t have enough money to warrant the services of a planner--which suggests that the planning message should shift from “We help you take care of your money,” to “We help you manage the growing financial complexities of your life.”

The American Institute of Financial Gerontology is an interesting new presence in our field; its mission is to educate gerontologists about financial planning issues and how to deal with new financial complexities, and to educate financial planners are the increasingly complex gerontological issues that they are about to face. The organization provides a 3-day training program for each side, and has begun to help us prepare for what might be described as an interesting, potentially chaotic future where there will be more work than all the planners in the country will be able to handle.

Here’s the web site: <http://www.aifg.org>. ■

**Practice Management****Wall Redux**

*What advisors are saying about their own encounter with "The Wall."*

*by Bob Veres*

I don’t think any article in my newsletter has ever generated quite as much interest as “The Wall” article last month, I think because so many advisors have their own war stories to tell about it. So this column is a collection of wisdom and insight on the subject that might help you if and when you find yourself in a situation where your opportunities suddenly, tragically exceed your capacity.

One theme that I heard over and over again is to focus on keeping your head above water (or keeping yourself from spending 60-hour weeks in the office) rather than short-term profitability, because high short-term profitability is the royal road to a collision with The Wall. “One of the mistakes I have made over the years was not hiring soon enough to support the growth we were experiencing,” says Larry Ginsburg, who practices in Oakland, CA. “The hard part is making sure we step back often enough to give ourselves the attention we would most certainly give one of our best clients.”

Ginsburg suggests that you think of your planning firm as its own most important client. “For me, having been taught to do good for others first, it was hard to take an honest look at what is in my best interests. If taking on a client who

creates chaos allows me to help them (if that is at all possible), what damage does this perceived “need to serve” do to me and my team? Unfortunately, the financial impact is usually not beneficial to the office, and the social cost is enormous. Learning how to fire myself from client relationships that do not meet our business needs was a difficult process, but it made a significant difference in our capacity and focus.”

Brian Grodman, who practices in Manchester, NH, suggests another metric for self-evaluation. “If the planner is thinking of his/her business fairly often outside of the office then s/he is nearing the wall,” he says. “Thinking of the business almost constantly means you are hitting the Wall. When personal relationships and sleep begin to be adversely affected, the Wall is in your face.”

Len Coris, of Watermill Financial Group in Tucson and Boston, points out that it’s hard to be objective about your business when you’re running it from the inside on a day to day basis. His advice: set up a personal advisory council and open yourself and your business up to them. “Nominal pay and a good meal for five or six good business friends--preferably from outside the financial services business--can be the most cost-effective way to get

the greatest sounding board you will find," he says.

He also suggests that you define your bottom-line economic goals for the business, rather than simply focusing on our gross income in your business planning activities. And he says that you shouldn't lose sight of your own financial goals. "Investment in your business is very important, but it should be coordinated with personal savings and investments, which can give you incredible control over your life," he says. "I don't think that growth for growth's sake is a virtue, and personally hope to work on a controlled basis for as long as I am physically and mentally able."

Another issue is to maintain your own productivity in the face of crisis. Jim McGurren, of Garden City, NY, advises you to protect your confidence--because the chances are good that you're the key to solving the issues that arise. "When something goes wrong in the day-to-day practice, don't let it suck the life out of you and get you depressed," he says. "You'll end up in a funk for several days and waste another few days trying to drag yourself out of it. Instead," he suggests, "stop and think of all the great things you've done for your clients that week, think about the ones who say they can't thank you enough--the clients you have great relationships with. Think positive and move ahead."

McGurren also found that using a weekly planner made it easier for him to see his tasks ahead of time and avoid overextending himself. "Planning 20 tasks and only getting three or four done will leave you with a sense of failure

at the end of the week," he says. "Properly planning a handful of strategic projects, and keeping the important ones in front of you, will keep things manageable and help you make meaningful progress."

Don Akridge, who practices in Kennesaw, GA, notes that not every collision with The Wall comes about because you aren't growing as fast as clients are coming at you. In his case, it hit because a key person left unexpectedly. "When my key person left for Wisconsin," he said, "it shocked me into doing something that I should have done earlier. I hired two people to replace her. I'm now training and cross-training them so that I don't get slammed again." Learn from his example and you may not get slammed the first time.

Steve Sant, who practices in Lynnwood, WA, has chosen to build excess capacity into his firm the easy way, by restricting himself to meeting with clients three days a week, using one day as an overflow day if necessary, and one day for golf. The shorter schedule requires him to be efficient, and of course if a lot of work comes in the door, he can temporarily handle it while working to get his free time back.

As you're focusing on the business details, Roy Ballentine, of Ballentine, Finn & Co. in Wolfeboro, NH, offers some big picture advice for whenever you're tempted to take shortcuts. "Remember that your reputation is all you really have," he says. "Everything you do in your practice affects your reputation, and without a sterling reputation nothing else matters."

When you're looking at business planning issues, he says,

don't kid yourself about your compensation. "Pay yourself a salary equal to the market value of your services, and make sure that your business generates profits commensurate with the capitalized value of your practice," says Ballentine. "If these two conditions are not being met, you need to take a hard look at your business."

Interestingly, there may be another "wall" waiting for you after you get through the practice management wall. Bart Metzler, who practices in Cincinnati, writes from the other side of The Wall and says that it takes some getting used to. "You have more free time, and suddenly you feel concerned because you're not working so hard," he says. "I reduced my practice by about 30% and revenues are slightly higher than they were before," he says. "The biggest difficulties I've faced since then are emotionally questioning whether I made the right choices--because now I have the time to ask those questions--and I have to fight the temptation to use my time to go back to lower-level tasks that I gave up long ago."

Sant found himself in a similar situation. "Imagine what it feels like to cross everything off your list," he says. "It took some mentoring to realize that I needed to shift my thinking."

The problem, says Metzler, is that there aren't many role models who have successfully found their way to the other side of The Wall. Hopefully, with the help of these articles and a lot of focus and attention on how to run your business more efficiently, we can change that. ■

## THE PRACTITIONER FORUM

### *A COMPENDIUM OF THOUGHTS, IDEAS AND PRACTICE ISSUES FROM AROUND THE PROFESSION.*

#### *Bigger Picture*

**P**aula Hogan, who practices in Milwaukee, WI, has an interesting perspective on just about any planning issue; she looks at the default planning assumptions and often sees a deeper issue that may invalidate the normal recommendation.

One example is Section 529 plans for clients who have college-age children. “The alleged benefit is that the grandparents can accelerate five years of gifting into one year,” she says. “Then, if you live five years, it is out of your estate, and if you don’t, the appreciation is out of your estate.”

What’s wrong with that? Hogan says that the estate benefit is not really very large, and you give up a lot of flexibility in the process. If the 529 account goes down in value, you lose the chance to take the capital losses, and you give up control of the assets. And, she says, in many cases the 529 plans have had significant fees going to the state government. “You could have just given the gift each year, and if you wanted to keep control, you could have given the money in trust,” she says. And of course you could have gifted appreciated stock, and allowed the child, when he or she gets over age 14, to sell and pay capital gains taxes at his or her lower tax rate.

But before you get into that, Hogan thinks it makes sense to take a big step back. “Before I make any recommendation,” she says, “I’d want to know the values of the client. What is she trying to do? If you have a grandmother who wants to reduce her estate tax, and she believes in education, you might want to ask the children whether this contribution is helpful or not. They may say, hey, we’re still paying off school debt ourselves.”

Nor is she impressed with the tax-sheltering aspects of the 529 plan. “First of all, if this is a near-term need, then you probably aren’t going to want the money in the stock market,” she says. “You can get the federal tax exemption in a tax-exempt bond fund or use government I bonds or a tax-efficient index fund.”

#### *Paradigm Shift*

**W**hat else is Hogan looking at? “People say that stocks become less risky in the long run, but that just isn’t true,” she says. “The longer your time horizons, the wider the range of possibilities both positive and negative.” Yes, historically the volatility has evened out, but Hogan points out that we are working with a very small data set.

Planners who think that we will return to the good old days of high returns may be in for a surprise. “My understanding is that in the financial economist world, they are not saying, when will the bull market come back,” says Hogan. “The stereotypical Ph.D. thesis topic right now is: why did we have that bull market in the first place? They cannot make sense out of it.” In fact, since 1926, many, perhaps most, national stock markets in the developed world have gone completely bust at least once.

“When the financial advisor talks about the debate over whether a safe payout from the portfolio is 3.5% or 4%,” she says, “the economist would say, what are you talking about? That’s an insurance problem!”

Hogan is not enamored with the currently available insurance solutions. But she believes that before long, Fortune 500 companies will offer, in conjunction with an insurance carrier, a 401(k) option that provides an inflation-indexed future income in retirement--with full transparency as to costs and assumptions. Eventually, the same product will make its way into the planning world.

“I tell my clients that the marketplace is going to come out with equity-indexed annuity-like products that I would want them to buy” she says. “We are going from one paradigm to another, and that is always a difficult transition.”

#### *Trial Gifting*

**D**o you have time for one more? Hogan is concerned by the number of grandparents who come into her office with the assumption that they need to be giving

## Parting Thoughts

# DON'T FENCE US IN

by **Bob Veres**

money to their kids. "I'll ask: is that something you would like to do?" she says. "And frequently, they'll say NO. I don't want to do that at all. But I'm supposed to." When she asked why they believe this, they say that their friends told them, or their lawyer who was looking at estate tax issues. "This used to be a compelling argument when estate taxes started at \$675,000," Hogan adds. "But when the estate tax doesn't start until \$2 million, that excludes a lot of people. It is dressed up as an estate tax problem, but when I ask clients if they have a problem, or if the problem can't be handled if we had a few days to give gifts, or if they care that much, I discover that there are a whole lot of assumptions that really aren't being examined."

As a result, Hogan has seen a lot of people who cannot afford gifts, who are giving them right now.

Hogan find out, first, whether the checks which ARE being made represent a gift or some kind of unwritten deal. "Does the grandmother want something in return?" Hogan asks. "It may be that she wants her kids to send her grandchildren to parochial school, or visit her on every holiday."

Suppose the client isn't sure whether she wants something or not? In that case, Hogan will avoid any long-term commitment to gifts, and instead have the client celebrate her birthday by offering a gift to members of her family. "Then, six months later, I ask them: how did you feel about making that gift?" says Hogan. "Some people will feel wonderful about it. Some are upset because they didn't get a thank you card." ■

**A**s you can see from the masthead, this issue marks my 16th year of offering the Inside Information service, and I think the issues and the profession have grown consistently more interesting every year. Many times, I've wondered what it would be like to cover a profession that is not constantly evolving, changing, growing, challenging itself and raising its own bar in terms of ethics and client services. Financial planning is more an experiment than a profession right now, more a work in progress than the public or the media realizes, but the experiment seems to be leading in a positive direction, and I would argue that adapting to new conditions is a welcome change from the stodginess I see in other fields.

In fact, I think it's possible that the planning world is in the very early stages of defining an entirely new way to organize a profession. In the past, when smokestack industries dominated the skyline, the professional credo was stability, and so you had large organizations with firm rules for behavior, like the AMA and the AICPA, which change at approximately the same rate as a glacier, only not quite so willingly. Those organizations have moved into a world where the pace of change is increasing, where new insights and innovations are overturning the conventional wisdom, and they're obviously struggling to catch up. Their regulatory systems and bodies of knowledge have hardened in a way that financial planners have never experienced.

In the future, it is possible that these professions will have to create a new model, not unlike what we have in our profession today: RIA regulations which mostly focus on whether or not there is actual harm to the consumer, with relative freedom to offer advice under whatever model or system seems most appropriate given recent innovation; services delivered through small, flexible offices rather than institutions like hospitals or multi-layered legal firms; professional organizations that focus on standards and public education and conference experiences, rather than defining how planning needs to be practiced or who should be let into the lodge. The result is a kind of messy regulation-by-public-awareness, which means that some people are getting ripped off while more astute consumers find financial planners who will sit on their side of the table, but we also have a constant growth in ethics and voluntary setting-aside of conflicts of interest. If this continues, there will be fewer people getting ripped off by planners than by, say, doctors or lawyers or

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## Parting Thoughts

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plumbers.

There are people who say that we can't ever be a profession until the states and the federal government create boundaries and regulations and bureaucracies that oversee the activities of the individual planners in the field, but I think that if you talk to professionals in other fields, they will tell you that they're looking at ways to dismantle all of those ossifying structures that surround their profession and obstruct their progress. The future will require a certain amount of flexibility, as standards and technology and new practice innovations all move forward. The goal for us, today, is to figure out how to stay out of our own way, how to avoid creating roadblocks for the next generation

of planners who will take the profession to places we cannot even envision today.

Maybe I just like to write about a profession that never seems to stand still. Certainly it's more interesting to watch constant change, and there never seems to be any shortage of things to write about. But more than that, I've enjoyed watching progress these last 16 years, and I hope it never stops. When I start publishing my 32nd volume of this newsletter in January 2022, I hope that we can all look back at today and see a struggling, primitive, idealistic but unformed profession that has become something glorious. Freedom to change comes at a price, but it's one that I would be willing to pay every time. ■