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The Rewards of Risk Review

by Stephen D. Gresham and Glen E. Gresham

Life is full of risks, and the financial advisor's job is largely to minimize the financial perils their clients face. What the risks are, how they will be reduced and what it will cost to do so must all be taken into account with the knowledge that the task will vary from one household to the next. Nor are the concerns of every generation the same.

Contrary to what you would expect from conventional wisdom and this space, the greatest fear of baby boomers is not death or a market collapse. Instead, according to Age Wave guru Ken Dychtwald, their chief worry is the loss of independence characterized by contracting a major illness or being confined to a nursing home. A Dow debacle didn't even make the list.

One thing that everyone should agree on is the need to take a good hard look at the risks an advisor can help clients deal with financially, from the risk of having to pay damages in a lawsuit to the risk of outliving their resources. The rewards for the financial advisor in taking on the job are not always apparent, but they're real.

Consider this story, related by an outstanding life insurance agent and estate planner with over 50 years experience. The advisor had a client who was not 30, yet was a successful entrepreneur with four young children. The advisor pushed the young man to establish an estate plan, which was finally completed after a long process. Very soon afterwards, the man was killed in an accident, but his family was taken care of financially.

To make it easier to consider what dangers exist beyond anyone's control, we've broken it down into 10 separate risks.

Medical

Loss of independence is the biggest fear for the biggest client base — the baby boomers — in the decades to come, and advisors who ignore this do so at the peril of losing their clients. Advisors should talk to them about it. Ask them if they worry. Get it all out in the open. Every top client household should complete a family medical history to isolate potential health risks and begin open discussions with you about the possibility of trouble down the road.

Liquidity

The boomer generation owns this risk more than any previous generation. Real estate equity, closely held businesses — even partnership investments like hedge funds — can lead to bloated balance sheets but insufficient cash balances. The liquidity comfort level for each household is different, but advisors we know suggest that nothing calms clients like having a year's income available within a few days — if necessary. Watch this issue grow in importance as real estate accounts for a greater proportion of affluent household wealth and as more investors buy illiquid alternative investments.

Purchasing Power

Much of the investing public has forgotten the devastating impact of double-digit inflation on retirement savings. Younger clients won't appreciate the risk, but older clients talk to us often about the bad memory of inflation and how it can destroy purchasing power. Stress test your clients' portfolios for the inflationary risk. Beware the impact on retirement-income payments if there are annuities or other payout options without protection (such as cost-of-living adjustments to annuity payments).

Premature Death

Only one-fourth of all millionaire households have a current estate plan and, as the story of the young entrepreneur shows, advisors may need to push their clients into one. One way to ease into the subject is to have clients complete an advance directives questionnaire that provides a blueprint of what assets are available and how they would be distributed. That process should create enough awareness of shortfalls and other vulnerabilities to make it much simpler to address full estate planning.

Disability

Get a summary of your top 20 clients' disability coverage and get busy. Most high-net-worth families couldn't sustain their current lifestyles for 10 minutes with the policies available through most groups. And if the client has a business, there is almost no coverage that can come close to making up for potential losses. That said, advisors can't do this alone. This is a specialty item, so advisors need to find a partner for this service.

Legal

Surveys of affluent people indicate their concerns about litigation — especially if they own a business. We know all too well the world of medical malpractice insurance and believe the same force is bearing down on the financial-advice industry. Of special note, consider your retirement plan clients. Ask them, for example, if they are conforming to ERISA. Begin to incorporate into your reviews and into your dialogue with clients a few questions about their legal liability and their level of preparedness.

Market

A favorite question of life insurance advisors I know is to ask prospects what would happen to their net worth if the stock market dropped 10 percent — or 20 percent. Most affluent clients couldn't tell you — but they worry about it. So ask them the question and remember they don't want to take more risks with their investments than they already do.

Family Care

Every family has concerns about how aging parents will be cared for, but the most prepared actually know the roles of the individuals involved and they make sense. It's good having children with money who are close by, but the burdens of care can fall disproportionately on them — fueling rivalries and hostility. Advisors should emphasize the need for a plan that everyone can get behind and that works. The richest and closest child, for example, may not be up to the task of power of attorney.

Longevity

Baby boomers will live longer than any other generation, perhaps a lot longer. It's a problem and one that is destined to get worse when it comes to providing for their financial future. Advisors need to ask what protections they have in place so they will be able to maintain their standard of living well into their 80s — and beyond.

Reputation

It's hard to put a dollar value on it, but there is always the chance that someone you know or are affiliated with can damage your reputation in a way that will cost a client financially, as well as personally and professionally. It could be a sloppy business colleague, an out-of-control relative or a spiteful partner. Advisors should ask their clients about the possibility and what they have in place as far as damage control is concerned.

It's possible, as Mary Beth Emson, a financial advisor for Smith Barney, notes that the cost of minimizing any risk may be more than a client may wish to pay. Not to worry. It's their priorities that matter. All the advisor can do is lay out the risks and help develop a plan that gives them — and their families — peace of mind.

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