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FAQ

General Financial Planning

Question: I received an agreement to continue my working engagement with a financial planner after my first consultation. How do I understand the contract I'm signing? Is there someone who should review the document?

Answer: Most professionals have engagement agreements that both parties sign in order to protect both parties in the event of any disagreement or misunderstanding. Beware of statements that give too much latitude to the financial planning professional. For example, "Client agrees that the financial planner may have full discretion in managing the accounts of the Client." Such agreements should give you a choice and you should be marking your choice and initialing it. In other words, you should have options and you should understand the repercussions of the options you choose. Engagement letters should be "plain language" where both parties understand the agreement.

Retirement

Question: What would be the best possible funds to invest in pertaining to my 401(k)? Ranging from highest to lowest return.

Answer: Designing an investment portfolio depends on several factors including your age and risk tolerance. Most 401(k) plans are built to only have a select number of mutual funds to choose from. Your 401(k) provider should have a list of accounts available for you to invest. Generally, individuals shouldn't be extremely bullish on stocks, nor extremely bearish on bonds. It's usually ideal to diversity your portfolio with different types of assets.

Question: My husband and I are trying to start a savings plan for retirement and investing. Are there any tips to start saving for the future?

Answer: The best way is to make it systematic. Many people will use tools such as an automatic debit from their paycheck or checking account once per month or pay period. It can go automatically into a mutual fund or savings account. Some companies offer a service for their employees to automatically transfer from their paycheck.

For retirement savings, you will want to take advantage of an employer plan that offers pretax savings. If there is no plan in place, you can set up an individual retirement account (IRA) at a bank or brokerage firm where you can invest a certain amount each month. The most important part of saving is that you do it at least monthly and set it up so you cannot access the money.

College Planning

Question: We have two children and make monthly contributions to 529 plans for each child. Is it more advantageous to continue to make monthly contributions to 529 plans or re-direct these monthly contributions to Roth IRAs? If our children need to apply for college loans, will the money saved in the 529 plans penalize them?

Answer: Contributing to an investment program is more important than the selection of the particular program. 529 Savings Plans are generally the property of the account holder (e.g., parent, grandparent, etc.). Federal financial aids are considered low impact assets in this regard. On the other hand, Roth IRAs currently are zero impact assets, unless withdrawals are made, and have the added benefit of providing tax free accumulations for your retirement if not used for education expenses. If you are under age 59 ½ when withdrawals are made from the Roth IRA, the earnings will be taxable, although not subject to penalty if used for higher education expenses.

The answer hinges on whether you are investing enough for retirement. If you are fully utilizing the qualified plans available to you and already setting aside sufficient money to provide for your financial independence, then earmarking funds for education using 529 plans is a good idea–and an excellent vehicle for grandparents. If resources are limited, counting on Roth IRA assets or loans from 401(k) plans may be a better idea.

Budgeting

Question: My wife and I are having trouble sticking to a budget. We occasionally spend more than we should. Can a financial planner help us stick to a budget? Is it possible to have a financial planner pay our bills, help us save money and keep us on track? What would the costs typically be for this type of service if available?

Answer: The question really speaks to motivation and alignment between you and your spouse on spending. Is it that you spend before paying your bills and then are short, or do you pay your bills and don't feel you have enough remaining? Is this problem primarily with one of you or do you "take turns?" If you both agree on a budget, or spending plan, then it is up to you to keep each other honest. It is a good idea for each person to have personal funds they can do anything with without recrimination.

First, create a written budget or spending plan. Calculate what your monthly fixed costs are and estimate your variable costs. Are you each allowed a personal slush fund? Does your written

budget contain line items for savings and retirement savings? Pay yourself first by saving before anything else.

Second, create a written financial road map that includes your goals and objectives (e.g., "we want to retire at age 55 with a monthly income of $8,000 in today's dollars). Make sure to review it periodically to check your progress. Are you making progress toward your goal? All roads lead somewhere – but you need a map to find the road that takes you where you want to go.

Third, when you say you spend more than we should, what do you mean? Is it incidentals (coffee, lunch out, drinks after work, etc.) or something larger like a plasma television? Other compulsive spending such as clothing or shopping? Is this over spending done with cash or credit cards?

You can find someone to pay your bills, but I don't know if that is the issue. Bill paying services vary in price, but I would expect it to be at least $100 a month. A lot of vendors (mortgage companies, utilities, etc) allow you to set up auto-payment from your checking account – all you have to do is make sure the funds are there when needed. One useful technique is to have a separate bill paying account from which all household bills, including additions to savings, are paid. You would each deposit an agreed-upon amount in this account each payday.

Finally, your goals have to be the primary driver of your behavior. If you have a written goal and you "own it", your subconscious mind will take over and direct you towards your goal.

Question: I'm a recently divorced mother paying a mortgage, my daughter's tuition and bills, and my bills. Unfortunately, my credit card debt increased when I lost my job and now all my bills are late, if I can pay anything at all. I tried pay day loans, but that did not work. I am scared I will be sued for outstanding payments. Is debt consolidation a good idea, or should I try to pay everything off as best as I can?

Answer: Your situation is among the most difficult because there are no easy answers. Based on your note, I'm assuming you are still unemployed and that you are receiving some type of unemployment insurance coverage. My first suggestion is for your daughter to go the financial aid office tomorrow morning and research all funding opportunities available on financial aid. You should also educate yourself about the financial aid process, and if necessary get the process started as soon as possible. The goal would be to shift as much, if not all the college expenses to your daughter even if most of the aid are loans whose payment is deferred until six months after she leaves or graduates college. The loans can be paid off later.

Regarding the rest of your bills, I suggest you get a pad of paper and make the following list:

- Make a list of all your bills and the amount you owe for each loan
- Know your regular payment and how much you may be behind on each obligation
- Know your budget - how much income you have available
- Know how much you can afford to pay each creditor
- Call each creditor making notes of the time you called and the person you spoke with (I would probably start with your home lender)
- Start each call with your name and account number
- Tell them you lost your job
- Tell them the amount you propose to give them, reinforcing the fact that you have a plan and are trying to be fair to each obligation

Tax Planning

Question: Can I claim my mother's in-home caregiver on my income tax return? I pay thousands of dollars for her care as she cannot be alone while I am away from home. Unfortunately, she makes more than $3,400 per year. She gets about $1,600/month from Social Security and from her teacher's pension. But, her cost of caregiving is sometimes upwards of $2,000 per week!

Answer: Based on the information that you provided, you are correct that your mother does not qualify as a dependent for income tax purposes, due to her income exceeding the personal exemption amount. If she did meet all of the tests to qualify her as your dependent, you could include any medical expenses you incur for her along with your own when determining your medical deduction.

On the other hand, if she doesn't qualify as your dependent only because of the gross income or joint return test, you can still include her medical costs that you pay for her with your own. The costs of qualified long-term care services required by a chronically ill individual are included in the definition of deductible medical expenses. "Qualified long term care" services are necessary diagnostic, preventive, therapeutic, curing, treating, mitigating, and rehabilitative services, and maintenance or personal care services required by a chronically ill individual provided under a plan of care presented by a licensed health care practitioner. To qualify as chronically ill, an individual must be certified by a physician or other licensed health care practitioner (e.g., nurse, social worker, etc.) as unable to perform without substantial assistance at least two activities of daily living for at least 90 days due to a loss of functional capacity, or as requiring substantial supervision for protection due to severe cognitive impairment (memory loss, disorientation, etc.).

Estate Planning

Question: I recently lost both of my parents within 18 months of each other. My father left my mother as a beneficiary on his 401(k) plan. My mother moved the funds from his plan to an IRA, and I am the beneficiary. My mom passed away in February 2007 and I do not know what to do with this account. Am I able to draw some funds from it and leave the rest the same? How much will I be taxed and will this be taxed as if it were my salary or as an inherited tax?

Answer: First of all, my condolences on your loss. It's always difficult to lose a parent, let alone both. You can take distributions from the inherited IRA in three ways:

1. Single Lump Sum (liquidate the account and take the cash all in one year)
2. Take the account balance out over a five-year period, paying income tax each year on the amount that you withdraw.
3. Take the balance of the account out annually based on your life expectancy. The distribution must begin in the calendar year AFTER the year in which your mother passed away. In this case, your first distribution should come in 2008.

All distributions will be taxed as ordinary income, just like your salary.

Insurance

Question: I'm a 51 years old, married and self-employed in good health with two adult children and two teenagers. I currently have a disability insurance policy, but I'm considering purchasing a long term care policy. I do not believe my budget will allow for both. Is there a general guideline or "rule of thumb" for determining the optimum time to drop a disability policy in favor of a long term care policy?

Answer: You are facing a quandary that many people face. Your current income protection weighs much more importantly than the possibility of long term care, at least in my view.

You may consider mitigating the cost of a long term care policy by reducing the benefits so that you are only partially protected. For example, let's say you are considering a long term care policy that pays benefits of $175 per day, with a 90-day elimination period that pays lifetime benefits. This will be a more expensive type of coverage.

Consider a policy that pays benefits of $75-$85 per day, with an elimination period of 180 or 360 days that pays benefits for up to five years. This may not cover your entire expenses of long term care; however, it will assist your family in paying for a portion of those expenses.

You can also apply for a long term care policy with an insurance company that would consider raising your benefits (and your premium) as you are closer to retirement.

As far as dropping a disability policy, my "rule of thumb" is as long as you need to protect that income, keep the policy in force. However, if your wife is able to go back to work or is currently working, you may be able to lower some of your disability coverage with your insurer to save premium dollars in order to pay for your long term care coverage.

FPA offers resources designed to help the public understand the importance of financial planning and the value of objective advice from a financial planner. The above is provided only as guidance. Before making any financial decisions, be sure to seek the advice of a Certified Financial Planner™.

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