1

The Financial Planning Process

Learning Objectives

An understanding of the material in this chapter should enable the student to

1-1. Explain the six steps in the financial planning process.

1-2. Describe three different approaches to financial planning, and identify several areas of specialization in which advisors concentrate their activities.

1-3. Identify the subjects that should be included in a comprehensive financial plan.

1-4. Describe what is meant by a person's financial life cycle, and explain how it relates to life-cycle financial planning.

1-5. Explain how a financial plan can be developed around the steps in the financial planning process.

1-6. Explain how a financial plan can be developed using the financial planning pyramid.

1-7. Explain the trends that are creating opportunities in the financial planning marketplace.

1-8. Identify the principal financial goals/concerns of most consumers, and describe three major obstacles that prevent them from achieving these goals.

The primary goal of this chapter is to introduce the six-step financial planning process. This process is the foundation on which the financial planning profession is built; it provides a framework around which financial planning practitioners develop comprehensive plans for their clients. The nine chapters that follow this one explore the basic tools and techniques used in financial planning as well as the environment in which financial planning practitioners operate.

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WHAT IS FINANCIAL PLANNING?

financial planning

One factor that has hampered the development of *financial planning* as a discipline and as a profession is the fact that there has been very little agreement among advisors as to what exactly financial planning is. Indeed, there are as many definitions of financial planning as there are people who believe they are engaged in it. This debate, which continues among financial advisors even now,[2] is not merely an exercise in semantics. The discussion becomes intensely practical when questions are raised about such issues as who shall regulate those advisors engaged in financial planning, who shall set standards for the financial planning profession and how those advisors should be regulated and compensated.

Financial Planning Is a Process

Despite this ongoing controversy among advisors, financial planning can be defined conceptually as a process that accomplishes both of the following:

- ascertaining the client's financial goals and objectives
- developing a plan for achieving the client's goals and objectives

financial planning process

Whether a single financial problem is being addressed or a comprehensive financial plan is being developed, the *financial planning process* has six steps: (1) establish and define the advisor-client relationship, (2) determine goals and gather data, (3) analyze and evaluate the data, (4) develop and present a plan, (5) implement the plan, and (6) monitor the plan. The steps are summarized in the following chart.

Advisors who primarily sell financial products generally view the financial planning process as a selling/planning process that has eight steps, that is, the six steps of the financial planning process identified above preceded by two additional steps: (1) identify the prospect, and (2) approach the prospect.

2. "Shelley A. Lee, "What Is Financial Planning, Anyway?" *Journal of Financial Planning*, December 2001, pp. 36–46."

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Table 1-1
Steps of the Financial Planning Process

Steps in the Financial Planning Process	***Detail***
Establish the Client/Planner Relationship	The financial planner should outline what are the responsibilities of the planner and what are the responsibilities of the client. The planner should disclose the length and scope of the relationship as well as the method and magnitude of planner compensation. Establishing the relationship helps guide the decision making process.
Gather Client Data including Goals	The financial planner should gather client data, including broad and specific goals and objectives. Ask the client about risk tolerance measures. Documents such as tax returns, wills, trusts, account statements and pay stubs may need to be collected to truly establish constructive outcomes.
Analyze and Evaluate Financial Status	Data gathered in the second step must be analyzed and synthesized within the context of meeting goals. This step of the planning process accounts for significant variations among planners. Planners without expertise in a specific planning area may find a benefit in including a technical staff or teammates when analyzing and evaluating client goals.
Develop Planning Recommendations and/or Alternatives	The financial planner develops recommendations based on evaluation (step three) of data collected (step two). Planners present recommendations and alternatives that address client goals and concerns. Presenting more than one recommendation to a client provides alternative courses of action, and may result in additional fact finding and discovery on the part of the planner. After making recommendations, the client may provide or revise their goals (step two) which will require additional analysis (step three).
Implement Financial Planning Recommendations	After agreement is reached between the client and planner on a course of action, the planner outlines how implementation will occur. If implementation results in additional planner compensation, the form and magnitude of compensation needs to be disclosed to the client. Depending on the business model of the planner, the client may implement his or her own recommendations or the planner may implement recommendations on behalf of the client. Any conflict of interest of the planner through the implementation of a product should be disclosed to the client.
Monitor Financial Planning Decisions	The sixth step of the planning process is limited by the first. The client and planner need to agree on monitoring responsibilities when establishing the relationship. Planners who entered into a long term relationship with their clients have an obligation of following up and updating the plan.

Steps in the Financial Planning Process

For advisors, this process for helping clients achieve their financial goals can be applied to the full range of client goals on a comprehensive basis. The process can also be applied on a narrower basis to only a subset of those goals or

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even to only a single financial goal of a client. It is not the range of client goals addressed that determines whether an advisor is engaged in financial planning. Rather, it is the process used by the advisor in addressing client goals that is the determining factor. The following pages present a brief discussion of the six steps in the financial planning process.

Steps in the Financial Planning Process

- Establish and define the advisor-client relationship.
- Determine goals and gather data.
- Analyze and evaluate the data.
- Develop and present a plan.
- Implement the plan.
- Monitor the plan.

Step 1: Establish and Define the Advisor-Client Relationship

The first step in the financial planning process is to establish and define the advisor-client relationship. This normally begins at the first client meeting, although it can start prior to this meeting through telephone interactions and/or disclosure documents sent to the client. In any event, the first client meeting is essential for establishing the framework for a successful advisor-client relationship. This meeting is where the advisor begins building trust with the client, ensuring client satisfaction, and creating a relationship with the client that it is hoped will span the client's entire financial life.

Establishing the advisor-client relationship when the client is a couple is a more complex challenge because the advisor needs to build trust and rapport with both parties. Covering the goals of both parties in one financial plan requires the advisor to be aware of the goals that both have in common and how their needs may differ. Couples may have different goals, priorities, risk tolerance or different planning objectives altogether. Planners must learn how to help couples negotiate through the planning process as a team, and in some situations refer couples with different interests to outside specialists.

In any kind of planned and purposeful communication setting, the first element that needs attention is structuring. Structuring serves to determine both the format and the subject matter of the interaction that is to follow. The financial advisor's task in structuring is to make the purpose of the initial meeting and those that follow clear to the client at the outset. This would include the inevitable introductions, an explanation of the financial planning process, a discussion of forms that are used (for example, a fact-finder form, risk tolerance questionnaire and a disclosure form) and the amount of time that will be required to complete them, a discussion of the confidential nature of the relationship, and some prediction of what kinds of outcomes the client might reasonably expect. This structuring need not be lengthy and cumbersome; in

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fact, it is far better to structure communication in a clear, straightforward, and succinct fashion.

More specifically, structuring for the financial planning process requires the advisor to explain how he or she works and the types of products and/or services that he or she is able to provide. It requires the advisor to explain the financial planning process and how that process is used to develop financial plans for clients. It may even require the advisor to give examples of how some of his or her products and/or services can be utilized to help clients meet their financial goals and objectives.

At the first meeting, the financial advisor also needs to disclose his or her background, philosophy, and method of compensation, whether that be fee-only, commission, or a fee and commission. The financial planning process does not vary by compensation type. The Certified Financial Planner® Board of Standards Code of Ethics and Professional Responsibility requires CFP® professionals to provide written disclosure to clients (prior to the engagement) of the method and source of their compensation, as well as information on their educational background, experience, conflicts of interest, and practice philosophy. Appendix B is a sample of the type of disclosure document that can be given to clients at the beginning of the initial meeting (or sent to them prior to the meeting) to satisfy this requirement.

Step 2: Determine Goals and Gather Data

Once having established and defined the advisor-client relationship, the advisor is ready to move on to step 2 of the financial planning process. This step can begin during as early as the initial meeting or in a unique meeting later in the planning process. Occasionally the planner may interview the client remotely (over the phone and Internet) to gather client data and discuss goals.

While it is true that few people begin a vacation without a specific destination in mind, it is also true that millions of people make significant financial decisions without a specific financial destination in mind. Determining a specific financial destination, that is, goal setting, is critical to creating a successful financial plan. Few people actually set clearly defined goals. By leading the client through the goal-setting exercise, the financial advisor helps establish reasonable, achievable goals, and also sets the tone for the entire financial planning engagement.

Clients typically express concern about a whole host of topics including retirement income, education funding, premature death, disability, taxation, and qualified plan distribution. Sometimes clients enumerate specific, prioritized goals, but they are more likely to present a vague list of worries that suggest anxiety and frustration rather than direction. The advisor’s responsibility is to help the client transform these feelings into goals.

Advisors should question clients to learn what they are trying to accomplish. Usually the response is couched in general terms such as, "Well, we want to have a comfortable standard of living when we retire." At first glance this seems to be a reasonable goal, but a closer evaluation reveals that it is far too vague.

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- When do they want to retire?
- What is meant by "comfortable"?
- How should inflation be addressed?
- Do they want to retire on "interest only" or draw down their accumulated portfolio over their expected lives?

Skillful and thoughtful questioning may reveal a more precise goal such as, "We want to retire in 20 years with an after-tax income of $60,000 per year in current dollars inflating at 3 percent annually and we want the income to continue as long as we live without depleting the principal." Helping the client quantify specific goals is one of the most valuable services a financial advisor can provide.

Another important service the advisor provides is goal prioritization. Clients usually mention competing goals such as saving for retirement and saving for education. Advisors help clients rank these competing goals.

After the client and advisor discuss goals, objectives, and concerns, the advisor must then gather all the information about the client that is relevant to the problem(s) to be solved and/or the type of plan to be prepared. The more complex the client's situation and the more varied the number of goals, the greater the information-gathering task.

Two broad types of information will need to be gathered: objective and subjective. A few examples of objective (factual) information that might be needed from the client include a list of securities holdings, inventory of assets and liabilities, a description of the present arrangement for distribution of the client's (and spouse's) assets at death, a list of annual income and expenditures, and a summary of present insurance coverages. Objective goals are typically quantitative in nature. Of at least equal importance is the subjective information about the client. The financial advisor often will need to gather information about the hopes, fears, values, preferences, attitudes, and nonfinancial goals of the client (and the client's spouse).

financial risk tolerance

One piece of information worthy of special attention is the client's *financial risk tolerance*. Advisors must determine the client's (and spouse's) attitude toward risk before making recommendations, preferably with the help of a scientific risk tolerance questionnaire developed by a third party. The American College's *Survey of Financial Risk Tolerance* is just such a questionnaire. It provides the type of analysis that helps the advisor suggest financial strategies and investment alternatives that are truly appropriate for the client. Such information offers the additional benefit of helping avoid (or at least defend) lawsuits from a dissatisfied client.

Before the financial advisor begins the information-gathering process, he or she should discuss a couple of concerns with the client. First, the client should be made aware that he or she will have to invest time, perhaps a significant amount of time, in the information-gathering stage of financial planning. Even though part of the financial advisor's responsibility is to avoid consuming the client's time unnecessarily, this commitment of the client's time is essential. The magnitude of the needed time commitment will depend on the scope and complexity of the client's goals and circumstances, but the proper development

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of even a narrowly focused and fairly uncomplicated plan requires information that only the client can furnish.

Second, the client should be made aware that he or she probably will have to provide the advisor with some information that is highly confidential, perhaps even sensitive or painful, for the client to reveal. Again, the scope and complexity of the client's goals will influence this matter. The creation of even straightforward plans, however, may require clients to disclose such things as their income and spending patterns, their attitudes toward other family members, or their opinions as to the extent of their own financial responsibilities to others. Another prerequisite for the effective gathering of client information is a systematic approach to the task. Although there are many possible ways to systematize the gathering of information, one way that has proven helpful is using a structured *fact-finder form*. Some fact finders are only a few pages long and ask for basic information, while others are thick booklets that seek very detailed data on each asset and amount. Most fact finders are designed for specific financial planning software to simplify data entry. For many client situations, a formal fact finder elicits considerably more information than needed. The sections that should be completed depend on the particular areas of concern to be addressed in each client's financial plan.

fact-finder form

Obviously, information gathering is far more than asking the client a series of questions during an interview in order to fill out a fact-finder form. Certainly that is required, but usually information gathering also requires examination and analysis of documents—such as wills, tax returns, employee benefit plan coverage, and insurance policies—supplied by the client or the client's other financial advisors. It also requires counseling, advising, and listening during face-to-face meetings with the client (and spouse). These skills are especially important because the advisor needs to help the client (and spouse) identify and articulate clearly what he or she really wants to accomplish and what risks he or she is willing to take in order to do so. Moreover, no matter how the information is gathered, it must be accurate, complete, up-to-date, relevant to the client's goals, and well organized. Otherwise, financial plans based on the information will be deficient—perhaps erroneous, inappropriate, and inconsistent with the client's other goals, or even dangerous to the client's financial well-being.

Financial planning is targeted to the unique goals and preferences of clients. Gathering data provides the necessary context for planning to take place. Client goals are moving targets, and gathering data gives financial advisors a way to aim.

Step 3: Analyze and Evaluate the Data

Once the client's goals have been determined and data has been gathered, organized, and checked for accuracy, consistency, and completeness, the financial advisor's next task is to analyze and evaluate the data in order to determine the client's present financial status.

Thorough analysis may reveal certain strengths in the client's present position relative to those goals. For example, the client may be living well

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within his or her means, and resources are available with which to meet some wealth accumulation goals within a reasonable time period. Maybe the client has a liberal set of health and disability insurance coverages through his or her employer, thereby adequately covering the risks associated with serious disability. Perhaps the client's will has been reviewed recently by his or her attorney and brought up-to-date to reflect the client's desired estate plan.

The analysis of a client's financial position will disclose a number of weaknesses or conditions that are hindering achievement of the client's goals. For example, the client may be paying unnecessarily high federal income taxes or using debt unwisely. The client's portfolio of investments may be inconsistent with his or her financial risk tolerance. Maybe the client's business interest is not being used efficiently to achieve his or her personal insurance protection goals, or important loss-causing possibilities have been overlooked, such as the client's exposure to huge lawsuits arising out of the possible negligent use of an automobile by someone other than the client.

One conclusion from the advisor's analysis may be that the client cannot attain the goals established in step 2. For example, the client's resources and investment returns may preclude reaching a specified retirement income goal. Considering an unfunded retirement, the planner can help coach the client and show what changes the client must make to achieve the goal. Postponing retirement, saving more money, seeking higher returns, and deciding to deplete principal during retirement are four ways to help achieve the goal. Presented with alternatives, the client can restate the original goal by either lowering it or revising restrictive criteria to make it achievable.

Step 4: Develop and Present a Plan

financial plan

After the information about the client has been analyzed and, if necessary, the goals to be achieved have been refined, the advisor's next job is to devise a realistic *financial plan* for bringing the client from his or her present financial position to the attainment of those goals. Since no two clients are alike, a well-drawn financial plan must be tailored to the individual with all the advisor's recommended strategies designed for each particular client's concerns, abilities, and goals. The plan must address the needs of the client, and not be colored by advisor compensation model, product offerings, or bias.

It is unlikely that any individual advisor can maintain an up-to-date familiarity with all the strategies that might be appropriate for his or her clients. Based on his or her education and professional specialization, the advisor is likely to rely on a limited number of "tried and true" strategies for treating the most frequently encountered planning problems. When additional expertise is needed, the advisor should always consult with a specialist in the field in question to help him or her design the client's overall plan.

Also there is usually more than one way for a client's financial goals to be achieved. When this is the case, the advisor should present alternative strategies for the client to consider and should explain the advantages and disadvantages

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of each strategy. Strategies that will help achieve multiple goals should be highlighted.

The financial plan that is developed should be specific. It should detail who is to do what, when, and with what resources.

Implicit in plan development is the importance of obtaining client approval. It follows that the plan must not only be reasonable, it must also be acceptable to the client. Usually interaction between advisor and client continues during plan development, providing constant feedback to increase the likelihood that the client will approve the plan.

Normally, the report containing the plan should be in writing (although plans developed for achieving single goals are often not expressed in a formal written report). Since the objective of the financial planning report is to communicate, its format should be such that the client can easily understand and evaluate what is being proposed. Some financial advisors take pride in the length of their reports, although lengthy reports are often made up primarily of standardized or "boilerplate" passages. In general, the simpler the report, the easier it will be for the client to understand and possibly adopt. Careful use of graphs, diagrams, and other visual aids in the report can also help in this regard.

After the plan has been presented and reviewed with the client, the moment of truth arrives. At this time, the advisor must ask the client to approve the plan and alternative recommendations (or some variation thereof). As part of this request, the advisor must ensure cash flow is available for the plan's implementation. The advisor and client must agree on their next steps together.

Step 5: Implement the Plan

The mere giving of financial advice, no matter how solid the foundation on which it is based, does not constitute financial planning. A financial plan is useful to the client only if it is put into action. Therefore, part of the advisor's responsibility is to see that plan implementation is carried out properly according to the schedule agreed on with the client.

Financial plans that are of limited scope and limited complexity may be implemented for the client entirely by the advisor. For other plans, however, additional specialized professional expertise will be needed. For example, such legal instruments as wills and trust documents may have to be drawn up, insurance policies may have to be purchased, or investment securities may have to be acquired. Part of the advisor's responsibility is to motivate and assist the client in completing each of the steps necessary for full plan implementation.

Implementation requires the delineation of duties between the advisor and the client. Duties will vary based on business model. Some advisors offering fee-only consulting will out source product acquisition decisions, advisors working in a commission environment will typically provide products to clients directly.

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Step 6: Monitor the Plan

The relationship between the financial advisor and the client should be an ongoing one that hopefully will span the client's entire financial life. Therefore, the sixth and final step in the financial planning process is to monitor the client's plan. Normally the advisor meets with the client at least once each year (more frequently if changing circumstances warrant it) to review the plan. The frequency of meetings is determined during the implementation stage. The first part of this review process should involve measuring the performance of the implementation vehicles. Second, updates should be obtained concerning changes in the client's personal and financial situation. Third, changes that have occurred in the economic, tax, or financial environment should be reviewed with the client.

In dynamic and changing times, clients need to hear from their advisors more frequently. Phone calls, informal visits, and structured meetings are all pieces of the monitoring process. Planners should contact their clients at least as frequently as the client's other professional relationships. If this periodic review of the plan indicates satisfactory performance in light of the client's current financial goals and circumstances, no action needs to be taken. However, if performance is not acceptable or if there is a significant change in the client's personal or financial circumstances or goals or in the economic, tax, or financial environment, the advisor and client should revise the plan to fit the new situation. This revision process should follow the same six steps used to develop the original plan, though the time and effort needed to complete many of the steps (for example, step 1) will probably be less than in the original process.

Summary Figure

The financial planning process described above is depicted schematically in *Figure 1-1, The Financial Planning Process: The General Model*. The blocks on the left represent the six steps in the process, while the blocks on the right indicate the main activities that should occur in each step. The phrase, "*Egad, I'm a financial planner*" is a good way to remember these six steps: *E*stablish, *G*ather, *A*nalyze, *D*evelop, *I*mplement and *M*onitor.

HOW IS FINANCIAL PLANNING CONDUCTED?

The ongoing debate over what financial planning is and, thus, who is engaged in financial planning has often centered on the breadth of services provided to clients. Some have contended that the financial advisor who focuses on solving a single type of financial problem with a single financial product or service is engaged in financial planning. Others have argued that true financial planning involves consideration of all of the client's financial goals and all the products and services available to achieve these goals. What if the advisor's focus is somewhere between these two extremes?

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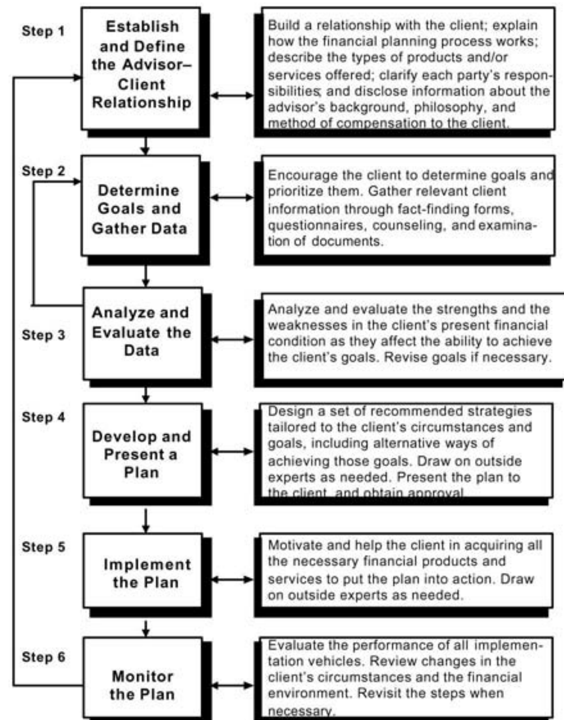
Figure 1–1 The Financial Planning Process: The General Model



Once financial planning is recognized as being a process, the traditional debate is relatively easy to resolve. Regardless of the breadth of services provided, an advisor is engaged in financial planning if he or she uses the six-step financial planning process in working with a client to develop a plan for achieving that client's financial goals. Thus, true financial planning can involve a single-purpose, multiple-purpose, or comprehensive approach to meeting a client's financial goals as long as the six-step financial planning process is utilized in doing so

Single-Purpose Approach

Some advisors take the position that the simple selling of a single financial constitutes financial planning. Clearly, these advisors would be incorrect if the financial planning process was not used to determine whether the problem their product solves is, in fact, the specific client's financial problem and if so, whether the products they are selling are the most appropriate for solving that client's problem. In this case, the advisor would be involved in product sales, not financial planning.

single-purpose approach

However, if an advisor sells the client a product to implement the recommendations of a plan developed according to the financial planning process and approved by the client, the service provided by the advisor constitutes financial planning. According to this specialist or *single-purpose*

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approach, all the following individuals would be engaged in financial planning as long as they use the financial planning process in working with their clients:

- a single-purpose planner who provides recommendations in only one financial planning topic area
- a stockbroker who advises a customer to buy shares of common stock of a particular company
- a salesperson who sells shares in a real estate limited partnership to a client
- a preparer of income tax returns who suggests that a client establish an IRA
- a banker who opens a trust account for the benefit of a customer's handicapped child
- a life insurance agent who sells key person life insurance to the owner of a small business
- a personal finance counselor who shows a client how to set up and live within a budget

Multiple-Purpose Approach

multiple-purpose approach

Client financial concerns and financial products and/or services are often seen as falling into one of the major planning areas: insurance planning and risk management, employee benefits planning, investment planning, income tax planning, retirement planning, and estate planning. Rather than taking a single-purpose approach of just solving a single financial problem with a single financial product or service, many financial advisors take a *multiple-purpose approach* by dealing with at least a large part of one of these planning areas, and perhaps some aspects of a second planning area. According to the multiple-purpose approach, the following individuals would be engaged in financial planning as long as they use the financial planning process in working with their clients:

- a multi-line insurance agent who sells all lines of life, health, and property and liability insurance
- a tax attorney who assists clients with their income, estate, and gift tax planning
- an investment advisor who is registered as such with the Securities and Exchange Commission
- a life insurance agent who also sells a family of mutual funds to meet both the protection and wealth accumulation needs of clients

Comprehensive Approach

comprehensive approach

Still other advisors take a *comprehensive approach* to providing financial planning services. Comprehensive financial planning considers all aspects of a client's financial position, which includes the client's financial goals and objectives, and utilizes several integrated and coordinated planning strategies

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for fulfilling those goals and objectives. The two key characteristics of comprehensive financial planning are

- comprehensive planning encompasses all the personal and financial situations of clients to the extent that these can be uncovered, clarified, and addressed through information gathering and counseling
- it integrates into its methodology all the techniques and expertise utilized in more narrowly focused approaches to solving client financial problems

Because of the wide range of expertise required to engage in comprehensive financial planning, effective performance commonly requires a team of specialists. The tasks of the advisor managing the team are to coordinate the efforts of the team and to contribute expertise in his or her own field of specialization.

In its purest form, comprehensive financial planning is a service provided by the managing advisor on an hourly fee-only basis. No part of the managing advisor's compensation comes from the sale of financial products or management of assets, thus helping to ensure complete objectivity in all aspects of the plan. Some team specialists also are compensated through fees, while others might receive commissions from the sale of products, while still others might receive both fees and commissions. In its less pure but often more practical form, comprehensive financial planning provides the managing advisor with compensation consisting of some combination of fees for service and commissions from the sale of some of the financial products. Again, other members of the team might receive fees, commissions, or both.

Furthermore, in its purest form, comprehensive financial planning is performed for a client all at once, meaning in a single engagement—not a single meeting. An engagement may span from a week to a decade. A single planning engagement conducted by the managing advisor and his or her team of specialists creates the one plan that addresses all the client's financial concerns and utilizes several planning strategies. This plan is then updated with the client periodically and modified as appropriate. In its less pure form, comprehensive financial planning is performed incrementally during the course of several engagements with the client. For example, the advisor in one year might prepare a plan to treat some of the client's income tax concerns and estate and insurance planning problems. In another year, the advisor might focus on the client's retirement concerns and investment planning problems and then dovetail the strategies for dealing with them with the previously developed income tax, estate, and insurance strategies. In a third engagement, the advisor might address the remaining issues in the income tax, estate, insurance, retirement, and investment planning areas and coordinate all the recommended strategies and previously developed plans. Again, each incremental part, as well as the overall plan, is reviewed periodically and revised as appropriate.

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FINANCIAL PLANNING AREAS OF SPECIALIZATION

Regardless of the breadth of the approach to financial planning—single-purpose, multiple-purpose, or comprehensive—employed by a particular advisor in working with clients, financial advisors tend to have areas of specialization in which they concentrate their activities. A survey conducted by the CFP Board of Standards in 1999 identified the following areas of specialization which, in turn, give an indication of the types of services provided by advisors to clients:[3]

- investment planning/advice—90 percent (of those surveyed)
- pension/retirement planning—87 percent
- comprehensive planning—73 percent
- estate planning—73 percent
- portfolio management—67 percent
- income tax planning—60 percent
- insurance planning—59 percent
- education planning—55 percent
- elder/long-term care planning—46 percent
- closely-held business planning—37 percent
- financial planning employee education—31 percent
- income tax preparation—25 percent
- divorce planning—19 percent

CONTENT OF A COMPREHENSIVE FINANCIAL PLAN

As indicated in the previous section, many financial advisors see comprehensive financial planning as being one of their areas of specialization. In practice, however, it is the least frequently encountered type of financial planning engagement for most advisors for several reasons. First, not many clients are willing to invest the amount of time that comprehensive financial planning requires. Second, it is usually affluent clients only who are able to afford to have a comprehensive financial plan developed. Third, not many clients can easily deal with the totality of their financial goals, capabilities, and difficulties all at one time. Instead, most prefer to concentrate on only a few related issues at once. As has been mentioned, however, even clients in the last group can have a comprehensive plan developed and implemented in incremental stages.

3. *First Annual CFP® Practitioner Survey: Executive Summary of Findings*, Certified Financial Planner Board of Standards, Denver, CO, Summer 1999, p. 7. The telephone survey of 661 CFP® practitioners was conducted by Market Facts, Inc.

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FOCUS ON ETHICS: Beginning a Dialogue on Ethics

Every chapter in this book contains an ethics dialogue box similar to this one. Ethics is a topic that should be implicit in any discussion of financial planning and the role of the financial advisor. This first box addresses a question that many advisors have asked: Is the highly ethical advisor financially rewarded for being ethical? The answer is maybe, but there is no guarantee. There are certainly some illustrations of the shady advisor reaping significant financial gains. Disciplined ethical conduct by itself does not guarantee financial success.

Perhaps the question should be addressed from a different perspective. Do clients want to do business with someone who really understands financial planning but who has questionable morals? Do clients want to do business with someone whose integrity is unassailable but whose financial planning skills are marginal? The answer to both questions is no.

The skilled financial advisor who is client focused and ethically well disciplined clearly has the attributes that clients desire and deserve. Again, the practice of ethics provides no guarantees of financial success. It is clear, however, that clients want to do business with financial advisors who have both earned their trust and are technically competent.

When the advisor prepares a comprehensive financial plan for a client, whether entirely in one engagement or incrementally over a period of time, what should the plan contain? Clearly, comprehensive financial planning is such an ambitious and complex undertaking that it must cover numerous subjects. At a minimum, these subjects should include the major planning areas identified by the Certified Financial Planner Board of Standards in its Topic List for CFP® Certification Examinations. These areas are

- general principles of financial planning (for example, personal financial statements, client attitudes and behavioral characteristics, and so forth)
- insurance planning and risk management
- employee benefits planning
- investment planning
- income tax planning
- retirement planning
- estate planning

A comprehensive financial plan should address **all** of these major planning areas as they relate to the client. If the financial advisor does not have the expertise to personally address each of the major planning areas in the development of the plan, he or she should form a team of specialists and serve as a quarterback manager. The advisor's role would then be to coordinate the efforts of the team and to contribute expertise in his or her own field of specialization. If one of the major planning areas does not apply to the client, the plan should spell out this fact and disclose what is and is not covered. This will indicate that an important planning area was not overlooked in the

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development of the plan but was investigated and found not to apply to the client at this time.

In addition to the major planning areas that pertain to almost every client, there are a number of more specialized areas that are relevant to many. These specialized areas are for the most part subsets of, and typically involve several of, the major planning areas. However, because all of these specialized areas are unique, they merit separate treatment. They should be part of a client's comprehensive financial plan only if he or she is affected by them. Typically, a single-purpose or multiple-purpose financial plan that is focused on the particular planning need deals with these specialized areas.

consumer price index (CPI)

The most important of these specialized areas in terms of the number of people it affects is education funding. Most clients understand the need to save for college and are aware that college costs have risen at a faster pace than the *consumer price index (CPI)*. Still, the vast majority of families accumulate far too little money for college by the matriculation date. They usually have to cut back on living expenses, borrow money, tap into retirement assets, or seek additional employment to meet the funding need. Often they lower their sights and target a school that is less expensive rather than the one best suited to their children's needs. Consequently planning to meet the costs of higher education has become a necessity for most parents.

The other specialized areas worthy of mention are those that can be categorized as financial planning for special circumstances. These areas typically include planning for

- divorce
- elder care
- disability
- terminal illness
- nontraditional families
- job change and job loss
- dependents with special needs
- monetary windfalls

As previously mentioned, all of these specialized planning areas are subsets of one or more of the major planning areas. For example, divorce planning could affect every single one of the major planning areas but, nevertheless, should not be part of a comprehensive financial plan unless the client is contemplating divorce. Even then, divorce planning would be better handled under a single-purpose or multiple-purpose financial plan because of its unique aspects and shorter planning horizon than the major planning areas.

Life-Cycle Financial Planning

financial life cycle

There are five distinct phases in an individual's *financial life cycle*. Starting at a relatively young age (age 25 or younger), a career-minded person typically will pass through four phases en route to phase five, retirement. These five phases and their corresponding age ranges are

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1. early career (age 25 or younger to age 35)
2. career development (age 35 to age 50)
3. peak accumulation (age 50 to ages 58-62)
4. preretirement (3 to 6 years prior to planned retirement)
5. retirement (ages 62-66 and older)

Together these five phases span a person's entire financial life. Although some people will not experience all of the phases or will spend more or less time in any one phase, the vast majority of career-minded people will go through all five.

As previously discussed, the first step in creating a comprehensive financial plan is for the advisor to establish and define the advisor-client relationship. Once the ground rules for the financial planning engagement have been set, the advisor's next task is to lead the client through the goal-setting process. Goal setting requires clients to recognize that there are several phases in their financial life; for young clients, the early career phase is the beginning of that life. The goals that young clients who are in this phase typically set reflect this fact. For example, a client who is in the early career phase often is newly married and has young children, and the client and/or his or her spouse are establishing employment patterns. The client probably is concerned about accumulating funds for a home purchase if he or she has not already done so. As the children grow older, the client begins to think about saving for college. Protecting his or her family from a potential financial disaster due to death or disability is also important, as is building a cash reserve or emergency fund to meet unexpected contingencies. However, the client's goals that pertain to retirement and estate planning generally will not have a very high priority in the first few years of the early career phase, but they still need to be considered if the financial plan is to be a truly comprehensive one.

Once the client has a comprehensive financial plan, it is incumbent on the advisor to monitor the plan. As the client moves into the career development phase of his or her financial life cycle, some goals may need revision. This phase is often a time of career enhancement, upward mobility, and rapid growth in income. The phase usually includes additional accumulation and then expenditure of funds for children's college educations. Moreover, the advisor should recommend coordinating the employee benefits of the client and his or her spouse and integrating them with insurance and investment planning goals.

As the client moves into the peak accumulation phase, the ever-vigilant advisor should be monitoring the plan for any needed changes. In this phase, the client is usually moving toward maximum earnings and has the greatest opportunity for wealth accumulation. The phase may include accumulating funds for special purposes, but it is usually a continuation of trying to meet the goals set for the major planning areas.

The preretirement phase often involves winding down both the career and income potential, restructuring investment assets to reduce risk and enhance income, and a further emphasis on tax planning and evaluating retirement plan distribution options relative to income needs and tax consequences. Throughout

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this phase, the financial advisor should be actively involved in keeping his or her client's financial plan on target to meet all the client's goals.

The final phase in the client's financial life cycle is retirement. If the advisor has kept the client's financial plan fine-tuned, then this phase should be a time of enjoyment with a comfortable retirement income and sufficient assets to preserve purchasing power. While all of the major planning areas should have been receiving attention throughout the client's financial life cycle, now is the time for the advisor to make certain that his or her client's estate plan is in order.

life-cycle financial planning

The advisor who monitors a client's financial plan throughout the client's financial life cycle is practicing *life-cycle financial planning*. A comprehensive financial plan that is developed for a relatively young client needs to be reviewed and revised periodically as the client ages and passes through the phases of the financial life cycle. Many of the client's financial goals will need adjusting as life's circumstances change; having the right goals is critical to creating a successful financial plan. The advisor's role in setting goals is to help the client establish reasonable, achievable goals and to set a positive tone for the entire financial planning process. The entire process encompasses not only the development of the client's first financial plan but also any future revisions and/or modifications to that plan.

The content of a comprehensive financial plan should, as already mentioned, include a discussion of each of the major planning areas. Financial planning is a process that should be ongoing throughout the client's financial life. That is why financial planning over the client's financial life is called life-cycle financial planning. Whichever phase of the financial life cycle the client is currently in strongly influences the priority given to the goals for each of the planning areas.

Format of a Comprehensive Financial Plan

A financial plan, whether comprehensive or not, is essentially a report to the client regarding the advisor's findings and recommendations. This report results from the application of the financial planning process to the client's present situation in an effort to assist the client in meeting his or her financial goals. Although there are as many different formats for a comprehensive financial plan as there are financial advisors, it is easy to agree that every comprehensive financial plan should include certain types of information. For example, every comprehensive plan should cover all of the major planning areas. Every plan should be based on reasonable, achievable goals set by the client. And every plan should be structured around strategies for achieving the client's goals. In addition, in the process of formulating strategies, assumptions have to be made and should be spelled out in the plan documents. Typical assumptions include the interest rate, the rate of inflation, and the client's financial risk tolerance, to name but a few. Finally, every plan is developed around information gathered during a fact-finding process. Much of this information, such as financial statements, should also be included in the plan.

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Recognizing that there are many possible variations for organizing all of this information into a cohesive plan, one possible approach is to structure the plan to parallel the steps in the financial planning process. This type of plan typically is developed for the client all at once. A single planning engagement with the advisor, generally with a team of specialists, utilizes several planning strategies and creates the one plan that addresses all the client's financial concerns.

A comprehensive financial plan organized to follow the financial planning process should start (paralleling step 1, establishing and defining the advisor-client relationship) by specifying the responsibilities of each party for implementing the plan and carrying it through to completion. Along with specifying responsibilities, the plan also needs to clarify how the advisor is to be compensated for his or her work in developing, implementing, and monitoring the plan. Covering these all-important ground rules at the beginning of the plan helps not only to define the advisor-client relationship but to set the tone for that relationship as well.

Next (paralleling step 2, determining goals and gathering data), the comprehensive plan should specify the client's stated goals indicating the priority of each one and the time frame for achieving it. Each goal, as indicated earlier in this chapter, should be stated as specifically as possible. Because there are likely to be a number of goals included in a comprehensive financial plan, it may be helpful for the client to list them in relevant categories, such as protection, accumulation, liquidation, and so forth. Keep in mind that the best solution for a specific goal may involve a combination of the major planning areas; whatever approach is adopted for categorizing the goals, the plan should be designed to avoid confusing the client.

In addition to specifying the client's goals, the plan should also describe the client's present situation based on both the personal and financial data gathered from the client. In terms of the personal situation, this should include not only basic information about the client and his or her family, such as names, addresses, phone numbers, dates of birth, Social Security numbers, and so on, but also other relevant personal information that helps define the client's present situation and consequently will affect the financial plan. This other relevant information could include such topics as a child's serious health problem, a feeling of personal obligation to support aging parents, a desire to treat adopted or stepchildren differently from natural children, previous marriages and alimony or child-support obligations, and gifts or inheritances pending or anticipated.

Besides defining the client's present personal situation, the plan should include a description of the client's present financial situation. This is most commonly done by including a copy of the client's financial position statement on the plan date, listing his or her assets and liabilities and showing net worth; a cash-flow statement that identifies all the client's income and expenses and indicates his or her net cash flow for the latest period; and a copy of the client's most recent federal income tax return and an analysis thereof. The information presented should also include pro forma statements, that is, projections of future financial position relevant to understanding the client's current position. The

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client's current investment portfolio should also be presented with an indication of, among other things, its liquidity, diversification, and risk characteristics.

Next, for each goal at least three critical areas of information should be presented

- (paralleling step 3, analyzing and evaluating the data) the problem(s) identified by the advisor that the client would encounter in attempting to accomplish the goal
- (paralleling step 4, developing and presenting a plan) the recommended financial and tax services, products, and strategies for overcoming the identified problem(s) (including any underlying assumptions the advisor made in formulating the recommendation) so that the client can achieve the goal
- (paralleling step 5, implementing the plan), recommendations for implementing the proposed solution for achieving the goal

financial planning pyramid

A second possible approach for structuring a comprehensive financial plan is to build the plan from the ground up in three stages. This type of plan typically requires several meetings with the client over a period of years. At the first stage of plan development, the advisor should concentrate his or her efforts on protecting the client against unexpected occurrences that could cause financial hardship. At the second stage, the advisor should focus on the client's wealth accumulation objectives. At the third and final stage, the advisor should address retirement and estate concerns. To help in understanding how these stages fit together in a comprehensive plan, look at the *financial planning pyramid* below.

The financial planning pyramid is a common approach to prioritizing a comprehensive financial plan over a period of time. The pyramid illustrates how developing a plan begins with a sound foundation and proceeds in an orderly fashion. Stage 1, the foundation of the pyramid, in its simplest form protects the client against life's financial uncertainties. It is built with emergency savings, insurance coverages, and a properly drawn will.

Stage 2, the middle part of the pyramid, is the wealth accumulation component of the financial plan. As the client moves up the pyramid (that is, as the client's financial well-being improves), the focus of the plan shifts from income protection needs to wealth accumulation goals. This typically involves growing money through various types of investments.

Stage 3, the top part of the pyramid, becomes important once the client has achieved most of his or her accumulation goals. This last component of the financial plan addresses both the management of retirement assets and the conservation and distribution of the estate. This part of the financial plan typically is carried out by an estate plan and other advanced planning strategies including trusts and an updated will.

Regardless of the format a financial advisor adopts to organize a comprehensive financial plan, the important point to remember is that the plan should be communicated to the client in the form of a written report. The format of this financial planning report should make it easy for the client to understand and evaluate what is being proposed. In general, the simpler the

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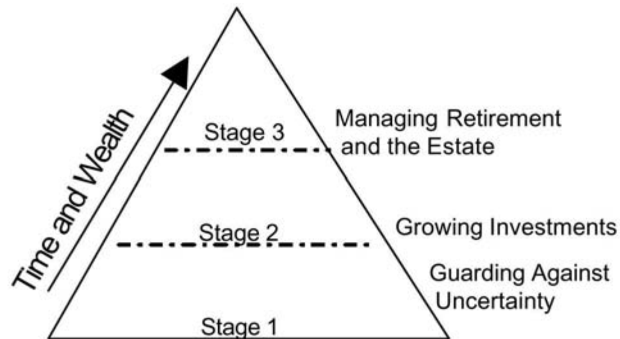
report, the easier it will be for the client to understand and adopt. Careful organization, as well as the use of graphs, diagrams, and other visual aids, can help in this regard.

Figure 1–2 Financial Planning Pyramid



TRENDS CREATING OPPORTUNITIES FOR FINANCIAL PLANNING ADVISORS

A number of trends having important implications for advisors engaged in financial planning have emerged in the United States in recent years. They all point to enormous opportunities for these advisors to render valuable service to clients.

One of the most important trends is that the population is growing older. The median age of Americans has risen more than 7 years in the past 3 decades, meaning that a larger proportion of the population has moved into the period of highest earnings. Also, as people get older they tend to devote a smaller share of their income to current consumption and a larger share to savings and investments.

baby-boom generation

One of the causes of the rising median age of Americans is that the members of the baby-boom generation are no longer babies. The children born from 1946 to 1964 now range in age from their mid 40s to their early 60s and constitute about 30 percent of the U.S. population. Another cause of the rising median age is that Americans are living longer. Approximately 12.4 percent of them are now age 65 or over as compared to 9.2 percent in 1960, and this percentage will continue to rise. Government statistics indicate that the average life expectancy for 65-year-old males is now over 16 years and for 65-year-old females is now over 19 years.

The aging of the American population means that more consumers need retirement planning assistance during both their remaining years of active work and their retirement years. An increasing proportion of the population also needs assistance in planning for the cost of their children's college educations.

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Table 1-2
Consumer Price Index Changes (Urban Consumers), the Prime Rate, and Standard & Poor's 500 Stock Index: 1965-2008

Year	Percentage Change in CPI	Average Prime Rate (%)	Average S&P 500 Index
1965	1.6	4.54	88.47
1966	2.9	5.63	84.46
1967	3.1	5.63	92.18
1968	4.2	6.31	98.54
1969	5.5	7.96	97.58
1970	5.7	7.91	83.45
1971	4.4	5.72	98.21
1972	3.2	5.25	109.82
1973	6.2	8.03	106.51
1974	11	10.81	81.48
1975	9.1	7.86	87.13
1976	5.8	6.84	102.79
1977	6.5	6.82	97.48
1978	7.6	9.06	95.46
1979	11.3	12.67	103.33
1980	13.5	15.27	119.58
1981	10.3	18.87	127.84
1982	6.2	14.86	120.28
1983	3.2	10.79	160.72
1984	4.3	12.04	160.32
1985	3.6	9.93	188.97
1986	1.9	8.33	238.92
1987	3.6	8.21	285.99
1988	4.1	9.32	267.72
1989	4.8	10.87	326.31
1990	5.4	10.01	332.68
1991	4.2	8.46	381.53
1992	3	6.25	417.12

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Year	Percentage Change in CPI	Average Prime Rate (%)	Average S&P 500 Index
1993	3	6	453.45
1994	2.6	7.15	460.66
1995	2.8	8.83	546.88
1996	3	8.27	674.85
1997	2.3	8.44	875.86
1998	1.6	8.35	1087.86
1999	2.2	8	1330.6
2000	3.4	9.23	1419.73
2001	2.8	6.91	1186
2002	1.6	4.67	989.38
2003	2.3	4.12	967.93
2004	2.7	4.34	1132.6
2005	3.4	6.19	1207.75
2006	3.2	7.96	1318.31
2004	2.7	4.34	1132.6
2005	3.4	6.19	1207.75
2006	3.2	7.96	1318.31
2007	2.8	8.12	1500.00
2008	3.8	5.01	832.14

Percentage change in CPI calculated from data provided by the U.S. Department of Labor, Bureau of Labor Statistics and available at: www.bls.gov/cpi/home.htm. The source for Average Prime Rate is: "H.15 Selected Interest Rates: Historical Data" (updated weekly), the Federal Reserve Board available at: www.federalreserve.gov/releases/h15/data.htm. Average S&P 500 Index is based on monthly data provided by The Financial Forecast Center™ and available at: forecasts.org, *except for 2008 data, which is provided by Standard & Poor's*.

A second important trend in the financial planning marketplace is that dual-income families are increasingly common. This trend results from an increasing percentage of women entering (and reentering) the labor force, even during the years when they have young children. Dual-income families typically have higher total incomes, pay higher income and Social Security taxes, and have less time to manage their finances. The opportunities for financial planning advisors to assist people in this situation are obvious.

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Trends Creating Opportunities for Financial Planning Advisors

- rising median age
- increased impact of dual-income families
- volatility of financial conditions
- evolving tax environment
- technological change
- concern over fraud and firm failure

prime interest rate

Standard & Poor's 500 Index

A third broad trend is the increasing volatility of financial conditions in the American economy. Three indicators of this volatility that have confronted and confused Americans for the past 40 years are the changes that have occurred in inflation rates, in the level of interest rates, and in common stock prices. For example, during the first half of the 1960s, annual increases in the CPI averaged only 1.3 percent; the *prime interest rate* charged by banks on short-term business loans averaged only about 4.68 percent, and the Standard & Poor's 500 Index of common stock prices averaged around 72.0.

Inflation and interest rates rose steadily in the late 1960s, and they were undoubtedly a motivating factor behind the growth in the number of advisors engaged in financial planning. Inflation and interest rates then cooled but bounced up again sharply in the mid-1970s. After a 3-year respite, they rose very sharply in the late 1970s and into the 1980s. Throughout this entire period, stock prices rose only modestly.

Inflation rates slowed again during the mid-1980s, as did the prime interest rate. Meanwhile the stock market rose dramatically but erratically. As the 1980s came to a close, inflation and interest rates were creeping up again and average common stock prices were gyrating sharply from day to day. Then in the early 1990s, inflation started cooling again, stock prices rose dramatically, and interest rates plummeted. The mid-1990s saw continued moderation of inflation, yet interest rates crept upward while the stock market set record highs. Inflation in 1998 dropped to 1.6 percent, its lowest level in 3 decades. From 1997 to early 2000 the stock market soared to unprecedented highs but also displayed unsettling volatility. In mid 2000, the stock market turned downward and continued to drop in 2001, 2002, and early 2003. From a high near 1500 in the summer of 2000, the S&P 500 Index average of daily closing prices fell below 1000 by the middle of 2002, quite close to where it was in the beginning of 1998. Meanwhile, in response to actions of the Federal Reserve, interest rates dropped to their lowest levels in decades, declining from 9.50 percent during December 2000 to 4.00 percent in July 2003. Then rates increased as the Federal Reserve raised its target for the Federal Funds rate by ¼ percent 17 times in 17 consecutive meetings of the Fed Open Market Committee starting in June 2004.

In addition to the volatility of inflation rates, interest rates, and stock market prices, another destabilizing factor faced by American consumers has been important U.S. income tax laws—from the 1986 Tax Reform Act to the Economic Growth and Tax Reform Reconciliation Act of 2001, the Jobs Creation and Workers Assistance Act of 2002, the Jobs and Growth Tax Relief

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and Reconciliation Act of 2003, the Working Families Tax Relief Act of 2004, the American Jobs Creation Act of 2004, and the Pension Protection Act of 2006—tax laws that affect all aspects of financial planning. With these tax acts, the landscape for personal and estate taxes changed dramatically and these changes increased the need for financial advisors.

With the possible exception of the bull market of the late 1990s where many investors felt they could "do it themselves" without either professional advice or paying much attention to risk,[4] volatile economic conditions generally create greater demand for financial planning services. They also emphasize the need for financial advisors to continuously monitor their clients' financial circumstances and to adjust the plans as circumstances dictate. These volatile financial conditions make it doubly important that advisors thoroughly understand and abide by their clients' risk tolerances. With the 3-year decline in the stock market that began in 2000 and its major impact on the value of invested assets, investors are again recognizing the value of financial planning services and the need to consider risk as well as return in attempting to achieve their financial goals.

A fourth major trend in the financial planning market is the technological revolution that has occurred in the financial services industry. This revolution has made possible the creation of many new financial products and has made it easier to tailor these products to individual client needs. Also the technology has made possible the improved analysis of the performance of these products by advisors with the skills to do so.

CONSUMER NEEDS FOR FINANCIAL PLANNING

A basic and inescapable principle of economics is the law of scarcity—in every society—human wants are unlimited whereas the resources available to fill those wants are limited. The available resources must be somehow rationed among the wants. This rationing problem creates the need for financial planning even in affluent societies, such as the United States, and even among the most affluent members of such societies. To put it colloquially, there is just never enough money to go around.

What are the main financial concerns of American consumers? Are they able to handle those concerns on their own or do they need professional help? In short, do American consumers have a significant need and effective demand for professional financial planning services in the early years of the new millennium?

4. "Nancy Opiela, "The State of Financial Planning: A Grassroots Perspective,"*Journal of Financial Planning*, December 2002, pp. 8-16."

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A national consumer survey conducted by the CFP Board of Standards in 2004 identified the following top 10 reasons people begin financial planning[5] (shown in reverse order for effect):

- generating current income (25 percent of those surveyed)
- sheltering income from taxes (26 percent)
- providing insurance protection (29 percent)
- accumulating capital (31 percent)
- building a college fund (32 percent)
- traveling/vacation (34 percent)
- managing/reducing current debt (34 percent)
- building an emergency fund (40 percent)
- purchasing/renovating a home (41 percent)
- building a retirement fund (82 percent)

In reporting the results of its 2004 Consumer Survey, the CFP Board of Standards also broke the findings down according to three key groups of respondents—"up and coming," "mid-life," and "retirement cusp."*Table 1-3, Financial Planning Needs* shows the financial planning focus of each of the groups and highlights the relative importance of retirement planning to all three consumer groups.

The annual update of the Retirement Confidence Survey conducted by the Employment Benefit Research Institute (EBRI)[6] emphasizes that in many cases there is a strong need for professional help in planning effectively for retirement.

- Long retirements are expected.
  - EBRI survey: The average number of working respondents expects to retire at age 65 and spend 20 years in retirement.
- Retirement income needs are underestimated. (Retirement planning professionals typically recommend 75 to 90 percent of preretirement income to live comfortably in retirement.)
  - EBRI survey: Fourteen percent of working respondents expect to need less than 50 percent of their preretirement income in retirement; 36 percent indicate 50 to 70 percent; and 28 percent indicate 70 to 85 percent. Thirteen percent of workers estimate they will need 85 to 105 percent of their preretirement income in retirement.

5. *2004 Consumer Survey*, Certified Financial Planner Board of Standards, Denver, CO. This was a survey of 1,122 upper-quartile households of all ages (incomes ranged from $60,000+ depending on the householders' ages).
6. *The 2006 Retirement Confidence Survey*, EBRI Issue Brief No. 292, April 2006, Employee Benefit Research Institute, Washington, DC.

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Table 1-3
Financial Planning Needs

Consumer Group	Who Are They?	Financial Planning Focus
Up and Coming • 39% of respondents	• Ages: 20-39 • have a written financial plan • 52% completed plan within the last 3 years • Most tolerant of risk • Most likely to use the Internet for financial purposes • Most likely to have financial software	• Prepare for retirement • Manage/reduce debt • Build an emergency fund • Build a college fund • Save for a home purchase/renovation
Mid-Life • 36% of respondents	• Ages: 40-54 • 39% have a written financial plan • 56% completed plan at least 4 years ago • More likely to use a financial professional to develop a plan • Highest amount of household income • Have low to moderate risk tolerance	• Prepare for retirement (strongest focus of all three consumer groups) • Build an emergency fund • Vacation/travel • Finance college education • Manage/reduce debt • Shelter income from taxes
Retirement Cusp • 25% of respondents	• Ages: 55-69 • 47% have a written financial plan • 62% completed plan at least 5 years ago • Higher net worth and lower risk tolerance • Most likely to have a financial professional as a primary advisor	• Prepare for retirement • Vacation/travel • Accumulate capital • Generate income • Shelter income from taxes • Provide for future medical needs • Build an emergency fund
Source: *2004 Consumer Survey*, Copyright © 2009, Certified Financial Planner Board of Standards, Inc. All rights reserved. Used with permission.		

- Retirement savings are insufficient.
    - EBRI survey: Twenty-four percent of nonretired workers indicate they are *very confident* in having enough money to live comfortably throughout their retirement years; 44 percent indicate that they are *somewhat confident*. Twenty-two percent of the very confident workers are not currently saving for retirement.
- Planning has been inadequate.

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– EBRI survey: Forty-two percent of the nonretired respondents indicate that they have tried to calculate how much money they will need to have saved by the time they retire so that they can live comfortably in retirement

As previously stated, baby boomers, Americans born between 1946 and 1964, are now in mid-life. A study conducted by the American Association of Retired Persons (AARP) in 2004 found that while baby boomers appear to be quite optimistic about their retirement years, their optimism is moderated somewhat by concerns about finances.[7] Another study conducted by the AARP in 2004 found that the personal finances of baby boomers is one area of their lives with which they are least satisfied, along with their work.[8] About one-third of the survey respondents indicated that they are worse off financially than they thought they would be at this point in their lives. Many baby boomers feel financially strapped, especially when it comes time to pay college tuition. While 29 percent of those surveyed have made "improving their personal finances" their top goal over the next 5 years, nearly half do not believe they are likely to achieve their goal due, among other things, to their own inability to handle credit cards and debt, the volatile stock market, the cost of living, and economic uncertainty in the workplace.

Another study of baby boomers conducted by The Allstate Corporation in 2001 suggests that many baby boomers are likely to encounter a retirement that is quite different in financial terms from the past.[9] Among other things, the survey revealed that during retirement, more than one in three baby boomers will be financially responsible for parents or children, 7 percent will be financially responsible for both parents and children, one in five will pay college tuition for one or more children, and more than 70 percent will continue to work. The survey also suggests that baby boomers appear to be poorly prepared for these financial burdens in retirement. Survey respondents saved only an average of 12 percent of the total they will need to meet even basic living expenses in retirement. Furthermore, they have grossly underestimated the predicted increase in the cost of living over the next 20 years.

sandwiched generation

The baby-boom generation is also known as the *sandwiched generation* because many members are faced with financing their children's educations and aiding their aging parents at the same time when they themselves should be saving for their own retirements. Retirement, college funding, and long-term

7. *Baby Boomers Envision Their Retirement II-Key Findings: Survey of Baby Boomer' Expectations for Retirement, AARP, Washington, DC, May 2004. Prepared by Roper ASW for AARP*. A telephone survey of 1,200 Americans ages 38 to 57.
8. *Boomers at Mid-Life 2004: The AARP Life Stage Study*, AARP, Washington, DC 2004. A telephone survey of 3,850 adults 18 and older (including 2,266 boomers) was conducted by Princeton Survey Research Associates for AARP.
9. *Retirement Reality Check*, The Allstate Corporation, Northbrook, IL, December 2001. Harris Interactive polled 1,004 people born between 1946 and 1961 with household incomes ranging from $35,000 to $100,000. An update of this survey has been released annually since the original survey in 2006.

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care are important to many clients but especially to sandwiched boomers. Boomers Envision Retirement II (an AARP study) reports that 35 percent of boomers have been or are responsible for the care of elderly parents; 18 percent expect to provide financially for an aging parent or in-law during retirement; and 19 percent expect to have an aging parent or in-law living with them during retirement.[10]

Obstacles Confronting Consumers

The results of the surveys discussed above and similar studies make it clear that many American households still have not gained control of their financial destinies. Certainly, there are many reasons why they have not developed financial plans that will enable them to do so. Three of the strongest obstacles they face are the following:

- the natural human tendency to procrastinate—Delaying the task of establishing a financial plan may result from a hectic lifestyle, the seeming enormity of the task of getting one's finances under control, and the belief that there is still plenty of time to prepare for achieving financial goals.
- living up to or beyond current income—This is a very common tendency among Americans. The pressure in households to overspend for current consumption is enormous, and many families have no funds left with which to implement plans for the achievement of future goals.
- the lack of financial knowledge among consumers—Although in recent years there has undoubtedly been some growth in the financial sophistication of Americans, there is still widespread ignorance about how to formulate financial objectives and how to identify and properly evaluate all the strategies that might be used to achieve them.

Role of Financial Planning Advisors

A basic inference that can be drawn from the results of consumer surveys is that Americans need help in managing their personal finances to achieve their financial goals. Moreover, many Americans seem to realize that they would benefit from professional help, and with better education many others would reach the same conclusion. A major part of the challenge facing financial planning advisors is to help clients overcome these obstacles by educating them and motivating them to gain control of their own finances.

10. *Baby Boomers Envision Their Retirement II*, op. cit., p. 8.

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CHAPTER ONE REVIEW

Key Terms and Concepts

financial planning
financial planning process
financial risk tolerance
fact-finder form
financial plan
single-purpose approach
multiple-purpose approach
comprehensive approach
consumer price index (CPI)
financial life cycle
life-cycle financial planning
financial planning pyramid
baby-boom generation
prime interest rate
Standard & Poor's 500 Index
sandwiched generation

Review Questions

The answers to the review questions are in the supplement. Self-test questions and the answers to them are also in the supplement and on The American College Online.

1-1. Identify the six steps in the financial planning process and briefly indicate the kinds of activities involved in each step. [1-1]

1-2. Describe each of the following approaches to financial planning:
a. single-purpose approach [1-2]
b. multiple-purpose approach [1-2]
c. comprehensive approach [1-2]

1-3. At a minimum, what subjects should be included in a comprehensive financial plan? [1-3]

1-4. Explain what is meant by life-cycle financial planning. [1-4]

1-5. Explain the financial planning pyramid. [1-6]

1-6. Describe the opportunities in the financial planning marketplace resulting from each of the following trends:
a. rising median age [1-7]
b. increasing number of dual-income families [1-7]
c. volatility of financial conditions [1-7]
d. increasing use of sophisticated technology by the financial services industry [1-7]

1-7. What are the top 10 reasons why people begin financial planning? [1-8]

1-8. Describe three of the strongest obstacles preventing Americans from gaining control of their own financial destinies. [1-8]

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