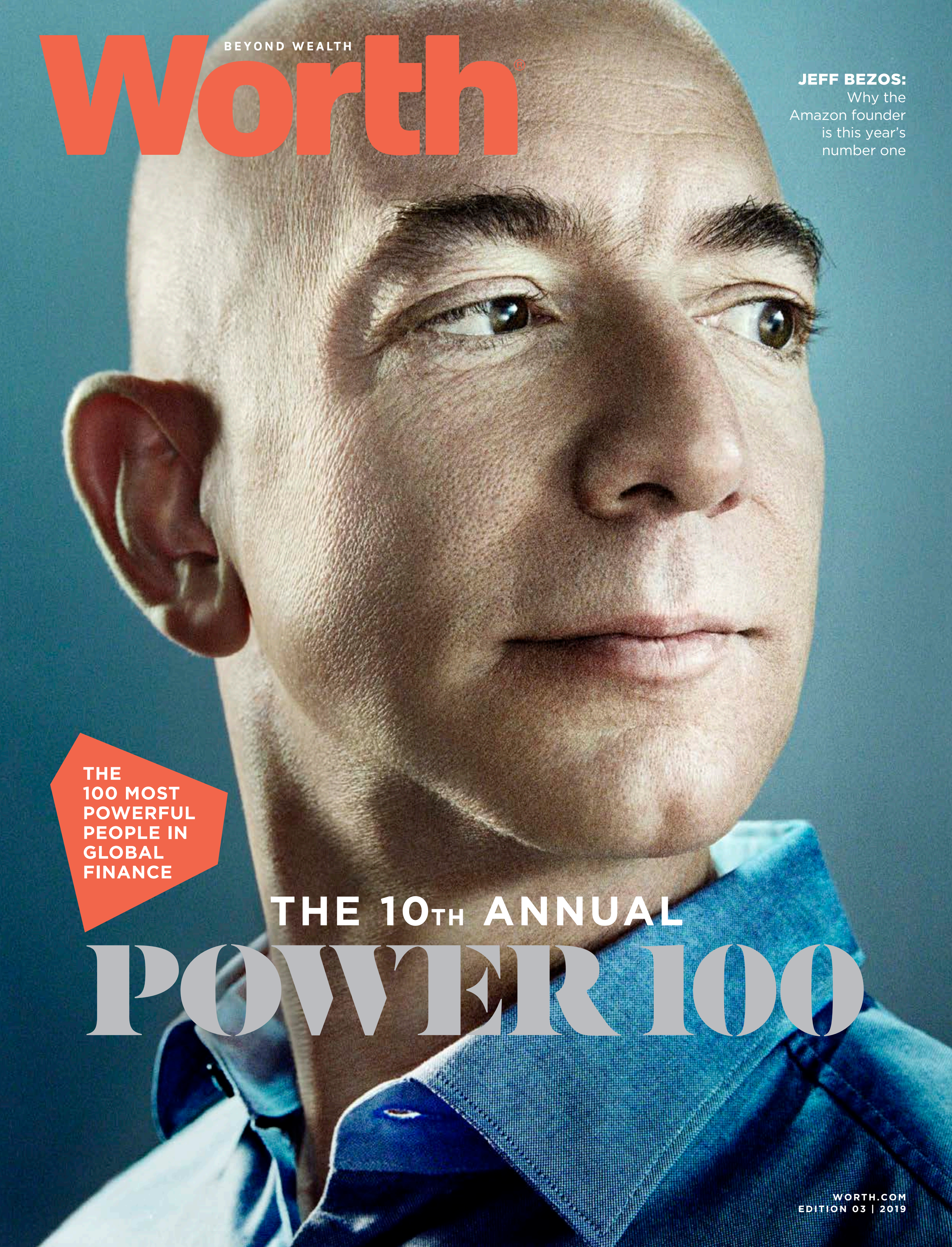
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Q:

Should I have an investment policy statement *and* a distribution policy statement?

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▶ **When it comes to investors,** I think of them as people who experience two stages in the continuum of their financial lives. The first is the accumulation stage, when they build their assets, the second is the distribution stage, when they retire and crack open their nest egg.

What the two stages have in common is the need for a carefully thought out plan. Investors in the accumulation stage may be familiar with what is called an investment policy statement, or IPS. Simply put, an IPS is a document that sets out a client's overall investment goals and objectives and outlines the strategies that the investor and his or her wealth manager agree should be employed to achieve those objectives.

As essential as an IPS is to asset building for the distribution stage, a manager and investor also need a carefully thought out rule book. That document is called a distribution policy statement, or DPS. It's critical to understand that the items necessary for consideration in a DPS are equally important and almost as numerous as those in an IPS. Here is a partial list of issues that a DPS should address and resolve.

1. Decide the sequencing of accounts to pull from once retirement begins—after-tax accounts, IRAs, Roth IRAs, and so on. When setting up the sequence, keep in mind that the required minimum distribution rule associated with IRAs for taxpayers starting at the age of 70½.

2. Identify the securities from which to create liquidity.

3. Decide what to do with dividends and interest income regarding taxes, and the like.

4. Decide the best time to begin taking

Social Security benefits.

5. Decide which account(s) will be used to pay the taxes when they come due.

6. Determine when to rebalance the portfolio and how often.

7. Determine which family members will be given, or considered for gifts.

8. Decide on a method for determining the withdrawal amount necessary to account for inflation and/or unexpected expenses.

9. Decide what to do with real estate holdings. Use the asset? Do a reverse mortgage? Transfer some or all of the assets or holdings to a trust?

10. Determine the ideal amount of a cash reserve and a timetable to replenishing it. One year's worth? Two years? Three?

11. Have a plan for down markets. This is referred to as "sequence of return risk," and to mitigate that risk, an investor should stop withdrawing funds from equities during a declining time period. That is where the cash reserve comes in.

Let's say an investor withdraws funds yearly from stock investments, but the market finishes negative for a calendar year and the bear market continues. The following year, the investor will draw from that cash reserve. Since bear markets last, on average, just under 24 months, it seems prudent to set aside two years worth of fixed living expenses.

One additional essential element to a successful DPS concerns two very human elements: being flexible and realistic. For example, it is understandable that most investors are highly reluctant—even adamant—about taking anything from their principal. But the reality is this: Most investors' accumulated asset balances will not generate enough interest income to cover their desired retirement income. So smart and flexible investors will include guidelines for accessing principal in their DPS.

The final element for a successful DPS is commitment. Think of it this way: The whole point of the IPS and DPS is readiness—that is, being prepared for the inevitable and the uncomfortable. This should ensure that though investors may sometimes be tempted to reach for the panic button, they will not actually hit it. ●

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