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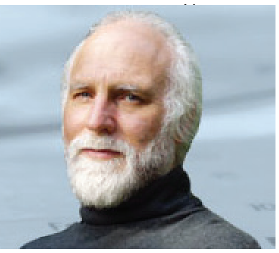
inside information



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Special to this issue:

Out of the Box and On the Money

Synopsis: ***Here's a fresh look at how to keep clients on track for retirement, and keep them from overspending once they get there.***

Takeaways: ***Create three policy statements for clients: the Investment Policy Statement, a Retirement Savings Policy Statement and a Withdrawal Policy Statement. Monitor the clients' annual savings rate, and calculate how much of their anticipated retirement spending can be cut if the markets go south at the wrong time.***

I might as well come out and say it: Jim Shambo, of Lifetime Planning Concepts in Colorado Springs, CO, has made as many important contributions to financial planning thought leadership as the more-famous Bill Bengen (author of the 4% rule, first person to map out sequence-of-return risk in retirement). So I watched with great interest Shambo's capstone presentation at the AICPA PFP Conference in Las Vegas—the last thing he would do professionally before he retired at the conference's end.

Some of you may not have heard of Shambo, or his contributions, but that will change here. Your most likely intersection point would have been his authorship of *The Hedonic Pleasure Index*, published in the November 2008 issue of the *Journal of Financial Planning*. There, he demolished the idea that advisors

EARLY WARNING

•Julie Littlechild--one of the leading practice management and marketing thinkers in our profession, is collecting data via a quick survey on client engagement. You can find it here: https://www.research.net/r/Y8QZD2B. This newsletter will report on the research results as they're released, and they should be VERY interesting.

This year's T3 conference (February 10-12, 2016 in sunny Ft. Lauderdale), still has a handful of openings, and Inside Information readers receive a $150 discount on the $499 registration price. To register for the conference, you go here: http://www.technologytoolsfortoday.com/conferences and insert the discount code: VEREST3 (all caps).

Make plans to include my Insider's Forum conference--September 19-21 at the Hotel Del Coronado near San Diego. Visit our website and see the full schedule at: http://www.insidersforum.com and register with coupon code INSIDEVIP for a $150 discount.

Jim Shambo: Don't rely on the CPI--or Monte Carlo.

should rely on the Consumer Price Index for their inflation adjustments when they model client spending in retirement. (You can see my writeup of his positions here: *file:///Users/bobveres/Downloads/the-fallacies-in-today-s-retirement-plan-assumptions-putting-the-hedonic-pleasure-index-to-work.pdf*). As a much better alternative, Shambo suggested that you look at actual spending data compiled by the Bureau of Labor Statistics in its CEX surveys—and, of course, you should also factor in the actual spending habits of your clients. You'll see some of this thinking shortly, but the bottom line is that for many clients, the CPI does a poor job of capturing actual changes in expenditures.

More recently, Shambo has authored a review of the most important research into retirement planning, called The *CPA's Guide to Retirement Planning*, which includes some of his insights interwoven with detailed explanations of the research authored by better-known figures such as Wade Pfau, Michael Finke, David Blanchett, Jon Guyton and Michael Kitces. AICPA PFP Division members can get it free: *http://www.aicpa.org/InterestAreas/PersonalFinancialPlanning/Resources/RetirementPlanning/Pages/Retirement.aspx*.

Not an AICPA member? The ebook can be purchased for $55 at: *http://www.cpa2biz.com/AST/Main/CPA2BIZ_Primary/PersonalFinancialPlanning/PRDOVR~PC-PPF1501E/PC-PPF1501E.jsp*.

Shambo's presentation can be viewed as a short-hand index to the contents of the *Guide*, where he pulled out and expanded on some of the key insights that advisors can incorporate into their retirement planning advice.

It was organized around a variety of risks to your clients' financial security in retirement.

Modeling Savings Rates

The early part of Shambo's presentation honed in on future spending assumptions extrapolated from today's budget. Suppose you're sitting across from 50-year-old clients, and you've defined their current spending, assumed that the mortgage will be paid off at their retirement date, estimated that they'll be traveling more often, and generally nailed down their expected spending in retirement. Later in this presentation, you'll see a more detailed view of this process, but for now, the presentation focused on a pair of innocent mistakes that can have disastrous consequences:

1) Growing this retirement spending figure by the inflation rate between now and the retirement date; and

2) Using that expected retirement spending figure as your basis for calculating how much the clients need to accumulate in their various retirement portfolios between now and the day they receive their gold watch.

What's wrong with that? Shambo pointed out that one or both of these clients will probably get promoted several times in the next 15-20 years, and they will certainly receive numerous

Identifying pre-retiree's personalized inflation

30 year old couple Current wage $75,000 Annual Savings Rate = 12% Annual dollars saved - $9,000	Dollars	%	Share of Raise to each category
Raise	$4,125	5.5%	
CPI-U – Maintain current SOL	-$1,500	-2.0%	36.36%
Portion Saved – for future SOL includes 6% 401(k) and 6% employer match	-$ 500	-.667%	12.12%
HPI and taxes – Increase current SOL Includes estimated additional income tax of $725 at 20% effective tax rate	$2,125	**2.833%**	51.52%

raises and bonuses along the way. With that higher income, they'll increase their standard of living. By how much? It's impossible to project, but every standard of living increase will raise future retirement expenses and make your initial savings goal increasingly irrelevant.

If you can't predict how much the clients will increase their lifestyle, then how can you give meaningful retirement planning advice? Shambo's solution is to create a Retirement Savings Policy Statement, which allows you and your clients to model, year-by-year, their savings and spending habits in relation to their retirement goals.

The core assumption with the Retirement Savings Policy Statement is that most of us need to maintain a constant 15% savings rate to afford retirement at roughly the lifestyle that we will end up with at the end of our careers. This assumes a 30-year worklife and a 30-year retirement, and the numbers to support this come from, among other places, Shambo's summary of Wade Pfau's research, which he did not present but which is in the *Guide*. This target savings rate can be raised or lowered if the work/retirement years ratio goes above or below 1:1, and can certainly be modified due to special circumstances.

How does this change the way you give advice?

"The RSPS starts with a very simple calculation," Shambo told the group. "It looks first at what the client is saving as a percent of income. Then it bifurcates future annual raises into three areas."

You can see an example in the slide above, which shows a 30-year-old couple earning $75,000 a year, and saving $9,000 of it: a 12% current savings rate.

Now suppose these clients get an annual raise equal to $4,125, increasing their income by 5.5%. In the calculations that go into the Retirement Savings Policy Statement, Shambo divides the additional income into three components. The first is the proportion of the raise that will go toward maintaining the clients' current standard of living, which might be calculated using a modification of the Consumer Price Index. (Shambo showed how different parts of the country, and even different cities, experience different inflation rates as measured by the Bureau of Labor Statistics; you can find the numbers here: http://www.bls.gov/regions/home.htm.)

These clients will spend $1,500 more a year just to hold their ground with their existing lifestyle. In column 3, we see that this represents a 2% increase in their annual spending, and column four shows that this accounts for just over a third of the total raise.

The second component is the amount that will be saved out

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of this increase in income—in this case $500, or .667% of the new income total. On the right, we can see that this raises the clients' savings rate from 12% to 12.12%.

Finally, in the bottom rows of the chart, we can see that these particular clients' will spend $2,125 of the raise on increased lifestyle expenditures plus additional taxes—raising their annual spending rate by an additional 2.833% that is not accounted for in the traditional retirement planning software—over half of the raise.

"This is important," Shambo told the group, "because you might be doing a projection and inflating the individual's need by the inflation rate—around 2%. Here," he added, "you can see that we should probably be inflating that need by more than 4.8%, which will give you a completely different level of standard of living when they reach retirement—which, in turn, will require a very much larger nest egg."

What does all this have to do with the Retirement Savings Policy Statement? The policy statement would set a savings percentage goal for the client—in this case Shambo is assuming 15% a year. This simple worksheet shows that, with this increase in income, the clients have made very little progress toward that goal. It's time to have a conversation.

"The retirement policy statement will help you monitor how clients are adjusting their savings and spending rates over time," Shambo told the group. "And it lets you really get a feel for how much they're spending relative to each raise."

Advisors who use the CPI to calculate future lifestyle expenditures could be missing decades of standard-of-living increases.

Suddenly, as a result of one simple chart, the Monte Carlo projections of spending increase, and the recommended savings rate to reach retirement goals, begins to look rather quaint and imprecise. One might argue that this, alone, is a significant breakthrough contribution to how the profession should be creating and monitoring retirement plan accumulation.

Portfolio Risks

The second set of retirement risks are relatively straightforward, and the most troublesome of them were outlined by Bengen: the risk that returns won't cooperate with the retirement plan you devise. When modeling this risk, Shambo recommended that you throw away the Monte Carlo numbers and perform a simple stress test for clients. Instead of telling them they have a 90% chance of success, look at the maximum one-year loss of the diversified portfolio you've created for them. Shambo recommended that you go back to 2008, and hypothesized that the maximum loss for a hypothetical portfolio would be 22%. (Your assumptions may vary.)

Then walk right past your optimizer to a spreadsheet, and assume that this 22% loss occurs in the first year of the clients' retirement. Further, assume that some other losses are front-weighted in the early years, at which point the returns come back to normal and deliver a long-term performance closer to the averages. "Let your clients know that you tested this portfolio that you recommended with the worst-case scenario right out of the gate," Shambo proposed.

If the clients are in no danger of running out of money over the next 30 years, based on this analysis, then you're probably looking at a pretty safe retirement plan. But chances are the worst case scenario will lead to a shortfall down the road. This analysis provides some important information that the Monte Carlo simulations do not: just exactly how much of a shortfall the client would be looking at in some of those failures buried in the cheerful "90% chance of success" analysis.

More importantly, it helps you model what can be done about it. You can devise a plan for managing the worst-case scenario if it manifests.

How? Shambo proposed that you add a Withdrawal Policy Statement to your Investment Policy Statement and the Retirement Savings Policy Statement for your clients. The Withdrawal Policy Statement concept was created originally by Jonathan Guyton, reproduced in chapter 5 of the Guide.

How do you create this document? "You ask clients: *when bad times happen in retirement, how will you react?*" Shambo told the group—meaning that clients will agree to scale back their retirement spending if the markets go down, and cut back more if the markets are terrible. "Then you document it," Shambo added. "Get them to agree, so that when bad times happen, when they come in, we can bring out that withdrawal policy statement and say, this is what we said we were going to do. Are we ready to do it?"

Modeling to the Penny

Shambo has created an interestingly detailed method for estimating a client's first-year retirement spending—the amount that will be inflated in all later retirement years by a customized inflation rate. To get at that number, he creates a 5-column spreadsheet with eight sections. I've reproduced two of those sections here: the one that relates to heathcare spending (which Shambo described as the biggest retirement spending wildcard) and the last one, which lets you see the total sums in each column.

Table 14-2: Retirement Needs by spending priority – Page 106 First Section

Expense Category		Current from QuickBooks	Adjusted for Retirement	Basic needs	Wants	Dreams
Healthcare						
	Health Insurance	$17,800	$13,000	$13,000		
	Medical Services	9,500	6,000	6,000		
	Long Term Care Insurance Premiums	6,300	2,500	2,500		
	Dental Services	4,500	1,000	1,000		
	Drugs and Supplements	1,000	1,000	1,000		
	Acupuncture, Chiro & Massages	600	1,600	0	$1,600	
	Eyeglasses	0	200	200		
Total Healthcare		$39,700	$25,300	$23,700	$1,600	$-0-

Table 14-2: Retirement Needs by spending priority – Page 107 Final Section of 8 Sections

	Expense Category	Current from QuickBooks	Adjusted for Retirement	Basic needs	Wants	Dreams
	Durable Goods annual savings or payments	$0	$3,600	$3,600		
	Employer Provided Costs assumed in retirement	$0	$0	$0	$0	$0
TOTAL OTHER ITEMS		$0	$0	$3,600	$0	$0
TOTAL BEHAVIORAL SPENDING		$89,560	$126,700	$70,350	$46,350	$10,000
	Income Tax estimate	$95,000	$27,000	$27,000		
TOTAL RETIREMENT EXPENSES		$184,560	$153,700	$97,350	$46,350	$10,000

Column one is the client's current expenditures in a wide variety of categories—travel, buying a new car every few years, and of course food, housing eating at restaurants etc. The second column adjusts each amount for retirement; for instance, in retirement the mortgage will be paid off and monthly gasoline expenditures might be lower when the commute to work has ended. Parking fees won't apply

Table 14-3: Cash flow and estimated needs - Page 109	Adjusted for Retirement	Basic needs	Wants	Dreams
Total Retirement Expenses	$153,700	$97,350 (63% of total)	$46,350 (30% of total)	$10,000 (7% of total)
Less: Social Security at age 70	(63,000)	(63,000)		
Net Retirement Expenses for asset coverage	$90,700	$34,350	$46,350	$10,000
Meeting this Cash Flow Need:				
1) Annuity 8% Payout to cover basic needs and wants		$429,375	$579,375	
OR Without annuity:				
1) Assets Needed at 4% IWR	$2,267,500	$858,750	$1,158,750	$250,000
1) Assets Needed at 3% IWR	$3,023,333	$1,145,000	$1,545,000	$333,333

in retirement, and there may be a lower expenditure for business clothing.

This adjusted figure is then subdivided into three categories: basic needs like food, shelter and, in the case of this first page of the worksheet, Medicare and supplemental insurance, medical services, LTC premiums, dental services etc.

As the reader can see, Shambo normally recommends airtight health insurance coverage as a way to replace potentially catastrophic unknown expenses in the future with known expenses along the way.

The next column estimates the costs of things that that were included in future expenditures that are "wants." These are things which can be eliminated when the client faces hard times. And the third column puts some expenditures into a "dreams" category which might be called stretch goals, and which would be the first expenses to go if the markets went the wrong way.

This accomplishes several things. First, the advisor monitoring this spreadsheet can monitor how actual spending matches up with those last three columns, especially the two on the far right. If the client is spending more in retirement for one or another category than the estimate, then something else would have to be reduced. If the market portfolio experiences severe sequence-of-return setbacks, the advisor knows exactly where to recommend a reduction in spending.

In addition, and related to that recommendation, the spreadsheet makes it possible for the advisor to evaluate how resilient these clients are likely to be should they face a severe downturn. If discretionary spending—the two right-hand columns—makes up more than a third of overall spending, then the Withdrawal Policy Statement will have particular effectiveness, because there is more room to cut back without affecting the basic survival needs. In this case, discretionary spending is 37% of the total, in the safe zone.

What would a non-resilient client look like? What could cause the basic needs column to represent 75% or 90% of overall spending? Excessive debt is one. Others would be lifestyle assets like a house or boat, which cannot be easily monetized and impose fixed expenses.

In his presentation, Shambo offered Table 14-3, which shows how nervous clients could identify cash flow products to cover their basic needs. In this case, he subtracts out Social Security benefits, which is the ultimate cash flow product, and then calculates the amount that these particular hypothetical clients would have to allocate to an immediate annuity to pay for their basic retirement expenses. If the client wanted to ice down the "wants" as well, then Shambo has calculated that (larger) annuity amount. At the bottom of the spreadsheet, he has also calculated the portfolio size that would be needed to cover, respectively, the client's basic needs, the wants and the dreams, based on different safe distribution ratios.

Conclusions

There was a lot more to the presentation, but in my opinion, these were the groundbreaking insights. Shambo talked about having a conversation about retirement housing with clients, and addressed some of the mathematical assumptions that economists and researchers make which don't map out very well to actual flesh-and-blood behavior. In one example, he noted that most of the research that has been conducted on retirement spending is almost certainly skewed, because it is generally collected from individuals who are meticulous about keeping records—and who will therefore tend not to be spendthrifts.

Shambo also addressed the idea of recommending deferred annuities, which look terrific on paper, but many clients will be reluctant to give an insurance company $125,000 with no expectation of receiving any money back until they reach age 85—IF they do.

But the focus was on the *Guide*; one of the profession's most original, out-of-the-box thinkers offering his perspective on a collection of the very best thinking in the retirement space. Shambo hasn't gotten the recognition he deserves as a thought leader, perhaps because he belongs to the accounting tribe which infrequently overlaps with the CFP, FPA, IMCA and NAPFA tribes.

If you buy the *Guide*, and start incorporating some of the more advanced client analytics it provides, you might also pause for a moment to appreciate the out-of-the-box, on-the-money thinking Shambo has lent us over his career. ■

Investing

Follow-Through

Synopsis: ***What's new at Max My Interest and Performance Trust?***

Takeaways: ***Performance Trust has created a new platform for advisors whose clients invest in individual bonds. Max has a new platform for advisors who want to maximize the interest return on their clients' cash holdings.***

Recently, we wrote about Max My Interest (https://www.maxmyinterest.com/), a service that allows advisor clients to park their cash in the highest-earning online savings accounts—potentially generating an additional 100 basis points on the money that was formerly sitting around in their checking accounts. (See the December 2015 issue, page 19.) Cost is two basis points a quarter; a total of eight a year.

The service automatically redeploys money in the highest-paying options each month, automatically sweeps out money from the client's checking account, automatically limits the account sizes at each online bank so as to have FDIC insurance coverage, and at the end of the year, it produces a tax report showing everything the tax preparer would need to account for this income.

What was missing in Max My Interest was a way for the financial planner to track the assets of clients who are participating in the Max service. That has changed, as the company has created Max Advisor Dashboard, which can be accessed here: https://www.maxmyinterest.com/advisors. Advisors who sign their clients up for Max My Interest will now be able to track and manage those assets.

Specifically, the dashboard enables advisors to see their clients' cash balances across multiple institutions on one screen. They can see the status of each client's optimization, view the next scheduled optimization, see the weighted average yield being earned across all their linked savings accounts, and the system will calculated the estimated annualized interest income. You can also refresh client balances.

Max My Interest will not allow advisors to take money out of any of the accounts, which means you aren't going to be deemed to have custody of the money. The service has put an uncommon amount of energy into cybersafety, and one of the checks and balances is that it is a closed system. Meaning? Money can be swept from the client's checking account into the client's online savings accounts, and moved back again, but it cannot leave the savings accounts in any other way.

The number of participating banks is growing, but for now, to move money in and out of the online institutions, your client would need to have a checking account at one of these institutions: JP Morgan Chase, Citibank, Wells Fargo, Bank of America or First Republic Bank. Participating online banks include: GE Bank, Barclay's Bank, Ally Bank, Capital One 360 and American Express Personal Savings.

The IMA works much like a traditional SMA, but without taking discretion, and without adding a quarterly AUM fee.

Performance Trust

In our December 2013 issue, we reported on a company called Performance Trust Capital Markets (*http://www.performancetrust.com/ptag)*, a Chicago-based institutional bond consultant which, several years ago, opened up its services to the financial planning community. Advisors provide Performance Trust with information about a specific client's current bond allocation, and the company goes through an analytical process that shows an optimal combination of bond types (long or short duration, premium or discount, callable or non-callable), based on something called "shape analysis."

This author was surprised to discover that there are nearly always better solutions than the traditional bond ladders, based on total cash outcomes for different types of allocations under interest rate assumptions from a steep drop in rates to a steep increase. Not uncommonly, a particular barbell approach will outperform ladders under all plausible future scenarios.

In addition, Performance Trust will shop the market for the bonds to implement these recommendations, provide transparent cost information and also create a due diligence file on each purchase. As the clients' bonds mature, the portfolio can be incrementally moved to this more optimal allocation.

Thus, advisory firms could delegate most of the hard work of investing in individual bonds without giving up discretion. However, the arrangement wasn't enough for advisors who like the convenience of mutual funds or separately-managed accounts (SMAs). So the company has recently created a service for advisors to offer individual bonds to their clients that is nearly as convenient as a mutual fund, and looks a lot like an SMA. Performance Trust's preferred term is "Internally Managed Account" (IMA).

It works much like a traditional SMA but without the outside firm taking discretion. For select clients, advisors give their custodian authorization to show Performance Trust the current and ongoing bond holdings of those clients without also giving any trading authority. At the same time, they shift their bond trading with the custodian to prime brokerage, and segregate those clients' bond holdings into a separate account. "That way, instead of doing ten trades for ten different clients, we can do one trade and allocate the bonds to those ten clients," says Brian Battle, director of trading at Performance Trust. "It's less expensive and more efficient for us to create an Excel or CSV file, and put all the allocations together, so the advisor can upload it to the custodian. And," he adds, "it also means we'd only be looking at the clients' bond holdings, rather than all their assets."

Perhaps most importantly, the IMA arrangement allows Performance Trust to perform its shape management analytics on the client's current holdings, and buy strategically (as cash becomes available) to move the client toward a higher-return, safer allocation. The firm has an algorithm which will examine every one of each clients' bond positions initially and every night, and make recommendations to the advisor on how to deploy assets. Each client could potentially have a unique mix, and often will.

This is not a market-timing device. The IMA would only recommend a sale if Performance Trust analysts detect a change in credit quality on existing holdings, or if the economics have changed—for instance, if a 10-year bond has moved down to a one-year maturity, and the economics dictate a longer duration.

The great majority of the recommendations will be redeploying money. "If there's a cash event—if a bond matures, if there's a call, or if there's a coupon in there, we're going to notify the advisor and make our recommendations," Battle explains.

Shape management was described in our earlier article, but it's worth explaining once more. Performance Trust creates a graph which shows the client's 10-year bond ladder, and then evaluates all the possible weightings of 3-year, 5-year, 8-year, 10-year and 15-year maturities. This produces a second graph, which shows an optimal weighting. Based on the pure mathematics of the two investment options—the coupon (cash) returns plus the future value of the remaining bonds—the current and recommended portfolio are compared under seven scenarios over the next three years: if interest rates stay the same, if they go up or down 1%, 2% or 3%.

The goal, which is often achieved, is to find a mix of bond maturities that will outperform the current allocation in all scenarios—and, for advisors, the emphasis will be on rising-rate environments.

"The thing about this is that it's mechanized," says Battle. "We can do this for thousands of accounts."

If there's cash in the account, advisors will receive a list of recommendations, and they can approve them—or not. "You can say, I approve of Clients 1, 2 and 3," says Battle. "But I happen to know that Client 4 is buying a boat, so don't invest their cash this week. We are not," he emphasizes, "doing any activity without the express consent of the advisor. We have no discretion on these accounts."

The goal of shape management is to find a mix of bond maturities that will outperform the client's current allocation in all future interest rate scenarios.

Each advisor receives confirmation after the IMA transactions have been made, with a summary for the client's file that shows the bonds that fit into each sector, with the names, type of bond, ratings, coupon, maturity, yield-to-maturity and the tax-equivalent yield.

You also get that graph, which shows the clients' original holdings, current holdings and the target holdings—the model portfolio—which shows the progress toward the target allocations. The report also projects cash flow in the client's IMA for the next 36 months, including principal and interest.

For now, Performance Trust's Internally Managed Account service is limited to muni bonds, which (at today's rate spreads) happen to be ideal for clients in higher tax brackets. The plan is to expand the service to other bond categories in the future, possibly as early as this summer.

"What we're addressing here is ease of implementation," says Battle. "For advisors, time is of the essence. Instead of poking around trying to decide, should I buy a 5-year or an 8-year for the Johnson family, and should I invest $50,000 or $80,000, we give them an advise and consent role. We have 200 people who analyze bonds all day long," he adds. "Advisors can leverage our expertise."

Cost? 15 basis points at the time of each transaction, which means if the bonds are yielding 3.15%, the markup would take that yield down to 3.00%. "We buy them at 3.15 and sell them to you at 3.00," says Battle. "And we only charge for the bonds we buy for you, rather than a quarterly fee on the total account." This may be the biggest difference between the IMA and a typical SMA that charges 30-40 basis points a year.

Basically, the IMA is leveraging Performance Trust's institutional scale. "We're not just buying 50 bonds for somebody's client," says Battle. "We may buy 5 million in one transaction. And that client will get 50, while an insurance company might take two million, and a bank will take another two million. Everybody we've talked with about this," he adds, "says they've never seen anything like it before—and we've talked with custodians, advisors and institutions." ■

Client Services

Social Security Made Easy

Synopsis: ***Social Security Advisors will not only create a customized claiming strategy for your clients, but also implement it through the Social Security Administration.***

Takeaways: ***Recognize that clients who go through the claiming process, online or in person, may not get what they are asking for. And don't make the mistake of assuming that Social Security benefits will vanish if/when the trust fund runs out of money.***

By now, pretty much everybody knows that Congress has made the file-and-suspend Social Security claiming strategy much more complicated, and has restricted the people who can take advantage of it. Today, only persons age 66 or older can have their spouse claim a spousal benefit on their (the over 66 person's) account, which is a great advantage, because these spouses can receive Social Security checks while allowing their own retirement credits to accrue to age 70, and then switch over to claim maximum benefits based on their own account thereafter. Meanwhile, those age-66-or-older persons, the ones who suspended their benefits, can allow THEIR credits to accrue in the same way.

For everybody else, this strategy is effectively over. Meanwhile, those eligible individuals face a deadline: they have to file and suspend by April 29 of this year—a deadline that is awfully close for planning purposes. (People who have already filed and suspended are grandfathered.)

You might think that it's pretty straightforward to send your clients to the nearest Social Security office with instructions to file, then suspend their benefits, then have the spouse claim the spousal benefits based on the suspended record. Matthew Allen, founder of New York-based Social Security Advisors and himself a former financial services professional, agrees that it should be simple—in principle. "Why should there be a problem?" he asks. "But unfortunately, we're finding that it can be hit or miss if clients try to do it on their own," he continues. The Social Security Administration employees at the lower level are often not aware of the options. What ends up happening is that they mistakenly default to the deemed filing rule, where Social Security will pay out benefits on the highest records available, taking into consideration all the benefits that the couple is eligible for. Then Social Security will pay out on both records, as opposed to allowing both to continue to accumulate credits."

> ***"We don't make advisors learn any software or navigate the 2,728 Social Security Rules."***

Allen has also seen people go to their local Social Security office and file for benefits a few months before their actual birthday, to make sure they start on time—and come away with costly results. "If they don't word it exactly correctly with the Social Security Administration, if they don't have an employee who really understands what they're intending," he says, "it could easily end up where they miss out on retirement credits."

Social Security Advisors is a rapidly growing resource for advisors, and the recent rule changes have made Allen's business more attractive and his life more complicated. The firm works with advisors to identify a customized maximum Social Security strategy, which details exactly when and how the clients should file to maximize their benefits—a service that can make a $50,000 or more difference in total retirement income. "We don't make advisors learn any software program or navigate the 2,728 Social Security Rules," says Allen. "We do it for them, customized to each client."

Getting the strategy right is step one. Step two is helping clients with the actual filing, making sure that the paperwork—

"The basic strategy is to suspend your benefits until they no longer exist."

"I'm not following him until the market is down another 15%."

and the benefit package—reflects the strategy.

"This is really one of the last things that advisors want to get into," says Allen. "We set up a GoToMeeting session with the clients, and we fill out the application for them, including the special comments box that describes their particular strategy. It typically takes about 25 minutes to complete a Social Security filing online, and at the end of the process, we turn over control of the mouse. The clients can use the mouse to sign the application so it is submitted to the Social Security Administration," he adds. "We send them and their advisors a copy at the end of the process."

This service is available to the public, and also to advisors; the advisor-related version is called Social Security Concierge. Cost to advisors is $99.95 for the strategy and an additional $99.95 if the advisor and client want to take advantage of the filing service. (You can find Social Security Advisors here: h*ttp://www.SocialSecurityAdvisors.com*.)

After working with advisors on Social Security issues since 2008 (Allen doesn't do planning or investment work), what has he seen in the advisor community? "Most planning professionals have a lot more expertise in estate and tax planning than in the nuances of Social Security," he says. "And so they miss out on a lot of ways to add income to their clients' retirement, which they can add just by understanding the options."

Allen also thinks that advisors are undervaluing Social Security benefits in their retirement projections—particularly for younger clients. "We're consistently seeing Social Security as an afterthought in the financial plan, when actually it should be thought of as a portion of their clients' fixed income allocation," Allen says. "Over and over again, we run into advisors who say to their younger clients, well, Social Security is in a shaky position, and we can't rely on it, so we'll factor it in as a zero."

He points out that, according to the most recent government actuarial projections, if the system isn't tweaked, the worst-case scenario is that the Social Security trust fund will be exhausted in 2033, at which point beneficiaries will receive an estimated 77% of the promised benefits, paid directly from current workers.

"Seventy seven percent is obviously a lot different from zero," Allen comments. "I think it's a big mistake to factor it in as a zero."

It's hard to see why advisors would want to go through the labor of navigating the Social Security system on their own when they have an outsource option at this price point. Now that Congress has created a certain immediacy for certain clients, and given the less-than-stellar competency of the Social Security staff, this may be a great time to contact Social Security Advisors on behalf of those clients for whom the April 29 deadline may be relevant. ■

Practice Management

Tales of Data Conversion

Synopsis: ***How painful is it, really, to move your client data to a new portfolio management system?***

Takeaways: ***There are actually a number of advantages, including having a consultant help you clean up your data. Decide how far back you want to go, flag any nontraditional investments, and make sure you make an internal commitment to participate in the process.***

Most advisors who are using legacy portfolio management software have probably thought about switching at one time or another. But they're stopped by fear of what the data conversion might entail.

Is the process really as painful as they're imagining? To find out, I asked Rob Major of AssetBook (https://www.assetbook.com/), which created the Radar portfolio management software, to give me three challenging examples of conversions from three legacy portfolio management programs—and I asked him to get into the weeds a little bit on how each conversion was handled.

Let's start with Michelle Smalenberger, vice president and director at Kabarec Financial Advisors in Palatine, IL. Smalenberger is a financial advisor who also handled operations duties at the firm during the conversion process from PortfolioCenter to Radar, and before that from Advent to PortfolioCenter.

Advisory firms usually have to reach a pain point before they're willing to go through the hassle of converting their portfolio data. "In our case, we wanted to get away from having to fix things," says Smalenberger. "With both of the other systems, every time we found an error, we'd have to re-run the performance intervals for that client, and sometimes for a handful of clients, before we could run a report. We wanted a dynamic system where you fix something and the whole database is updated right there in real time."

> ***Your first question: How far back do you want to go when converting data to a new system?***

Her firm also was looking for a way to outsource the downloading and reconciliation process—a service that is bundled with Radar's software. "We needed our time back," Smalenberger explains. "We're growing, and we don't have the luxury of doing things we don't need to be doing."

Finally, the firm was looking for a package that included a portal where clients can view their accounts in an engaging way.

Scope of the project

The data conversion can be a big or small challenge depending on the cleanliness of your data. Smalenberger says advisors might be surprised at how many small errors can accrue in their client performance history over the decades. "Firms like us, that have been doing the downloading and reconciliation in-house, will have years and years of errors," she says. "You say to yourself, we'll never run that report, and move on."

These errors were a bigger issue in the Advent-to-PortfolioCenter conversion than the more recent one, but it forced some trade-offs in both cases. The most fundamental trade-off was deciding how far to go back when cleaning the data.

"In the first conversion, we decided to only pull in the data for the last ten years," says Smalenberger. "It was going to cost a lot more to go back and fix everything before that, so we set a cutoff point."

For Kabarec, this wasn't painful, because the firm had never provided since-inception performance data to clients. "If you gave out performance since inception every quarter or every year," says Smalenberger, "then you'll probably need to have clean data all the way back. Our reports are always quarter-to-date and year-to-date."

Major says that a relatively small handful of advisory firms run annualized rates of return going back to the mid-1980s. "If they've been doing it for years, and it makes sense for them," he says, "then it's going to be a lot more work to audit that much information, going back that far."

Process and problems

The conversion process started with a handful of reports from the PortfolioCenter system, showing internal rates of return, beginning and end value and the net flow. Major's staff then compares these numbers to the IRR reports coming from Radar, looking for discrepancies. "In this case," he says, "those initial reviews were very good."

But not everything went smoothly. "We have a couple of holdings that are not listed at our custodian," says Smalenberger—private investments in startup companies and oil and gas programs. "Our clients get a dividend check every month, so we want to show those returns in their statements," she continues. "But it's tricky, because there are so many different components to the returns of those investments."

"We don't have any problem accounting for the held-aways," Major says. However, in this case, the outside investments had been tracked in Advent, then PortfolioCenter, as if they were held in the custodial accounts, and then later they were pulled out and tracked separately. "They took those investments out of client portfolios," says Major, "but—and this is not uncommon—rather than using transactions to facilitate that, they just moved the position out."

Michelle Smalenberger: "We don't have the luxury to be doing things we don't need to be doing."

So? "The problem that caused for us is, if I had a $100,000 held-away one month, and then at some point in time, all of a sudden the position is gone—that shows up as a big loss on the performance side," Major continues. "It took about 30 days to get it all resolved."

What about tax reports? In general, the conversions for stocks and funds held at the custodian are simpler today than they were five years ago, because today the custodians keep all the tax basis information in their own database. "The custodians started sending reconciliation files on a daily basis," says Major. "So I can actually reconcile our tax lots against the custodian tax lots, and find out if there's an issue." In the Kabarec conversion, it wasn't necessary to pull the tax lots from PortfolioCenter.

Side-by-side

Another issue for advisory firms is how long to run their old system alongside the new one—in parallel. This can save a lot of problems down the road if the new service provider turns out to be dysfunctional or unable to handle your data.

"Before we switched from Advent to PortfolioCenter, we actually tried to do a conversion with an outsource provider," says Smalenberger. "We ran their system alongside Advent for three quarters, and we were so thankful that we did, because we didn't end up moving forward with them. It was a nightmare."

Kabarec ran Radar in parallel with PortfolioCenter for six months, although just four of those months overlapped with the period of active data conversion. Even today, Smalenberger says, she continues to keep the Advent and PortfolioCenter software on her computers.

"Unless you decide to sell the PortfolioCenter license, you can always get back into it at any time and look at that original data," says Major. Smalenberger admits that there were a handful of times when she went back to the old software—and even back to Advent's original data—during the conversion. "I never do that any more," she says, "But last year, one of the private holdings closed, and it goes back 20 years, so all of that initial cost basis information was originally input in Advent, and I needed to verify it."

A successful data conversion requires active participation on the part of the firm. The firm can't just let the vendor handle everything, because there are a lot of judgment calls.

Challenges

Were there any unusual challenges with the Kabarec conversion? "Once we were authorized to go into their Schwab files," says Major, "we discovered that even though they were using PortfolioCenter, they had been receiving files in Advent format. Before this, I had no idea that PortfolioCenter can import and absorb Advent files."

Instead of a straight data conversion from PortfolioCenter file formats, which AssetBook has largely automated, Major had to consolidate the master account numbers into one umbrella master and then pull the data in piecemiel. Along the way, Major's team had to leave the original files as they were. "We couldn't disrupt their format in order to get our format during the parallel trial," says Major. "But eventually we started getting the files in the right format for all the masters under the umbrella."

Lessons

Major emphasizes that a successful data conversion requires active participation on the part of the firm. "No matter what system you're moving from or moving to, the implementation process has to involve heavy, heavy communication," he says. "Michelle and I have spoken dozens of times on dozens of occasions. The vendor has got to lead the advisor through the process, explain exactly what's going to happen, outline the projected time frame, and keep them aware of everything that's happening in the conversion all along the way. And the advisory firm can't just let the vendor handle everything, because there are a lot of judgment calls along the way."

Arkansas Financial Group

The second case study is interesting. Arkansas Financial Group, based in Little Rock, was founded by Rick Adkins, who was one of the early dbCAMS users. "I think it was at the first IAFP Conference for Advanced Planners, I heard a presentation on how you could be a breakaway broker," says Adkins. "I met [company founder] Dave Huxford at that meeting, and we started using CAMS pretty much immediately."

Adkins rode the ancient technology for decades. Finally, after 25 years of having to get up every morning at 6:00 and do downloads from his house or hotel room, and spending anywhere from 2-4 hours of daily work on the database, Adkins decided that it was time to try a more modern portfolio management software solution.

"My big concern was that I have to get everything to where my planning firm works just fine without me around," he says. "And I can tell you, there is nobody else who is going to get up and do all that stuff."

Looking at the software market all over again, Adkins discovered that he could also add new capabilities. For instance, Radar allows him to aggregate all of a family's accounts into a single household, so that funds can be funneled from different accounts into a centralized account that handles distributions and everything would be properly accounted for.

"Rob was able to write an agent that checks each morning and recodes those transactions from deposits and withdrawals to transfers," Adkins says, "so that it doesn't screw up our deposit and withdrawal information, which we need to see when we look at client behavior. It was one of those things we had to manually fix every quarter, and now it's basically fixed each morning," he adds.

Rick Adkins: "We had 50 people with their hands on that part of the database. Some of them knew what they were doing; others didn't."

The process

To get the conversion process going, Adkins sent AssetBook 25 years of dbCAMS data on one of his first clients. "Within a couple of days, they had it where I could pull it up in AssetBook, and it looked just like it did in dbCAMS," says Adkins. "It gave me confidence that we could move forward."

As the conversion proceeded, Adkins and his team of advisors ran similar reports for each client, a year at a time. "We created a report that gave beginning balance, deposits, withdrawals, dividends, interest, capital gains, fees, ending balance and total return," Adkins explains. "If those reports looked the same in both dbCAMS and AssetBook, we'd mark off that client, so we knew which of the others we had to focus on."

The messiest part of the conversion was cleaning up bond data before it could be transferred over. "In dbCAMS, our staff had to go in and manually enter the type of bond, the accrual method and the dates where interest payments were made—because Fidelity and Schwab didn't give you that information back then," says Adkins. "I'll bet we had 50 people with their hands on that part of the database over the years," he adds. "Some of them knew what they were doing, and frankly, others didn't."

Another issue was data on held-away assets, which were accounted for in a strange way in dbCAMS.

"The way we were doing it, if a client deposited $2,000 in their 401(k), it went in at $2,000 with a $1 'share' price value, instead of saying it was X number of shares trading at this price," says Adkins. "We had to fix all of that."

A final problem—in some ways bigger than the others combined—had to do with the fact that dbCAMS was built on very old technology called FoxPro, a programming platform that doesn't perform self-validation error checks on dates and numbers.

"There might have been a downloading error 20 years ago, and now you've got something in a date field that isn't a date; it may be just a random asterisk or character, or sometimes you have a character in a number field," Major explains. "When you try to import that data, it just throws up all over itself. We converted somewhere between 4 million and 5 million transactions, and our staff had to get a FoxPro driver to literally give us a window into the database, to find each corruption and delete or correct it.

That's purely a dbCAMS issue," he adds, "that we face every single time we try to convert from one of their databases."

Parallel and redundant

Arkansas Financial Group ran Radar and dbCAMS redundantly for almost two years, but Adkins admits that he might have been overly cautious. "I could tell sooner that it was going to work," he says. "We took it slowly, and got it piece by piece in place, and tested the data, continually running side-by-side reports. I don't think most people would have taken that long. We were pretty deliberate."

"Rick really did a super-thorough job in terms of auditing the data, which is why it took so long," adds Major. "The data in there now is absolutely pristine. That's the benefit of going through all the labor."

Stonebrook Capital Management

Stonebrook Capital Management, in Oak Park, IL, came to Radar directly from the Advent Axys program. "We converted five years of history for them," says Major.

Mark Vincent, a portfolio specialist with the firm, says that his firm had been using Axys for ten years before making the conversion. He led the push for a different program because he wanted to offload all the downloading and reconciliation labor from himself and his staff. "There was always the headache of managing all of our data in-house," he says. "With Advent, you get a disk, and you put it in, and they dump a lot of data into the system, and invariably there were problems with it—anything from a bad price, or missing a file extension, or they would have a security that is labeled wrong and the software doesn't recognize it for what it is."

Advors who have opted to do the downloading and reconciliation in-house tend to have the messiest conversions.

Looking for a solution, Vincent went through the TD Ameritrade Institutional affinity program listings. "When I saw the one from AssetBook," he says, "there was a message that said: we take really good care of your data. I thought it was interesting because nobody else said that in any of their materials."

The process

Vincent says that the conversion process ran into some early snags with individual transactions that affected multiple clients. "There would be one security where the whole sale was missed across every account," he says. "We'd have to go back and say, here is where we sold this, on this date, and we sold it everywhere. That would clear up a lot of different accounts that were getting flagged."

Comparing the data in the two databases was, at first, a daily activity. "We started off with a list of 400 items," Vincent says. "But I might cut the list in half just by fixing a few different things. You do that over and over again, and pretty soon it's down to close to nothing."

Because his firm had been doing its own downloading and reconciliation for years, there were were more problems than there would have been if an outsourcer had been handling it. "I suspect this was this a tougher assignment for Assetbook than most," Vincent says.

Major agrees that advisors who have opted to do the downloading and reconciliation in-house tend to have messiest conversions. "In our experience, most advisors don't even know they have data errors," he says. "When advisors are maintaining their own database, there could be dozens of people who have worked on it at various times over the years, doing different things, all doing it their own way. When you convert that data, we tend to uncover all of the mistakes that happened over the years."

The Stonebrook conversion ran into a few additional snafus. One is something that everybody converting from Advent will run into. "Advent requires that prices be carried through the weekend, which means there is no automated process for updating prices on Saturday and Sunday," says Major. "If a Saturday happens to be the end of the month, the system will tell you that the account owns ten positions, but it won't value those positions."

The weekend values were blank? "Yes, in Advent they were," says Vincent. "It never was an issue in our system," he adds. "We would do our reports quarterly, so if the last day was a Saturday or Sunday, we would fix that manually to the end of the last trading day. When we converted, we had to go back and take those Friday last prices and fill them them in over every single weekend."

Other problems are fairly typical for any conversion. "There are always issues around corporate actions and how those are handled," says Major. "Splits and mergers like what Google did recently will be handled differently in every system we convert, as well as every custodian that we download from. Even a share class conversion, where you move from an A to an F, can be problematic in terms of how these legacy systems will handle it."

All of this means AssetBook had to get granular with the Stonebrook reconciliation. "We audited every single month," says Major. "We were looking at the beginning value of the month, the end value of the month, what is the gain and what is the IRR of the month. We computed that ourselves and compared that to what the legacy system was saying."

Redundancy

Stonebrook ran Radar and Axys side-by-side for six months, although the conversion took just three months. "A lot of that time I didn't have anything to do with the conversion process," Vincent says. "We sent quite a lot of information over there, they worked on it for a long time and checked in with us when there were problems. Our Advent reporting cut off in late November of 2014, and we started running reports on January 1, 2015," he adds. "There was a month there that I didn't have access to any reports."

At the risk of repeating himself, Major says that the main determinant of a successful conversion is the communications between the firm and the new vendor. "This has to be a team effort—and sometimes it can be an awful lot of work," he admits. "We probably put Mark to work for 10-12 hours. Sometimes it can be more. We've been doing this for 15 years, and we know there are going to be issues that arise," he adds. "The conversions that we struggle are the ones where the firms are so hands-off that they tell us: you need to do that. If everybody works with us through the issues," he adds, "then we will have a successful conversion."

I think my biggest takeaway from this series of interviews is that conversion from an older legacy system to a newer one represents an opportunity to clean up your client data and identify what problems have been accruing, sometimes for decades. Major says that the historical data can be one of the advisory firm's most valuable assets, and he sees his firm as, in part, a data cleaning consultant.

The biggest takeaway: these conversions are an opportunity to clean up your client data and identify what problems have been accruing.

On an ongoing basis, AssetBook includes in the Radar licensing fee the downloading and reconciliation chores—in part because this saves the firm a lot of phone time with advisors who have made some kind of downloading error, in part because it ensures consistency and a certain level of expertise with the process. So the firm is also in the data maintenance business, like some of the outsource providers.

"I knew that there were things that could be better," Vincent concludes. "This was an opportunity to have people who know what kinds of problems can arise and do these things every day help us fix all the mistakes that crept in over time. I'm much more confident about our data today," he adds, "than I was a year or two ago."■

Parting Thoughts

Opportunity of a Lifetime?

As some of you know, I've been doing a lot of interviews lately to gather the best thinking on how to hire advisors into your firm—best practices for attracting and hiring talent.

The results have been very interesting, and will be reported in detail in another issue of Inside Information. But one thing I noticed about the discussions is that none of the firms I talked with are hiring ex-Wall Street brokers.

There'a a reason for this. One of the most consistent best practices that I heard was to hire for your values—on the theory that if the new hire doesn't share the values of your firm, right off the bat, it's going to be awfully hard to change them, and they may change the attitudes of others in the firm in negative ways. You can teach how to use software and estate planning techniques. It's much harder to teach (or change) values.

But… I suspect that there's a huge opportunity for advisory firms who are willing to roll up their sleeves and commit to retraining people whose values are different from theirs. I've recently predicted that the planning profession is about to experience a flood of "refugees" (as I call them) from the brokerage world, driven by four forces:

1) Some horrible new Wall Street scandal that we can't predict, but seems inevitable given the greed-driven, predatory incentive structure at the brokerage firms.

2) Increasingly intrusive FINRA regulation; that is, new rules that are coming from an organization that wants the world to believe it is not managing a sales culture, when in fact it IS managing a sales culture.

3) The absurdly one-sided compensation split that the brokerage firms have hung onto far longer than they can justify: taking for themselves 60% of an advisor's "fee-based" revenues when they could be earning a far greater percentage by working with an advisory firm.

4) This is perhaps the most powerful driver: the increasingly simple ACATs process, where, instead of going through reams of paperwork, today you can pick up prepopulated online forms, which already indicate where the client needs to sign, and the client can do an e-signature in the specified places. Moving a client over to your new custodial home can take 10 minutes instead of three weeks. No longer need brokers fear the transfer process.

Just because brokers are knocking on your door doesn't mean you have to invite them in. Why would you want to? Because every broker who migrates to the fiduciary shores becomes the worst nightmare of the brokerage office down the street. These people know what goes on behind closed doors, they know the weak spots of the competition, and they know how to bring in business.

In addition, they will bring their clients with them, adding to the size of your firm. And if you bring in one or two initially, they can become the recruiting department that helps you bring in—and train—other brokers who are interested in leaving.

Why would you NOT want to? I'm told by advisors who have recruited former wirehouse reps that it takes a peculiarly long time for them to "get" the idea that they work for clients. The way it has been described to me is that their values are broken; that is, they have heard years of lip service about working with the client, accompanied by knowing winks and nods. They have seen their compensation incentives work at cross-purposes to actually delivering the best advice to their customers. They've struggled for acceptance in a good old boy's network of older brokers who are masters of the predatory revenue and service model.

I suspect many readers are weighing the good with the bad, as outlined here, and finding the scales heavily weighted to the bad side. Why take on somebody else's mess?

But I'm also told that many of these ex-brokers would like to be idealistic; they just don't trust that there isn't some hidden agenda that they aren't being told about, hiding somewhere behind all your blather about fiduciary and client service and putting the interests of the client first. You have to build that trust, and people tell me the reprogramming can take a year or more, as they see that you're actually walking the talk. Words are less effective than actions.

My prediction is that over the next ten years, a certain number of advisory firms are going to make a concerted effort to help ex-brokers

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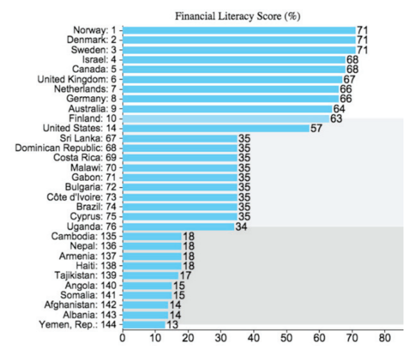

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escape not just brokerage firm employment, but also the brokerage firm mindset. As they get better at it (with the help of their initial recruits), they'll get that conversion time down to six months or less. They'll "rescue" hundreds, and then thousands of brokerage firm clients, and reclaim some of the brokerage firm talent.

In this new easy-ACATs environment, it's going to be much harder for the wirehouses to hang onto their sales agents, many of whom have been given financial planning training and even the CFP designation in an attempt to disguise their real agenda behind some real-looking services and advice. This is an opportunity that the RIA community simply cannot pass up, even though most of you, at first glance , might not consider the opportunity. ■