Appendix 1V
Baby Boomer Contemplating Retirement

PROFILE DESCRIPTION

Stage of life, rather than method of earning a living, is the distinguishing characteristic of this type of client. Faced with a major change in lifestyle within a few years, this individual or married couple will be most interested in identifying and evaluating the sources of financial independence and security to be relied upon when full-time employment (or self-employment) ends and retirement begins.

Boomer Alert: While many boomers remain in good health and maintain their mental acuity, some have experienced a slowing of their decision-making skills. Planners should allow boomer clients to fully digest all the facts and recommendations before expecting a final decision to act.

Client Characteristics

Generally, an individual or married couple contemplating retirement may be acutely concerned about PFP matters and thus may be especially willing to address them in a PFP engagement. The client typically faces many uncertainties: Will part-time work be necessary? Will health permit part-time employment? Will living expenses go up or down? Will pension and social security benefits be sufficient? Will the children help with or be a drain on financial resources? Clients contemplating retirement face these concerns and others. Financial planners may find that such clients require additional counseling with regard to their attitudes toward retirement. Client attitudes can greatly affect the PFP engagement, and it helps the planner to be aware of how the clients view retirement.

Accumulated Wealth and Income Stream

In many cases, the clients' accumulated wealth will be represented by home equity, the vested interest in qualified retirement plans, and savings. As retirement approaches, these clients may have shifted from equity investments to more conservative investments that provide fixed income. Typically, the clients' will have reduced their debt to low levels, except possibly for mortgage debt on a second (retirement) residence or debt incurred to purchase a recreational vehicle intended for postretirement use. The clients' income stream may be flat (if employed) or variable (if self-employed), and in most cases can be

expected to decrease after retirement.

Client Concerns

Understandably, the predominant PFP concerns are related to preparing for retirement and planning to maintain a comfortable standard of living. Many times, a postretirement budget is important to evaluate the level of retirement income needed to meet expected living expenses. Social security, employee retirement, and Medicare benefits (and choices) must be considered. In many situations, a major decision is whether to take retirement benefits in a lump sum or in a series of payments. In some cases, the use of insurance policy cash values or proceeds may be a significant factor in funding retirement. Investment planning is a concern as the clients look for safety and income from their redirected investment portfolio allocations and from prudent investment of their lump-sum retirement benefits. At this stage of life, clients usually review their estate plans.

Financial Planning Analysis

PFP issues, ideas, and strategies that may apply to clients contemplating retirement are summarized in this client profile. This client profile also describes several typical piecemeal planning engagements that the planner may be asked to perform for such clients.

PLANNING ISSUES AND STRATEGIES

Cash Management Planning

The clients may no longer be concerned about funding children's college educations or about many of the risk management concerns of younger clients. This client is typically most concerned about having sufficient cash flow after retirement to be able to live comfortably.

Estate planning may involve determining how much of the total estate to leave to heirs, and how much to dissipate before death to sustain a reasonable standard of living. The client decisions in this regard have a direct bearing on the cash management and budgeting aspects of the PFP engagement.

Cash management requires data. The clients should obtain a statement of earnings from the Social Security Administration to determine the amount of social security income to be received. The client should also inquire as to the amount of retirement benefits to be received under the employer's retirement plans and the extent to which the client is covered under the employer's medical plan after retirement. The planner then can determine the shortfall in income required to be funded from the client's personal assets.

In some cases, the clients do not have sufficient investment assets to be able to live off of investment income. The clients may have to work part-time or use principal for personal living expenses. The planner may want to provide the clients with a schedule showing how long they can expect to receive income and principal from investment assets before the principal is extinguished.

The clients' choice between a retirement plan lump-sum distribution or annuity is often an important consideration and requires careful analysis of taxation alternatives including rollovers. This critical PFP decision will be influenced by the clients' outlook, health, life expectancy, and family longevity history.

The clients might also consider a reverse mortgage.

When the clients have an insufficient combination of retirement plans, social security benefits, and investment assets to fund retirement, they may have no choice but to reduce their current need for discretionary income.

Risk Management Planning

In general, the clients will have attained a financial position that includes an emergency fund of several months' income. Often, instead of increasing life insurance coverage, the clients will be more interested in using life insurance policy cash values or proceeds to help fund retirement.

Life insurance may also be an alternative to consider when the retiree will have a choice at retirement to take either a single life annuity from a qualified retirement plan or to take a smaller joint and survivor annuity. In some cases, with sufficient advance planning, the couple can come out ahead by electing to take the single life annuity at retirement and funding the survivor benefits with a life insurance policy.

Several retirement planning issues relate directly to risk management. For example, a decision to retire early can have a direct effect on medical insurance coverage. Normally, Medicare does not begin until age 65. The retiree will have to provide coverage through an individual policy or continuation of the employer's group medical policy to cover the period until age 65. Medicare does not provide complete protection, and the client may need to plan (budget) for (Medigap) supplemental medical insurance, including long-term care insurance, after age 65.

In many cases, a retiree or spouse will decide (need) to work part-time after retirement. The part-time work, for example, real estate sales, may involve exposure to risk of personal or professional liability not covered by the retiree's existing liability insurance. Care should be exercised not to leave the retiree's accumulated retirement fund exposed unnecessarily to risk of uninsured loss.

In contemplating the postretirement budget, insurance premiums may be a significant item for some couples. To reduce premium expenses, consideration should be given to converting life insurance policies to paid-up policies and increasing deductibles on the homeowners' and automobile policies.

Education Planning

Education planning may not be a financial planning consideration; however, it is not unusual to have clients approaching retirement and still have children in college. Even if they do not have college-age children, education funding for grandchildren is a goal of many clients who are financially secure. There is a dual estate planning advantage that can result from education planning. If the payments for tuition are made directly to the school rather than to the parents or grandchildren, the payments are not counted

against the annual gift tax exclusion (i.e., these tuition payments can be made in addition to the annual exclusion gifts). Thus, for financially secure clients, paying the grandchildren's tuition allows the grandparents to transfer more out of their estates without transfer tax consequences. This strategy also allows their children to retain their own assets (because they do not have to spend them on tuition), effectively passing assets to the children completely outside of the transfer tax structure.

However, if grandparents want to help with education costs, they should consider if gifts to the student (whether outright or in trust) will reduce the eligibility for financial aid. The client may also consider Section 529 plans, which can effectively remove funds from the estate while retaining a measure of control.

Retirement Planning a

Preparation of realistic budgets and meaningful projections of income is easier the closer the client is to retirement. The client is, in many cases, for the first time willing to take a hard look at expenditures and to make adjustments in current spending patterns. The client can more easily see the practical advantages of spending less now to have more later. The goal of a comfortable retirement becomes important enough that the client is willing to redirect financial resources away from other PFP objectives and to emphasize retirement planning.

Social security decisions must be made. Retirement before reaching the full benefit age may be advantageous in terms of total social security benefits to be received but may have an adverse effect on retirement plan benefits. Spousal benefit elections must be planned and the trade-offs evaluated. For example, the wife may take benefits earned in her own name or may take a portion of her husband's benefits. If the husband's benefits are reduced because of early retirement, the wife's future benefits may be reduced.

Working part-time after retirement may be appealing to some clients. Yet part-time earnings may reduce social security benefits (if earned before reaching the full benefit retirement age) or may trigger income taxation of a portion of the social security benefits.

The retiree's decision to take a retirement annuity or lump-sum distribution from the employer's qualified retirement plan should be carefully analyzed. Among the factors to be considered are the client's investment acumen, tax-free rollover into an IRA, eligibility for favorable income averaging computations, the client's life expectancy and health status, and the adequacy of the available annuity to cover the projected monthly living expenses.

Estate Planning

The client may want to review his or her estate plan. A number of factors will affect his or her attitude toward estate planning, including marital status and the age and health of the client and spouse. Usually, the client will be considering whether the accumulated wealth level is adequate. How long will it sustain a reasonable standard of living? How much should be kept, and how much can be given away now or at

death? Will there be estate taxes to pay? What can be done to reduce or eliminate death taxes?

One of the client's objectives may be to take an inventory of just where he or she stands. At this stage of life, there seems to be a natural desire to "get organized."

Much of the data gathering and organization done for retirement planning also has application in estate planning. For example, the client may decide to prepare a list (or to update an old list) showing the location of all important papers such as wills, insurance policies, deeds, stock certificates, notes, bonds, etc. The planner can help the client by furnishing a checklist for this purpose, or can set up a documents portfolio for the client. While preparing a documents portfolio (or list), the client may find it convenient to write a letter, sometimes referred to as a testamentary letter, to the spouse explaining the client's wishes and instructions in the event of death. Such a letter can be of great assistance to the surviving spouse during the period immediately following death as the decedent's affairs are attended to and estate administration begins.

Domicile is a critical factor in estate planning. A client may decide to move to another state. There could be several reasons to move: lower income taxes; lower death taxes; lower cost of living; recreational benefits; better climate; better health care facilities; or proximity to a support group of relatives or friends. Normally, a change in domicile makes a review of the clients' wills essential and, depending on the laws of the respective states, can have a significant effect on the property rights of the spouses.

A client may have sufficient wealth to be subject to estate tax (depending on the date of death). If the client is married, wills should be prepared or changed to maximize use of the marital deduction and the gift and estate tax exclusion. This may involve use of the portability election or a bypass trust, estate trust, or QTIP trust. In connection with the review and preparation of wills, the retirement plan distribution choices and beneficiary designations should be reviewed and coordinated with the estate plan.

If the client has a substantial estate, consideration should be given to a program of lifetime gifts. Assuming the surviving spouse will not need the assets, gifts are one way to reduce the size of an estate that is otherwise vulnerable to taxation. Gifts in excess of the annual exclusion amounts are taxable, but the applicable exclusion amount allows much larger amounts to be transferred before tax is assessed.

A client with both charitable inclinations and a taxable estate may be a good candidate to set up a charitable remainder trust or a charitable lead trust. Both kinds of charitable trusts may be either *inter vivos* or testamentary and they operate to remove the trust corpus from the estate of the grantor while providing a charitable deduction either to the grantor or the estate.

Investment Planning a

The client who is approaching retirement or who is retired often cannot afford to be exposed to a high degree of risk. However, there is a tradeoff between risk and reward. A person who wants guaranteed preservation of capital will have to invest in a safe instrument, e.g., a Treasury bill, and accept a low return (very low when the effect of inflation is considered). Therefore, an investor must decide whether he

or she can afford to accept more risk for the opportunity to realize greater returns. It is the planner's job to control the client's exposure to risk while helping him or her achieve the defined goals.

Most retirees and people nearing retirement want and need to manage investment risk to preserve their capital. Most financial experts would agree; however, they would also argue that some degree of portfolio growth is necessary to protect against inflation. To achieve preservation of capital and moderate growth, the retiree would most likely require a balanced portfolio. Of course, the portfolio must be consistent with the client's risk tolerance.

Most retirees need to invest a portion of their assets in equities because of the potential (and track record) for growth, which will keep their capital from losing purchasing power due to inflation. One strategy would be to invest primarily in conservative growth or growth and income stock funds or ETFs, and in bond funds or ETFs for the income (taxable or tax-exempt, depending on the client).

The client nearing retirement may also be thinking about selling the personal residence and moving into a smaller residence, such as a condominium. Planners will need to help the client allocate the proceeds from the sale of the home to investment asset categories in accordance with his or her asset allocation plan.

PIECEMEAL ENGAGEMENTS a

This client profile discusses planning for the client contemplating retirement in all PFP subject areas; the list below describes several piecemeal planning and consultation engagements that may be appealing to the client.

1. *Management of Retirement Funds.* **a** The client will need help in deciding how to withdraw retirement funds, i.e., lump sum, annuity, or IRA rollover. This engagement potentially has ongoing tax planning and investment planning elements as the retirement funds are invested and managed. Investment planning may be a major concern as the clients look to preserve their capital.

2. *Cash Management after Retirement.* This type of client may also need some cash management help. How does the current budget compare to the expected budget after retirement? Are the retirement goals achievable? Will it be necessary to retire on a smaller income or postpone retirement for a few years?

3. *Planning for Incapacity.* Consider the use of living trusts so that family members can control finances if the client becomes physically or mentally disabled. Arrange for a durable power of attorney and durable power of attorney for health care (or alternative advance directive) to be given to a responsible family member or friend. Consider long-term care insurance and planning. The client should also consider executing a living will to direct health care when death is imminent.

4. *Review of Wills.* The planner could review the clients' wills to ensure that they express the clients' current wishes and that they understand the wills' provisions and their impact on the clients' estates. This is especially important if the clients have changed domicile or have experienced a major life event such as divorce or a birth or death in the family. The planner should consult with the clients'

legal counsel in conjunction with the review of the will.

Notes:

a Providing investment advice will subject the planner to the Investment Advisers Act of 1940 and applicable state laws. The planner may wish to consult a qualified attorney regarding the issue of registration.