Investor's Edge

RBC Wealth Management

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Q&A: Cash an important element for financial strategies

Cash plays an important role in a wealth plan. Eric Edstrom, director of Cash Management for RBC Wealth Management, provides background information.

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Why should I have liquidity in a well-balanced wealth plan?

Liquidity management is at the forefront for our financial advisors' client relationships because it provides diversity within a well-balanced financial strategy. It includes everyday living and lifestyle cash needs, strategic borrowing and generating an income during retirement.

RBC Cash Management approaches client liquidity needs in a variety of ways. For example, cash distinct options use operating cash for daily living, core cash for emergency funds or savings needs for larger purchases (down payment of a home/car/wedding, etc.), and long-term investment cash for supporting retirement income needs.

In addition, wealth planning-focused financial advisors gain an understanding of your short- and long-term goals.

Next to purchasing a home and paying for college for children and/or grandchildren, health care costs in retirement may be one of the largest expenses most investors need to prepare for in life. Increasingly, many financial advisors work with clients to consider retirement health care insurance options, including Health Savings Accounts, long-term care insurance and even prescription drug plans. It's important to have liquidity available in times of medical needs.

Lastly, liquidity management includes working with clients to generate additional income during retirement. Retirees typically live 30+ years post-retirement, thus, continued investing to generate income is vital. Financial advisors work with other professionals like tax and legal advisors to prepare for tax consequences during the investment liquidation stage of retirement, developing a tax-considerate strategy.

What are the differences among operating cash, core cash and strategic cash?

Operating cash is the necessary cash you need to support your lifestyle. This includes managing everyday expenses—car loans, mortgage or rent, insurance premiums, utility bills, etc. Operating cash generally resides in your checking account to satisfy these short-term needs. The expectation for this cash is

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Cash an important element for financial strategies, continued

immediate use, and often the account holding this cash is a non-interest bearing checking account.

Core cash is available for you to access and easily converts to operating cash. Core cash includes savings and escrow cash held to pay for taxes or insurance. Some instruments include savings accounts or money market funds. Core cash may be held in certain financial instruments that produce slightly higher yields and/or may include short duration instruments such as short-term CDs (1-, 3-, 6-month terms) or certain treasury products (T-bills, treasury bond funds, etc.). Traditionally, the goal for this cash is principal return plus a slight rate of interest or yield with a six- to 12-month time horizon for its use. A good example of core cash is saving for a trip, a wedding or a home purchase.

Strategic cash is surplus cash and intended for longer-term investment opportunities. The time horizon for this cash is generally one year or greater. This cash can sustain moderate volatility and you have a wide variety of choices to enhance the yield performance on it. These include short-term bond funds as well as certain mutual funds or ETFs with a focus on controlling risk and maintaining a focus on principle preservation.

How does RBC's WealthPlan help me plan for liquidity in my portfolios?

The WealthPlan tool offers many goal-setting objectives to build a wealth plan designed to generate the cash necessary to achieve your life and lifestyle needs in retirement. This includes documenting your wants, needs or desires during retirement, and the tool is flexible enough to project future expenses in retirement. It is a great budgeting tool for updating continuously to project the income necessary to meet your lifestyle needs during retirement.

How can I use cash smartly, while also pursuing other investing goals?

RBC Wealth Management continues to invest in our cash management services, making money movement easier through the RBC mobile application. Our new technology investments allow you to make deposits remotely, establish direct deposit with employers and receive pension, other employer retirement plan or Social Security payments. Further, we upgraded our bill payment platform to include a quick pay feature for recurring monthly bills from our mobile application. We offer Apple Pay® and will be adding other payment wallets in the near term, including Google Pay. Our VISA Platinum debit/ATM card offers everyday convenience to make purchases or access more than 800,000 ATMs worldwide and 32,000 surcharge-free ATMs.

A convenient technology tool available to monitor cash in your portfolio is the Total Wealth tool. This tool allows the RBC Cash Management account to serve as the "hub" account for all money movement and to execute on your WealthPlan objectives. With Total Wealth, you have the ability to connect to more than 14,000 financial institutions, allowing you and your advisor to see your entire wealth picture in one glance.

Incorporate a cash plan into your wealth plan

Connect with your financial advisor to determine how liquidity could strengthen your wealth plan to better meet your goals.

Planning for dementia and health care

There are many unknowns when it comes to planning for health care. Unfortunately, one of the possible health care concerns—dementia—comes with a high financial price, making it important for families to include in their health care planning.

Today, more than five million Americans are living with Alzheimer's, according to the Alzheimer's Association. That number is anticipated to double by 2040 because of the large cohort of aging baby boomers. Age is a primary risk factor for dementia.

From the outset, a dementia diagnosis necessitates services and care that bring about a mountain of expenses. Early on, families tend to step in as caregivers and coordinators, helping with everything from routine activities, like shopping and medical appointments, to daily tasks, like bathing and dressing. This can add to the financial burden in the form of lost wages, career disruptions and out-of-pocket expenses.

Following a dementia diagnosis, people generally live an average of 4.5 years. As the disease advances, the patient needs more care than most family members can handle, eventually requiring professional home and transition care and generally culminating in the need for a residential skilled memory care facility. In fact, most people with dementia spend 40% of their time after diagnosis in such a facility. This kind of care is expensive, and in 2019, was $90,155 a year, according to Genworth's Cost of Care Survey.

Covering expenses

Most of the nonmedical care costs associated with dementia are not covered by Medicare or traditional health insurance. Even for those with supplemental long-term care insurance, these care costs can be significant. For many, they can be so great that they lead to significant financial hardship.

Planning ahead can make all the difference between effectively managing the financial burden of a cognitive decline diagnosis and sustaining severe financial hardship. This is especially important if there is increased risk of dementia in your family, including hereditary factors and prior injuries.

Plan early

Families can take steps to mitigate the risk of the costs associated with a dementia diagnosis. Hybrid insurance policies that include a long-term care component as well as some life insurance policies may provide financial relief. But the key is to have the insurance in place before the diagnosis, particularly if there is a family history of dementia, so planning ahead is crucial.

The four warning signs of dementia include:

1. Changing routines
2. Repeating requests
3. Unexpected relationships
4. A change in risk profile

Upon diagnosis, it is important to act swiftly to protect the patient and family from financial missteps, abuse and liability. Planning should include having key legal documents and arrangements—like powers of attorney, health care directives and wills—in good order, as well as making sure assets are properly titled and beneficiary designations are current. Also set up a trusted contact for all accounts. This trusted family member or close friend is there to review financial statements and transactions on a regular basis and can act as a fail-safe when your financial advisor suspects fraud or detects a decline in the client's judgment.

Consider the benefits of trust and professional executor services, especially in the absence of a trusted and competent personal executor (generally a family member).

Your financial advisor can help you navigate these tough waters and help you take steps to reduce the risk of financial missteps and fraud.

Get a head start on 2020 tax filing

Many tax provisions happened in 2020 due to economic uncertainty caused by the COVID-19 pandemic and government passing new laws. As you look ahead to preparing your taxes for 2020, use this checklist to remember what financial changes you may have made, so you can share the information with your tax advisor.

Tax prep checklist

- Did you withdraw Required Minimum Distribution funds in 2020? The Coronavirus Aid, Relief, and Economic Security (CARES) Act changed the requirement for RMDs in 2020. If you took your RMD earlier in the year and redeposited that RMD back into an IRA account prior to August 31, 2020, be sure to share the relevant statements with your tax advisors to confirm that the withdrawal and redeposit are properly reflected on your 2020 tax returns. Or, if you had taxes withheld from your RMD withdrawal and redeposited that RMD back into an IRA account, make certain that your withholding is properly reflected on your annual tax statements and credited back to you on your 2020 tax returns.
- If you received unemployment compensation, verify that appropriate amounts were withheld from your unemployment compensation, and be prepared for any required income tax payments.
- Some companies participated in the payroll tax withholding option between Sept. 1 and the end of 2020. Those deferred taxes are to be repaid in 2021. If you are among the relatively few employees impacted by this deferral, discuss the amount of payroll taxes that is being deferred from your paycheck and develop a plan for repaying those taxes in 2021.
- The CARES Act allowed individuals impacted by COVID-19 to take a taxable distribution from their retirement account without an early withdrawal penalty. If you took a coronavirus-related distribution from your retirement account, ask your tax advisors what information they will need to certify that you were impacted by the coronavirus within the meaning of the tax code. When you receive your annual tax statements, verify with your tax advisors as soon as possible that the coronavirus-related distribution is properly coded, and request a revision if necessary. Discuss with your tax advisors whether to pay all of the income tax liability in 2021 or to spread the liability over three years, as permitted.
- For business owners who incurred tax losses during 2020, discuss the extent of those losses with your tax advisors in order to take advantage of certain planning techniques, such as Roth conversions or harvesting gains. And, if you are scheduled to make estimated income tax payments in January, discuss whether those payments may be reduced in light of expected losses.

Preparing for unexpected bills

It's important to work closely with your financial and tax advisors throughout the year to continuously plan for tax changes and prevent painful tax bills. But sometimes it's impossible to fully prepare for a tax situation. Flexible financing options such as securities-based lending may provide you the opportunity to leverage eligible investments in your portfolio to fund opportunities or cash flow needs without disrupting your long-term investment objectives.

One RBC Wealth Management client discovered she owed nearly $500,000 in unexpected income and capital gains taxes from the recent sale of her business. She had a liquidity event expected in a year, so she connected with her financial advisor, asking if she could liquidate some of her investment portfolio to cover the bills. Rather than interrupting her wealth plan and portfolio, the financial advisor worked with her to set up a securities-based line of credit. She was approved to borrow $500,000 against her portfolio for the 12-month period. The client plans to use that event to pay off the line.

By utilizing a securities-based line of credit, the client saved $150,000 in additional taxes from liquidating her portfolio, and kept her long-term investment strategy in place.

Contact your financial advisor if you need information about your finances to share with your tax advisor and about the possibility of setting up a securities-based line of credit so it will be available if you need it to cover an unexpected tax bill.

Client stories are for illustrative purposes only. They do not necessarily represent the experiences of other clients, and they do not indicate future performance. Results may vary.

Securities-based loans involve special risks and are not suitable for everyone. You should review the provisions of any agreement and related disclosures, and consult with your own independent tax and legal advisors about any questions you have prior to using securities-based loans or lines of credit. Additional restrictions may apply. If the securities in your account decline in value, so does the value of the collateral supporting your loan, and, as a result, the firm can take action, such as to issue a call and/or sell securities in order to maintain the required equity in the account.

RBC Wealth Management does not provide tax or legal advice. All decisions regarding the tax or legal implications of your investments should be made in consultation with your independent tax or legal advisor.

Teach your children financial literacy

A quarter of American parents admit they don't do a good job of preparing their children to manage money, indicating a large number of children in the next generation will be affected with financial illiteracy.

This February during I Love to Read Month, consider targeting financial literacy with your children, no matter how young or old they are. If you plan to transition your wealth to the next generation, give them the tools they need to be responsible managers of that money. Spending time with your children when they're young learning financial literacy may pay off many times in their future.

Young children

As soon as they're old enough to understand the concept of money, they're ready to learn about saving, spending and sharing—lessons they'll need for the rest of their lives.

Teenagers

Financial goals become important as children grow interested in higher-value items like cars, travel and higher education. This is an age where evaluating needs versus wants is put to the test, giving your children good practice for future financial planning as they get older.

Early adults

As they enter adult life with family financial support starting to ease, budgeting is a lesson many college-age children need to learn. This is also an age to learn about investing concepts, especially as these early adults begin to understand their future goals, including retirement and health care costs.

Young professionals

Young professionals start to adopt investing habits in their 20s, which will last them for the rest of their lives. They're learning how to be successful investors, maintaining a regular investing schedule and learning the importance of staying the course when markets swing up and down.

Using financial literacy to successfully transition wealth

Financial literacy shouldn't only cover the topics of managing and growing money. It's also important when you intend for your children to inherit your wealth and successfully preserve it. A 2017 RBC Wealth Management study found most Americans are unprepared when leaving or receiving an inheritance. Unfortunately, this fact lends credence to the "shirtsleeves to shirtsleeves" proverb saying wealthy families often lose their fortunes in three generations.

This is where a wealth transfer plan comes into play. It includes components of communicating with younger generations about the family wealth and educating them how to manage it. A wealth transfer plan can help your heirs feel confident in the financial decisions they need to make when they take ownership of the family wealth. For your legacy to last, it's important to transfer your knowledge about money management before it is time to transfer your wealth.

Your financial advisor has financial literacy information available to help teach children how to become money smart, fund future goals and set up savings. Be sure to ask for this information, and also for background on how you, as the parent, can talk with your children about money and transitioning wealth.

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