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WEALTH MANAGEMENT ADVISOR

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AUTOMATIC ENROLLMENT: NO RETIREMENT SECURITY GUARANTEE

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Best foot forward

Incentive trusts pass on wealth and encourage good behavior

You've built an impressive estate during your lifetime, but you have concerns about your heirs. Are they mentally and emotionally ready to manage their inheritance with responsibility and care?

To help ensure that your loved ones don't squander away the fruits of your labor — along with their own financial security — consider creating an incentive trust.

Great expectations

An incentive trust establishes specific criteria for how your beneficiaries become eligible to benefit from the trust. Rather than making distributions mandatory at certain ages or leaving them to the discretion of a trustee, an incentive trust uses provisions to reward beneficiaries for achieving a particular set of goals or behaving in a desired manner.

Incentive trusts can help:

Promote healthy lifestyles. You can structure an incentive trust to disallow payouts if your heirs engage in harmful or illegal behavior, such as abusing alcohol or using illegal drugs.

Encourage heirs to achieve educational goals. Incentive trust distributions can be contingent on your beneficiaries graduating from high school, earning certain grades, or enrolling in or graduating from college.

Celebrate personal and professional accomplishments. An incentive trust can include provisions that reward beneficiaries for becoming involved in the family business or mapping out a career path of their own.

Instill money management. You can set up an incentive trust to spread out inheritance distributions, particularly for younger beneficiaries, to allow them time to mature and learn how to manage their finances.

Endorse philanthropy. By building matching charitable donations into an incentive trust, you can help beneficiaries develop an appreciation for community service and volunteerism.

Incentive trust enforcer

When you create an incentive trust you must select someone to administer it per your instructions. An individual, such as a family member, a friend or a professional advisor, or an institution, such as a bank or trust company, can serve as your trustee. In fact, many people name both an individual and an institution to leverage their collective expertise.

With an incentive trust, your trustee's primary responsibility will be to enforce the trust's provisions. Because this can be a difficult job, make sure your trustee is willing to serve, and consider paying a reasonable fee for his or her services. In addition, provide for an alternate in case your first choice is unable or unwilling to perform.

Hiring a professional trustee can be beneficial in this circumstance because he or she has:

- No emotional bias,
- Impartiality — typically free of personal conflicts of interest with your beneficiaries, and
- Independence — sensitive to but not hindered by emotional considerations.

Conversely, choosing an individual trustee can give you additional peace of mind because he or she will be more familiar with your family. He or she also has the option of hiring professional advisors as needed.

Your wishes spelled out

When creating an incentive trust, it's important to be sensitive to your beneficiaries' unique personalities and to set attainable goals. By doing so, your heirs will be more likely to perceive the trust distributions as a reward rather than a means of control.

Make sure you discuss your intentions with your children and grandchildren. In particular, explain how the incentives work and why you're encouraging (or discouraging) particular behaviors. Remind them of the trust's positive aspects — such as its ability to provide steady income that's protected from creditors and estate tax.

Whether you're creating a new incentive trust or, if permitted, adding incentive provisions to an existing trust, be sure to make the provisions specific. For example, an incentive to pay a monthly stipend to a full-time college student could lead to a lifelong career as a student. A more effective incentive might be to pay a monthly amount based on full-time attendance at an accredited institution while maintaining a "B" average and graduating within a set number of years.

> An incentive trust establishes specific criteria for how your beneficiaries become eligible to benefit from the trust.

Also be sure to explain the incentives clearly to your trustee. It's important for him or her to understand your intentions so he or she is able to effectively enforce the provisions. (See "Incentive trust enforcer" on page 2.)

Flexibility for the future

It's a good idea to include trust provisions for dealing with a beneficiary who fails to achieve the incentive trust's requirements or whose circumstances change. For example, if a beneficiary becomes incapacitated and is unable to meet the trust's requirements, you may want him or her to still reap the benefits of the trust.

Finally, if you have only one beneficiary, the trust should provide for the disposition of some or all of the funds to a secondary beneficiary. Why? In case the primary beneficiary fails to meet the goals or dies while there are still assets in the trust, the funds will pass to another loved one of your choosing.

Legacy preserved

Creating an incentive trust is a complex balancing act. But when implemented with care and sensitivity, it can encourage your heirs to live productive lives without making them feel controlled, provide for their financial security and instill fiscal responsibility — while preserving your legacy for future generations. ■

How to get cash out of your closely held business

If you're an owner of a closely held business, it's likely that a large portion of your net worth is tied up in that business. As you approach retirement, you need to start thinking about whether you'll have the cash you need to fund the retirement you're dreaming of. Perhaps you already have a buy-sell agreement in place that spells out the terms under which your co-owners will buy you out — and the price. But if you don't, you'll need to look at your alternatives.

Selling your interest

Even if you don't have a buy-sell agreement in place, the most obvious way to turn your ownership interest into cash for retirement is to sell it.

If it's a family business and you want to keep it that way, you can create a succession plan that includes selling your stock to your children. There are several techniques that can provide tax advantages as well as help your children fund the purchase. For example, you will typically report gain on the installment method, paying tax only as principal payments on a note are received. If you sell your stock to a trust for the benefit of family members, and that trust is structured to be a grantor trust with its income taxable to you as grantor, you won't pay tax on the capital gain at all. Alternatively, you may make an outright gift of your stock to family members, or a gift to a trust, such as a grantor retained annuity trust, in which you transfer the stock but receive annual payments for a period of years.

If you have co-owners (whether family members or not) and you're ready to cash in your stock but the company is unable to purchase your interest for cash, it can redeem your stock in exchange for company assets, such as equipment. You can then sell the assets — or lease them back to the company.

If you have a management team that's interested in owning some or all of the business, you (and any other owners) can arrange for a management buyout (MBO) or leveraged management buyout (LMBO). With an MBO, the management team pools resources or borrows funds on their own to acquire all or part of the business. The LMBO is similar to the MBO, except that the buyers use company assets as collateral to secure financing.

MBOs and LMBOs are typically funded by a mix of personal investors, external financiers and the seller. The seller has provided a ready market for his or her stock and an incentive to management at the same time.

If there are multiple owners, another option is to divide the company through a tax-free split-up that allows each owner to receive a separate part. Be aware, however, that this approach can involve complicated tax considerations.

An employee stock ownership plan (ESOP) acquiring the company's stock can also provide a market for sale of your stock, and carries some tax benefits with it. This option may be especially attractive because the gain on the sale of your stock to the ESOP can be deferred and may ultimately receive a step-up in basis at your death. Bear in mind that ESOPs are costly to create and maintain.

Finally, you can sell the business to an outsider. It could take some time to find the right buyer, but this could be the best option if you don't need to make financial provisions for heirs.

Other alternatives

If you're not concerned about selling your interest but simply want to boost your retirement cash flow, consider one of these alternatives:

Deferred compensation. Under a deferred compensation agreement, your company can pay you after your retirement, either for services rendered or as payment for recognition of past work. You and your company can establish a substantial severance package before you leave its employ. The company can deduct the severance payments, if reasonable, as a business expense. But complex rules apply, so be sure to consult your tax advisor.

Covenant not to compete. Your company can pay you money under a noncompete agreement and deduct the payments as business expenses. The covenant must be reasonable in light of all surrounding circumstances. If the IRS finds the covenant to be suspect, it can treat the payments as a dividend to you, and the company will not receive a deduction.

Charitable remainder trust. You can use your company stock to fund a charitable remainder trust that provides you income and allows you to receive an income tax deduction for the current value of the remainder that will pass to charity when the trust terminates. Your children can have a right of first refusal to repurchase the stock, which may be useful if the charity has no interest in owning it.

Benefit plans. Some retirement plans — such as defined benefit plans and target benefit plans — can quickly fund large retirement accounts for older employees. Their structures allow the company to make larger annual contributions for the benefit of older employees because the contributions for the benefit of younger employees are projected to continue for a longer period of time. And the business can deduct the contributions when made, even though you don't pay tax until distributions are taken out of the plan.

Consider your goals

Before deciding on the best option for the disposition of your closely held business interest, carefully consider your financial goals. Whichever method you choose, remember that any arrangement must reflect a bargained-for agreement between you and the other parties to protect you from disputes that may arise in the future. ■

Wearing your investment heart on your sleeve?

Why emotions can get in the way of financial success

Emotions can cause otherwise rational investors to make bad financial decisions. Remember the technology boom and bust of the late 1990s and early 2000s? Or the current and ongoing subprime mortgage crisis? In both cases, many people let their emotions get the better of them and lost significant amounts of money as a result. History is filled with examples just like these.

Emotions have their place in investing, but too often they're an impediment to good decision making. As smart investors know, a key to generating successful long-term performance is to stay objective and keep your feelings out of your portfolio decisions.

Greed, fear, stubbornness and too much information

One reason emotions can come into play is that people tend to extrapolate future performance from recent trends. When the markets are moving steadily upward, for example, they may think that the good times will never end. Investors become more susceptible to greed and tempted to buy stocks at too-high prices — setting themselves up for possible big losses down the road.

In contrast, when security prices are losing ground week after week, fear can kick in. In an effort to minimize their losses, investors may unnecessarily lock them in by selling otherwise good stocks at bottom-of-the-market prices.

In difficult economic times, investors also may overlook potentially good buying opportunities, instead seeking "safe" investments, such as ultra-short-term bond funds or money market investments. But because of their limited appreciation potential, these are a poor choice for many long-term investors who need to keep their assets growing faster than inflation.

On the other hand, people typically don't like to admit when they're wrong. That stubbornness can cause investors to hold onto a bad stock (one with little potential to rebound) rather than cut their losses and reinvest the remaining proceeds into a better opportunity.

Too much information focused on short-term market conditions — made possible by the Internet and 24-hour financial news networks — can also lead to poor financial choices. When investors don't know how to prioritize what they read or hear, they may become paralyzed with indecision or resort to unprofitable strategies, such as excessive trading.

Unemotional investing

Here are a few tips for investing unemotionally:

Invest on autopilot. Automatic investment plans, offered by most financial institutions, allow you to invest set amounts of money at regular intervals. By investing on a schedule, you can avoid the temptation to buy and sell at inopportune times, and actually buy larger quantities when prices are lower.

Develop an individualized financial plan. Your financial advisor can help you determine the appropriate asset allocation for your age, future goals and tolerance for risk. Be sure to record these goals, making them as specific as possible. Stick to your plan, regardless of what's happening in the market, and meet regularly with your advisor to discuss any needed changes to your plan.

Diversify your portfolio. As the truism goes, avoid putting too many of your eggs in one basket — whether it's your employer's stock, a "can't miss" opportunity your friend is touting, or just a successful investment held for many years. Owning various types of securities that have responded differently to changing market conditions is one of your best defenses against market volatility. Knowing your portfolio is well positioned can help reduce your temptation to make poor financial choices.

Get objective advice

Emotions aren't all bad for investors. For example, the desire to provide your children the best education possible or ensure a happy retirement for you and your spouse can be an important source of motivation to invest in the first place. Your challenge, therefore, is to harness the power of your emotions without relying too heavily on them for specific financial decisions.

One way to do that is to get an objective portfolio review from a knowledgeable financial advisor. He or she can give you a balanced view of your situation and help you make unemotional decisions based on sound investing principles. ■

Automatic enrollment: No retirement security guarantee

Automatic enrollment has become an increasingly popular option for employers looking to boost participation rates in their retirement plans. With automatic enrollment, employees are signed up for their 401(k) plan by default and must opt out of the plan if they don't want to take part.

Automatic enrollment is beneficial for employees who have put off enrolling in their employer's 401(k) plan, but it can provide participants with a false sense of security that they're prepared for retirement.

Automatic risks

This first issue with automatic enrollment is that the contribution defaults are almost always too low — often just 2% or 3% of pretax salary. In many cases, that's not even enough to take full advantage of matching employer contributions. It's also not enough for most people to accomplish even modest retirement goals.

To address this concern, some employers have implemented automatic increases to the default employee contribution levels — typically up to 6% — but even that amount is insufficient for many people.

The other drawback of automatic enrollment is that employee contributions have traditionally gone into low-risk funds, such as money market or stable value funds. Again, these options may be better than nothing, but they generally aren't appropriate for younger investors — or even many investors close to retirement — because of their limited income and capital appreciation potential.

To address this concern, some automatic enrollment plans have begun to default contributions into target-date funds. They start out with a greater equity allocation that becomes steadily more conservative as retirement approaches. Even though they're a significant improvement over money market funds, target-date products aren't right for everyone, particularly individuals with plans to retire earlier or later than their fund's target date.

Take the next step

If your employer has automatically enrolled you in its 401(k) plan, take the next step toward retirement security by discussing both your contribution level and your investment options with your financial advisor. He or she can help you determine whether you're saving enough and in the right places. ■

Your source for customized investment and financial planning

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Successfully managing personal and family finances means making the right decisions today while considering their implications for the future. At Ferrell Wealth Management, our sole focus is our client's best interest, and we customize portfolios and financial plans to fit each individual's set of goals and objectives.

We provide a full range of investment management and advisory services including:

- Fee Based Investment Advisement
- Comprehensive Personal Financial Planning
- Portfolio Management
- Investment Policy Formation and Review
- Banking Services through Schwab Bank and other banking relationships
- Tax and Estate Planning
- 529 Plans
- Separately Managed Accounts
- Mutual Funds
- Government, Corporate and Municipal Fixed Income
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By working with our experienced team of advisors, you will benefit from the independent and objective perspective necessary to make your financial vision a reality.

James W. Ferrell, MBA, CFP®,CPA, PFS, CIMC
President
A Certified Public Accountant (CPA), Certified Financial Planner (CFP), Personal Financial Specialist (PFS) and Certified Investment Management Consultant (CIMC), Jim is the founding shareholder and President of Ferrell Wealth Management, Inc.

Jim is actively involved in local organizations including: Morning Star Charities, Inc. (President), Winter Park Chamber of Commerce, the University of Central Florida Foundation (Board of Directors), Winter Park YMCA (Board of Directors), on the Center for Entrepreneurship at Rollins College (Board of Directors) and is an Inductee in the UCF College of Business Administration Hall of Fame.

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A Certified Financial Planner (CFP) candidate with a Master of Business Administration Degree from Rollins College, Katie works as a financial advisor responsible for assisting clients set and achieve their long-term financial goals through investments, tax planning, asset allocation, risk management, retirement planning, and estate planning.

Katie is a member of the Winter Park Community Foundation Advisory Board and Investment Management Consultants Association (IMCA), and involved in such local organizations as the Central Florida YMCA, Orlando Chamber of Commerce, Winter Park Chamber of Commerce, and Camp Boggy Creek.

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A Central Floridian for 20 years, Mr. Negron is a Certified Financial Planner (CFP) candidate with a Master of Business Administration Degree from Webster University. Alex is responsible for assisting clients with their financial plan, which includes retirement, estate, and tax planning. He develops asset allocation plans using various types of investments in order to properly diversify and reduce portfolio risk.

Prior to becoming a member of Ferrell Wealth Management, Inc., Alex worked for Charles Schwab & Co., Inc. as a VP- Financial Consultant in Orlando, Fl.

Mr. Negron is involved with local organizations such as the Orlando Chamber of Commerce and Leadership Orlando Alumni. He holds the Series 7, 9, 10, 63, and 65 licenses.

Please call us today at 407-629-7008 to discuss your needs, or visit www.Ferrellwm.com for more information on our services.

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