The

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Court Ruling Hurts Brokers, But Is A Win For Fiduciaries

We're happy to report that the legal dispute between the Financial Planning Association and the Securities and Exchange Commission is over, and it's a victory for our firm and consumers. The U.S. Court of Appeals for the District of Columbia Circuit struck down a rule providing stockbrokers with an exemption from the Investment Advisers Act of 1940.

The FPA, the professional association for financial planners, won a huge victory on behalf of consumers and set straight a misguided effort by the SEC. The decision reaffirms an important distinction between stockbrokers, whose primary job is to sell investments, and financial advisors who provide broader services and serve as fiduciaries, legally bound to put your interests above their own.

Until late last century, most investors bought and sold securities through full-service brokerage firms whose brokers earned commissions on each transaction. Brokers, though they might steer customers to particular stocks or bonds, were exempt from the Investment Advisers Act because they were primarily in the business of selling securities, not giving advice. The brokers were required to recommend investments that were "suitable" for their customers but didn't have to register as investment advisors and act as fiduciaries.

Meanwhile, though, a growing number of financial planners and advisors began providing services to clients in a different way. To avoid the conflicts of interest that often arise when accepting commissions, these advisors instead charged fees for their advice. This approach, they said, aligned advisors' and clients' interests. These advisors operated as Registered Investment Advisors, or RIAs, and owed clients a fiduciary responsibility.

This alternative model proved popular with the public. In the 1990s, brokerage firms began offering their own "fee-based" programs. But that begged a question: were brokers who provided fee-based advice in fact still acting as brokers who were exempt from the Investment Adviser Act? Or should they be required to register as investment advisors? So the big securities firms asked the SEC for a new, broader exemption from the Act.

That's when the trouble started. In 1999, the SEC proposed a new exemption for the fee-based programs. After several years of public comment and revisions to what became known as the Merrill Lynch rule, the SEC in April 2005 adopted a final version. The new rule attempted to distinguish between brokers and advisors based on the services they provided. Those whose primary role was to recommend investments, even in a fee-based program, would be exempt from registering as investment advisors—because, essentially they were doing what they'd always done. The fee-based accounts, the SEC said, were just a new version of the old full-service accounts. Now, as earlier, investors expected and received guidance from brokers; the only change was in how they paid for it.

The U.S. Court Of Appeals ruling is a victory for our firm and consumers

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TMG's Fiduciary Status And More For 2008!

The Monitor Group is now one of the very few U.S. advisory firms to be granted the certified fiduciary designation. What is a fiduciary, you ask? The article on this page explains a recent court ruling in favor of the Financial Planning Association (of which we are members) against the Securities and Exchange Commission over just this question. This is extremely important to your wealth.

Rolling over any employer-sponsored retirement plan to an IRA (see page two) is complex and fraught with potential problems. We have navigated these treacherous waters hundreds of times. Please let us help!

There are many ways to give charitably. One increasingly popular strategy is to set up a family foundation (see the article on pages 2 and 3). This can benefit not only charities, but also your children in more ways than one.

Contemplating death and taxes may not be fun, but poor or nonexistent estate planning can create serious problems. Read the mistakes to avoid on the third page of this newsletter.

How much sleep should you get? If your answer is "eight hours a night," recent research findings (page 4) may surprise you.

We trust your spring and summer are shaping up to be enjoyable!

Cal Brown, MST, CFP®
Vice President

Retirement Rollover Do's and Don'ts

What to do with retirement-plan assets if you retire or change jobs? Normally, the best move is to roll over your money to an individual retirement account. First, though, consider:

Company stock gets a break. Shares distributed to you may qualify for more favorable capital-gains taxation instead of the ordinary tax rates for most plan withdrawals. However, the distribution must follow very specific rules.

Raiding the retirement kitty isn't smart. Besides losing the chance for continued tax-deferred growth, simply taking plan money means mandatory 20% federal income tax withholding and a big bill at tax time. But if you absolutely need the cash, consider withdrawing it before a rollover. Beginning at age 55, plan distributions avoid a 10% early-withdrawal penalty; for IRAs, the cutoff is 59½ .

Older workers enjoy an advantage. Participants born before January 2, 1936, are eligible for 10-year forward averaging, a way to cut taxes on a total distribution. This may make more sense than a rollover if you expect to spend the money soon.

Creditor protection rules are changing. Federal law shields plan assets from lawsuits, divorce, bankruptcy, and similar threats. In 2005, the U.S. Supreme Court ruled that IRAs are shielded from the reach of creditors in bankruptcy proceedings.

Currently, rollovers provide some significant advantages:

If you decide to move your assets to an IRA, the safest approach is to have your employer transfer the money directly to an IRA trustee or custodian

Rich investment menus. Typically offering many more investing options than company plans, IRAs can make it easier to construct a diversified portfolio personalized around your goals and risk profile.

Independence from your former employer. Hard times could put a company's retirement-plan assets at risk. Moreover, as an ex-employee, you may get mediocre service from the plan administrator.

Easy access. Employer plans may permit only quarterly withdrawals or investment changes—a potential problem in emergencies or when markets are in turmoil.

Flexible beneficiary designations. With careful, creative naming of contingent and co-beneficiaries, an IRA lets you leave your money to anybody and everybody you choose.

Greater benefit to heirs. They can stretch inherited IRA withdrawals over their lifetimes, whereas company pensions may force a lump-sum distribution, triggering immediate taxation on the entire nest egg.

If you decide to move your assets to an IRA, the safest approach is to have your employer transfer the money directly to an IRA trustee or custodian. Follow up to verify the transfer.

A bad idea is to have the plan write you a check for the account balance, minus 20% withholding. Then you have 60 days to deposit the full balance in an IRA or new employer's plan. To avoid tax and the 10% penalty, you must make up for the withheld tax, then get the money back when you file your taxes, and mistakes could result in unnecessary taxes. For more on these complex issues, please call our office. ●

Family Foundation Lets You Do Good For Others And Yourself

A family foundation lets you become a philanthropist even if you're not as wealthy as Bill Gates. But don't treat a nonprofit like a hobby or use it to an unreasonable personal advantage. To stay on the good side of the Internal Revenue Service, you must run it like a business.

More retirees are starting family foundations—with as little as a few hundred thousand dollars—to help a favorite cause directly. Other potential benefits include trimming taxes and building family members' social consciousness and business skills. But as the popularity of family foundations has soared, the IRS has begun scrutinizing them. Among the potential problems are family members being paid exorbitant amounts for running a foundation and donors gaining lucrative contracts for support services. Federal law prohibits this sort of self-dealing.

IRS rules generally forbid foundations from entering into financial relationships with insiders, known as "disqualified persons." That includes officers, directors, trustees, substantial contributors, and family members of people in any of those categories. Suppose Jack and Jill Jones start a foundation to raise funds for animal shelters and open a foundation office in a building they own, charging rent of only $50 a month. That's illegal, because it sets up a financial relationship. They could, however, donate the space.

There are a few exceptions to this rule. Money managers and attorneys may provide personal services even if they are disqualified persons, as long as they charge reasonable and customary fees. Similarly, salaries for officers must be "reasonable," meaning similar to what other comparable foundations—of like size and budget in the same geographical area—pay people with similar experience working the same number of hours and performing similar duties.

To help foundations comply with

Nine Estate Planning Mistakes To Avoid

Thanks to increased home values, well-funded retirement accounts, and hefty life insurance policies, many retirees today not only have enough money to live comfortably but are also likely to have wealth to distribute at the end of their lives. But it can be tricky making sure your bequest gets where you want it to go. Here are nine common mistakes to avoid.

Assuming you don't need an estate plan because you don't owe estate tax. With estate tax laws currently in flux, whether your estate is large enough to owe estate taxes may depend on when you die. But even if taxes aren't an issue, estate planning can ensure your assets are controlled according to your wishes if you're incapacitated and parceled out appropriately at your death. It can also help to avoid the cost and delay of probate and minimize emotional and financial burdens on your beneficiaries.

Not having a will. Without a will, state law will govern the disposition of your probate estate, with the government deciding who gets what. Depending on your state of residence, if you are survived by a spouse and children, your estate will typically be divided among them even if you had something else in mind. Moreover, assets could be poorly managed and your estate could end up paying more than it should in taxes and legal fees. A will lets you specify who gets what and could help minimize estate taxes.

Not having a "letter of instruction." What happens if you change your mind about who gets your favorite jewelry or whether you want to be buried or cremated? You can note these wishes in an addendum to your will called a letter of instruction. Though not legally binding in all states, this document will at least give your heirs an idea what you want and help them avoid needless conflicts.

Leaving your entire estate to your spouse. While many couples leave all assets to one another, that's not always the best strategy. You may want some property to pass directly to children from a previous marriage, or to go into a trust to make use of both spouses' estate tax exemptions. Trusts, which come in many varieties, may help you fine-tune your estate plan, are typically less vulnerable than wills to legal challenges, and can provide asset protection.

Owning all assets jointly. Most couples own property jointly, with rights of survivorship—meaning that upon the death of one spouse, the jointly owned property automatically passes to the surviving spouse, avoiding probate. But this may not be the best choice in all situations. For example, owning property separately could make it possible to fund a trust and take better advantage of the estate tax exemption.

Not considering annual gifts. Using yearly gifts to distribute your estate while you're living can be immensely satisfying, and it takes advantage of an annual gift tax exclusion that allows you to make tax-free gifts each year of up to $12,000 each to an unlimited number of recipients. (If you give with your spouse, the limit is $24,000.) You can use your $1 million lifetime gift tax exclusion to make even larger gifts. And any gift now avoids potential estate taxes later.

Failing to consider the benefits of charitable contributions. Fulfilling your philanthropic goals can also have many tax benefits. Your estate can take a deduction for gifts—including cash, personal property, real estate, and certain investments—made to charitable organizations upon your death. (Charitable gifts during your lifetime are also deductible, and reduce the size of your taxable estate.) Other options to consider are a charitable remainder trust that pays a lifetime income to you and distributes remaining assets to a charity at your death, or a charitable lead trust, which reverses the equation, paying the charity now and your heirs when you die. And you might use life insurance to "compensate" family members for the part of their inheritance that goes to charity, if you are insurable and inclined to do so.

Keeping life insurance in your taxable estate. Life insurance benefits aren't taxed as income but they do go into your estate and could increase your heirs' estate taxes. A better option may be to have your policy owned by an irrevocable life insurance trust that can pass along proceeds without tax liability.

Failing to update estate strategies periodically. Everyone's circumstances change. Your wealth may increase or decrease, new children may be born while others reach adulthood, and you could be widowed or divorced and remarry, adding the complications of a second family. Regular reviews can make sure your estate plan keeps up. ●

But You Can Be Too Good To Yourself

this law, several associations publish salary surveys. It is possible to pay an officer more than the median salary, but only if you can justify your decision by documenting the person's special skills or services. There are financial penalties for breaking the rule. If the IRS determines that an officer's salary is unreasonable, the officer would be assessed a "self-dealing penalty" of 10% of the excess compensation—that is, the amount the insider was paid above the amount deemed reasonable. So if an insider took an annual salary of $150,000 for a job for which reasonable pay was considered to be only $100,000, the officer would be personally liable for a $5,000 penalty—10% of the $50,000 difference. The foundation would also be penalized.

"In every instance, you have to put the foundation's interests ahead of your own," says Jeffrey D. Haskell, senior vice president of tax and legal affairs for Foundation Source in Fairfield, Conn. You need to document everything you do, Haskell says, maintaining complete records of all donations and transactions, and you should develop written policies covering conflicts of interest, investment practices, travel and expense rules, and document retention. ●

Also ask your advisor about donor-advised funds, a simpler and cost effective philanthropy alternative.

Too Much Sleep Also Not Good For You

According to longstanding conventional wisdom, eight hours of sleep is ideal. But a new British study is the latest to show that over the long term, seven hours of sleep a night may not only add an extra hour of productivity to your day, but perhaps years to your life.

In September of 2007 a team of researchers from the University of Warwick and University College of London presented their findings to the British Sleep Society. The team had examined sleep patterns of 10,308 civil servants aged 35-55 over a period of 17 years, and tracked the workers' mortality rates based on changes in sleeping times.

After taking into account age, smoking, and a number of health variables, the group's data confirmed that subjects who cut back to five hours of sleep or less a night faced a 1.7-fold increased risk of death from all causes—including twice the chance of a fatal cardiovascular problem. The study's author, Dr. Francesco Cappuccio, Professor of Cardiovascular Medicine at University of Warwick's medical school says that it's a trend that's increasing in industrialized nations as we attempt to fit in more time to work, play, socialize, and be entertained.

But what was even more surprising was that the data also showed those who increased their nightly sleep hours from seven to eight or more hours a night throughout the study were more than twice as likely to die—mostly from non-cardiovascular problems such as cancer.

These results support findings from a 2004 Japanese study conducted by Dr. Akiko Tamakoshi of the Nagoya University Graduate School of Medicine, which followed mortality and average hours of sleep among more than 100,000 people over a 10-year period. Those researchers also found that among their subjects, sleeping less—or more—than seven hours contributed to earlier mortality.

Daniel Kripke, a sleep researcher at the University of California-San Diego School of Medicine, noted that the Japanese study also showed a progressive factor. The longer the subjects slept per night, the more likely they were to die early. His own findings on the subject, which he presented in Seattle at the 2002 Annual Meeting of the Associated Professional Sleep Societies, showed that individuals who slept eight hours per night were 12% more likely to die within six years than were those who slept seven hours. The highest mortality rate—15%—occurred among subjects who slept more than eight and one-half hours.

Whereas medicine is able to connect sleep deprivation to a host of life-threatening problems, including diabetes, high blood pressure, and inflammation, the mechanisms by which oversleeping contributes to early mortality aren't clear. According to Dr. Cappuccio, "Potential mechanisms by which long sleep could be associated with increased mortality have yet been investigated... some candidate causes for this include depression, low socioeconomic status, and cancer-related fatigue."

Dr. Cappuccio said adults should try to get seven hours of sleep a night—not much more or less. He says, "In terms of prevention, our findings indicate that consistently sleeping around seven hours per night is optimal for health."

As far as the eight-hour ideal sleep in so-called conventional wisdom, sleep researcher Neil Stanley of Surrey University said of the Japanese study, "I've been in this game for 22 years, and I still don't know where that came from." ●

Court Ruling Hurts Brokers

(Continued from page 1)

Other brokerage firm advisors, who had discretion over client assets and provided comprehensive financial planning services, did have to register as advisors under the new rule, though they might also continue to serve other customers in their role as brokers, exempt from fiduciary responsibilities.

Complaining that all of this was confusing to consumers, the FPA sued the SEC. According to the FPA, investors didn't know what they were signing up for. They might reasonably assume that all advisors—including brokers in the fee-based programs and advisors in RIAs—operated under the same rules. But in fact, the FPA argued, there were big differences. RIAs had to disclose to their clients any conflicts of interest along with their qualifications and any disciplinary actions taken against them—and, most importantly, they were fiduciaries and therefore required by law to place a client's interests above their own. That's an important distinction. Brokers, in contrast, don't have those responsibilities, though they could call themselves financial planners or consultants and provide financial planning services.

In a two-to-one ruling in March, the appeals court sided with the FPA. Judge Judith Rogers wrote in the decision that the SEC had exceeded its authority by exempting brokerage firms from the Investment Advisers Act of 1940. That act, Rogers wrote, allowed exemptions only for brokers who don't get special compensation for giving advice, and asset-based fees qualified as special compensation. Rogers ruled that advisors in the fee-based programs would have to register as RIAs and could not give this type of advice as brokers.

The SEC has said it will not appeal the ruling, and now brokerage firms offering fee-based programs are scrambling to comply. In many cases, brokers are cramming for licensing exams that would qualify them to register as advisors and continue to serve their clients. But it will be some time before it's clear whether the FPA's hoped-for clarity will materialize.

You remain above the fray. You've chosen an approach to financial advice that has clearly defined rules and goals. We operate as fiduciaries as a matter of principle and of law. Your interests are always paramount. If you have questions, please give us a call. ●

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