

PERSONAL FINANCIAL PLANNING (556-1)

EO 1. **PERSONAL FINANCIAL PLANNING** develops and implements a coordinated plan for attaining an individual's or a family's **financial objectives** (objectives requiring money), such as enough retirement income and adequate college funds for dependents.

The three essential elements of personal financial planning:

1. a *coordinated* plan
2. for the client's *overall* financial status
3. based on *all the client's financial objectives*.

Five reasons people fail to do financial planning:

1. They don't think they have enough assets to justify planning.
2. They think their financial affairs are already organized.
3. They procrastinate.
4. They don't want to think about death or disability.
5. They think they can't afford to pay the fees for financial planning services.

EO 2. THE FIVE STEPS IN THE FINANCIAL PLANNING PROCESS:

1. Gather information and prepare personal financial statements-- **14 types of needed information:**

- a. the types and amounts of the individual's or family's investments;
- b. the types and amounts of current property, liability, life, and health insurance;
- c. the current employee benefits of the individual and spouse;
- d. the past and current retirement plans of the individual and spouse;
- e. the client's situation regarding income, estate, and gift taxes;
- f. the terms of existing wills, trusts, and estate plans of the individual, spouse, and dependents;
- g. powers of attorney;
- [h. *the names, ages, health, and residences of the individual, the spouse, and their dependents;*
- i. *the individual's attitude toward risk;*
- j. *potential changes in family structure (weddings, births, etc.);*
- k. *the types and amounts of outstanding debts;*
- l. *the Social Security eligibility status of the individual, spouse, and dependents;*
- m. *the current and projected income of the individual and spouse; and*
- n. *the job security of the individual and spouse.]*

Prepare

- a. **a personal budget** (plan for the client's anticipated incomes and expenditures) *and*
 - b. **a personal cash flow statement** (document indicating the sources and timing of a person's or a family's cash receipts and cash outlays).
2. **Identify financial objectives**--Protect against personal risks, accumulate capital, provide for retirement, plan for estate distribution, minimize taxes, *and* for provide investment and property management. [See EO 3.]
 3. **Analyze the client's current financial situation and consider his alternatives**--Evaluate the client's current financial condition relative to his objectives.
Consider alternative ways to correct for any deficiencies.
 4. **Develop and implement the plan**--Create a reasonable, detailed plan tailored to the client's needs. Explain alternative ways of achieving goals. Motive the client to implement the plan.
 5. **Monitor, review, and revise the plan**--Meet periodically with the client to review the plan and to measure its performance. Review changes in the client's personal and financial situations. Explain any changes in the economic, tax, and/or financial environment.
As needed, adapt the plan to fit the new environment.

EO 3. **THE SIX CATEGORIES OF PERSONAL FINANCIAL PLANNING OBJECTIVES:**

1. **Protect against the six personal risks of [See below.]**
 - a. premature death,
 - b. disability income losses,
 - c. medical expenses,
 - d. long-term care expenses,
 - e. property and liability losses, *and*
 - f. unemployment.
2. **Accumulate capital for**
 - a. **emergency funds**--to meet unexpected expenses, to pay for deliberately retained losses, *and* to provide a financial cushion in case of unemployment;
 - b. **family needs**--large, but non-emergency, family expenses;
 - c. **educational needs**--of the client and of his dependents; *and*
 - d. **investments**--to provide financial security, retirement income, *and/or* an estate for heirs.
3. **Provide retirement income.** [See Assignments 10, 11, and 12.]
4. **Minimize income taxation**--both during lifetime and at death. **Five tax-saving techniques:**
 - a. Reduce or eliminate taxes.
 - b. Shift the tax burden to others in lower tax brackets.
 - c. Accumulate wealth without current taxation, thereby postponing taxation.
 - d. Take returns as capital gains rather than as ordinary income.
 - e. Avoid taxation on capital gains.
5. **Plan for distribution of one's estate.**
6. **Provide investment and property management--Investment advisors may**
 - a. operate on a strictly discretionary basis, under which the advisor makes decisions *without* consulting with the client;
 - b. make decisions, but inform the client of reasons for the decisions before acting; *or*
 - c. let the client make the final decisions after extensive consultations.

PROTECTION AGAINST PERSONAL RISKS [Number 1, above]:

1. **Premature death--**
 - a. **The five categories of financial losses that may result from premature death:**
 - 1) **Lost income**--future income the decedent would have earned *from* the date of his death *until* the date he would have retired.
 - 2) **Costs associated with death**--last illness, funeral, burial, estate fees, probate fees, taxes, and outstanding debt that becomes due upon the decedent's death.
 - 3) **Increased expenses**--to replace the household activities (eg, childcare, lawn work, housekeeping) previously performed by the decedent.
 - 4) **Lost business values**--lower property values due to forced liquidation of a business (as a one-man insurance agency without the one man).
 - 5) **Estate shrinkage**--decreased value of the estate due to federal and state death taxes.
 - b. **Nine sources of protection against premature death--**
 - 1) **Life insurance**--individual life, group life, and credit life. [See Assignment 2.]
 - 2) **Social security survivors' benefits.** [See Assignment 2.]
 - 3) **Other government benefits.** [See Assignment 2.]
 - 4) **Death and survivors' benefits under pension plans.** [See Assignment 10.]
 - 5) **Death benefits under deferred profit-sharing plans.** [See Assignment 10.]
 - 6) **Death benefits under 401(k) plans.** [See Assignment 10.]
 - 7) **Death benefits under tax-sheltered annuity plans, plans for the self-employed, IRAs, nonqualified deferred-compensation plans, personal annuities.** [A 10 - 12.]
 - 8) **Informal employer death benefits or salary-continuation plans.**
 - 9) **All other assets and income.**

2. **Disability income losses--**
The disability income exposure is the possibility of lost income due to a wage earner's disability.
The incapacity exposure refers to the inability of an incapacitated person to manage his own affairs.
 - a. **Eight sources of protection against disability income loss:** [See Assignment 3.]
 - 1) **Health insurance**--individual disability income insurance, group disability income insurance, and credit disability income insurance.
 - 2) **Disability benefits under life insurance policies**--waiver-of-premium benefits and disability benefits under group life insurance.
 - 3) **Social Security disability benefits.**
 - 4) **Worker's compensation disability benefits.**
 - 5) **Other government benefits.**
 - 6) **Disability benefits under private retirement plans.**
 - 7) **Noninsured employer sick-pay plans.**
 - 8) **All other income and assets.**
 - b. **Two sources of protection against the incapacity exposure:** [See Assignment 15.]
 - 1) Powers of attorney (both a medical power of attorney and a general, property, **POA**).
 - 2) Revocable living trusts.
3. **Medical expenses--**
 - a. **Three categories of medical costs:**
 - 1) **Normal, budgetable expenses**--routine costs payable from the client's regular budget.
 - 2) **Larger-than-normal expenses**--costs that exceed expectations and are traditionally covered by comprehensive medical insurance.
 - 3) **Catastrophic medical expenses**--costs that are financially crippling and are traditionally covered under major medical expense insurance.
 - b. **Eight sources of protection against medical care expenses:**
 - 1) **Health insurance.**
 - 2) **Medicare.**
 - 3) **Medical payments insurance under liability and auto policies.**
 - 4) **Worker's compensation benefits.**
 - 5) **Other government benefits.**
 - 6) **Other employer-provided medical benefits.**
 - 7) **Other assets.**
 - 8) **Medical savings accounts (if available).**
4. **Long-term care expenses**--are the costs to provide custodial care to maintain a person who is unable to perform at least several of the activities of daily living.
Four sources of protection against custodial care expenses:
 - 1) **Long-term care (LTC) insurance.**
 - 2) **Accelerated death benefit provisions in life insurance contracts.**
 - 3) **Medicaid.**
 - 4) **Other income and assets.**
5. **Property and liability losses--Property ownership creates the risks of**
 - a. **direct loss** (financial loss resulting from reduction in the property's value) *and*
 - b. **indirect (consequential) loss** (lost income or increased expenses arising indirectly from the direct loss).

Liability loss occurs when an individual's financial resources are diminished as a result of a claim for money damages due to

 - a. injury to another *and/or*
 - b. damage to another's property.

Insurance is the most common form of protection against property and liability losses.
6. **Unemployment**--[Avoid unemployment by passing an Institute course every term.]

Unasked EO. **PERSONAL RISK MANAGEMENT** is the identification, analysis, *and* treatment of an individual's or a family's pure loss exposures. Personal risk management considers all alternative methods for addressing risk.

THE FOUR BASIC TYPES OF RISK MANAGEMENT TREATMENT TECHNIQUES:

1. **Avoidance**--Avoid exposures that don't have to be assumed *and/or* eliminate exposures that already exist.
2. **Loss control**--Use **loss prevention** to lower loss frequency.
Use **loss reduction** to lower loss severity.
3. **Retention**--Bear exposures totally or partially by choosing
 - a. deductibles,
 - b. coinsurance,
 - c. underinsurance,
 - d. bases of loss settlement (replacement cost, actual cash value, agreed value), *and/or*
 - e. **selective coverage of**
 - 1) **subjects**--what can be lost,
 - 2) **perils or causes of loss**--what can happen to the subject to lower its value, *and*
 - 3) **financial consequences**--how much value can be lost, directly *and/or* indirectly.
4. **Risk transfer**--Transfer the financial consequences of a loss exposure to a third party.
The most common risk transfer method is **insurance**, which transfers *some* of the financial consequences of risk to an insurer in exchange for the periodic payment of the insurance premium.

THE INSURANCE PRINCIPLE is based on the concept of **pooling**, in which the losses of a few members are redistributed over the entire group, thereby subjecting each group member to the group average loss rather than to his own actual loss. The first principle of insurance-buying (**the large-loss principle**) holds that the first risks to insure are those that could substantially deplete the insured's financial resources.

EO 4. **FOUR CONSIDERATIONS IN CHOOSING AN INSURER:**

1. **Financial strength**--is the *ability* to pay claims when due as due. An insurer's size does *not* indicate its financial strength. Rating organizations provide information about each insurer's financial history and rating. Although **state insurance guaranty funds** protect insureds and claimants against insurer insolvency, those funds might *not* cover the entire loss.
Six general considerations about insurer financial stability and strength:
 - a. The insurer should receive consistently high ratings from at least two rating agencies.
 - b. The insurer should be regulated by at least one state with strong insurance regulation.
 - c. The general financial press often provides information about insurers.
 - d. If rates or products sound 'too good to be true', they probably are.
 - e. In general, an insurer with a proven record of financial stability is less likely to experience financial problems.
 - f. If an insurer develops financial problems, the insured should change insurers.
2. **Claims service**--is the *willingness* to pay claims. The state insurance department's consumer complaint department files identifies insurers with histories of dissatisfied customers.
3. **Types of coverage**--reflects the ability to meet the client's needs by providing the needed coverage(s).
4. **Cost**--refers to reasonable rates for the chosen policy.

THREE CONSIDERATIONS IN CHOOSING AN AGENT OR BROKER:

1. **Knowledge, ability, and experience**--refers to the capability to identify, analyze, and address risks properly.
2. **Specialization**--refers to the ability to meet the insured's unique needs.
3. **Affiliation**--refers to representation of the preferred insurers.

EO 5. **THE ECONOMIC GROWTH AND TAX RELIEF RECONCILIATION ACT (EGTRRA)**
OF 2001

1. reduces individual income tax rates starting in 2001;
2. provides marriage penalty relief starting in 2005;
3. improves educational planning opportunities through Section 529 plans and education IRAs starting in 2002;
4. increases contribution and deduction limits for qualified retirement plans, IRAs, and other plans (with varying effective dates);
5. allows 401(k) participants to make elective contributions as after-tax Roth contributions starting in 2006;
6. increases the federal estate tax and generation-skipping transfer (**GST**) tax exclusion amounts from 2002 through 2009, repeals those taxes entirely in 2010, *and reinstates those taxes at 2001 levels starting in 2011; and*
7. repeals the step-up in income tax basis at death rule and substitutes a modified carry-over basis at death rule for 2010 and then reinstates the step-up basis rule in 2011 and thereafter.

The sunset provision in EGTRRA provides that *all* provisions of EGTRRA will expire on December 31, 2010, at which time the tax law will revert to the law that existed in 2001.