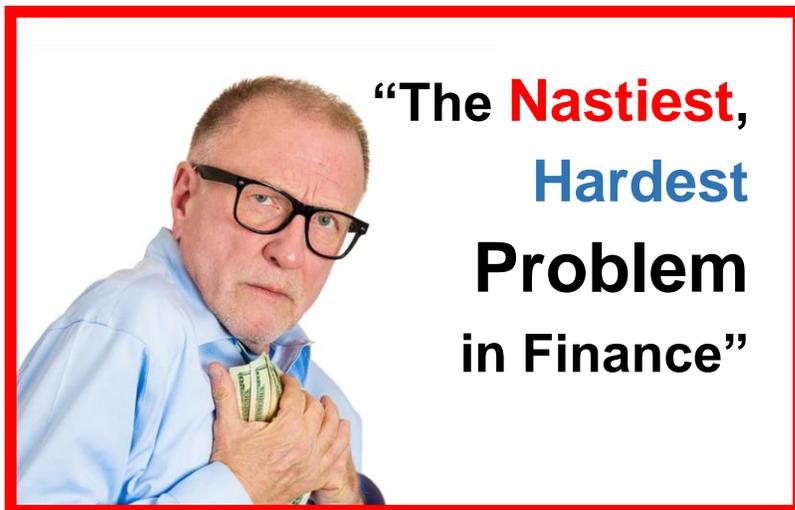


CREATIVE

WEALTH MAXIMIZATION STRATEGIES

LIVING LEGACY
FINANCIAL & INSURANCE SERVICES

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Sometimes, you get the idea the experts didn't think this through.

The Backstory

Almost five decades ago, financial policymakers began a concerted effort to encourage Americans to specifically save for retirement. Special accounts, like IRAs, 401(k)s and 403(b)s were introduced to encourage workers to build savings to supplement monthly checks from Social Security, and employer-funded pensions. These innovations were met with great acclaim; ambitious savers saw these accounts as a path to early retirement, a way to stop working in their 50s. Except...

An unintended consequence of 401(k)s and 403(b)s was the demise of pension plans. Defined-benefit pensions are a challenge to manage, especially when the pool of retirees gets larger and the employer has to make ever-larger

contributions to sustain the plan. Replacing pensions with 401(k)s or 403(b)s freed employers from pension obligations which were both large and uncertain. In 1998, 59 percent of Fortune 500 companies offered their employees a pension. By 2017, only 16 percent did.

Social Security, a government-administered pension, is under-funded; there are too many retirees and not enough workers to support future benefits. The fixes, to raise taxes or cut benefits, are politically uncomfortable. So, legislators keep waiting for a better solution.

Originally conceived as auxiliary retirement accounts, individual saving in qualified retirement plans is now the primary source of retirement funding.

Today, You Need to Save More!

To make up for the loss of pensions and the uncertainty of Social Security, economists, policymakers and personal finance pundits have redoubled their efforts to encourage personal saving.

The emphasis on more saving and larger accumulations is logical; without retirement savings, there can be no retirement. And since most Americans still aren't saving enough for retirement, the message “you need to save more” is still appropriate.

But accumulation is only half of the retirement equation.

Decumulation: The “Nastiest, Hardest” Other Half of Retirement Planning

The other is decumulation, the orderly and efficient spending down of retirement savings. While planning for accumulation is a relatively straightforward task (you determine how much you will save, where to invest it, assess your results, and adjust as necessary), decumulation is a much more complex planning task. In fact, in the opinion of William Sharpe, a Nobel Laureate economist:

“Decumulation is the nastiest, hardest problem in finance.”

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In a 2014 interview in *Advisor Perspectives*, Sharpe explained that the variables impacting decumulation are more numerous and interconnected than those at play during the accumulation phase of retirement planning. Where an accumulation projection might consider rate of return, taxes, inflation, and contributions, Sharpe says a reasonably thorough decumulation model could have between 50 and 100 variables and coefficients, and small changes in these assumptions generate big differences in outcomes. For example, the “consideration of whether you are alive along with your partner, or just one of you, or if it goes to the kids and the charities after we die,” results in dramatically different decumulation strategies. “The dimensionality is overwhelming,” Sharpe says, “and the behavioral issues are of course, very difficult.”

The Behavioral Issues

The narrow focus on maximizing retirement saving has inadvertently neglected decumulation, at least from the behavioral aspect. In a September 2017 white paper, “Save-Save-Save, But Then What?” UCLA Anderson Review author Carla Fried highlights the problem:

“After spending years in an accumulation mode where the only message has been *save, save and save more*, it’s a big ask to suggest retirees deftly make a 180-degree pivot and become masters of decumulation.”

Decumulation requires a different mindset. The transition from accumulation to decumulation is like traveling on one track for thirty-odd years, only to find the next phase of the trip requires jumping to a different set of rails.

Some retirees – especially those who have been prodigious savers – struggle with the change.

This can result in a “spending gap.” Studies suggest many well-off retirees could spend 8-10 percent more per year and not worry about running out of money. But there’s an ingrained mindset that finds it hard to let go of savings. Shlomo Benartzi, one of the pioneers in behaviorism, says, “It is well established that once people think they have something, they become reluctant to give it up.”

The reluctance to touch principal also affects retirees’ response to annuities. Economic studies show that annuities, with their potential for lifetime income, can be efficient tools to reduce risk and increase income. But while retirees can see the value of the annuity programs they already have (i.e., Social Security and/or a company pension), it’s a different story when they contemplate using their own saving to buy one. Per Benartzi: “The purchaser (of the annuity) has to write a big check to get a series of small checks, which may simply look like a bad deal to a naïve consumer. An annuity should be viewed as a risk-reducing strategy, but it is instead often considered a gamble.”

Unsure about how to spend, it’s no surprise that “Many Americans look with longing at old-fashioned pension plans,”

says Anne Turgeson in a February 2020 *Wall Street Journal* article. “(A)side from providing a guaranteed monthly paycheck for life, pensions spare retirees the hassle and anxiety of figuring out how to make their nest eggs last.”

But old-fashioned pensions aren’t coming back. So how are you going to handle the nastiest, hardest problem in finance? Try making it a group activity. Decumulation is not a DIY project; look for professional assistance.

And if you’ve been a rugged individualist of personal finance, diligently saving and making your own investment decisions, try to open your mind to the value of pooling assets and spreading risk.

A Transition from Balances to Benefits

The accumulation phase of retirement planning is a personal investment project, where success is measured by the accumulation balance. In contrast, decumulation is primarily an insurance project: the main objective is to ensure you won’t run out of money. The success of decumulation is measured in benefits, how much can be guaranteed for how long.

You can self-insure your decumulation; that’s what the retirees who won’t touch principal are doing. This makes the principal

your insurance, and not touching it is the annual premium. But insurance works best as a group effort, where the risks can be spread over a large number of people. That’s what pensions and annuities do; they ensure payments for everyone by pooling assets and risks to guarantee that those who live longer will be subsidized by those who did not. ❖



Decumulation requires a different mindset. The transition from accumulation to decumulation is like traveling on one track for thirty-odd years, only to find the next phase of the trip requires jumping to a different set of rails.

If you want to maximize your retirement assets and minimize the financial and emotional risk, you want to consider how insurance instruments can transform your accumulation balance into a stream of benefits, just like the company pensions used to do.



The Illusion of "Defeased" Debt

Question: If your mortgage balance is \$200,000, and you have \$250,000 in a liquid account, are you in debt?

Most respondents would answer “yes.” You are in debt, but you have \$50,000 more than you owe. This reflects a classic personal finance calculation:

$$\text{Assets} - \text{Liabilities} = \text{Net Worth}$$

But an idea gaining traction in personal finance circles asserts that *as long as you have liquid assets in excess of your loan obligations, you really don't have debt.* Rather, it is more accurate to say your debt has been “defeased.”

Defeasance: Debt, With a Twist

Defeasance is a contractual provision, typically used in conjunction with real estate transactions. A defeasance provision in a loan or a bond agreement voids the debt *on the borrower's balance sheet* if the borrower sets aside cash or other assets to repay the debt. Here's an example:

Suppose a lender agrees to finance a \$500,000 real estate purchase on the following terms: interest-only payments at 6 percent annually for 10 years, with a return of principal at the end of the term. Suppose also that because the lender wants to ensure a steady income for the next 10 years, it insists on a prepayment clause that prevents the borrower from paying off the debt early. Here's why: if the loan is repaid before the term ends, the lender might have difficulty reinvesting the principal to produce an equivalent rate of return.

However, the contract might allow the borrower to sell or exchange the property, as long as the borrower sets aside cash reserves so that the lender continues to receive payments, including the return of principal, according to the agreed-upon schedule.

This defeasance provision ensures a steady stream of payments to the lender, yet also allows the borrower to sell or exchange the property, and maybe take on more debt. Defeasance increases financial certainty for the lender, while expanding the borrower's options for maximizing value from the property.

A Rationale for More Debt

Using defeasance logic, as long as you have more liquid assets than liabilities, then you really aren't in debt. Yes, you

have loans and monthly payments, but if necessary, these debts could be retired at any time.

An example cited by Jared Dillian in a February 2020 blog post illustrates this dynamic:

“I have a friend who is obsessed with defeasing debt payments. For example, he talks about buying a Porsche, paid for by the income from a few rental properties.”

Since the car payments will be paid by rental income, Dillian's friend says he isn't increasing his debt by financing the car. There's a debt in one pocket, and cash to pay it in the other.

Defeasance in a commercial real estate transaction might be legitimate, but in a personal context, these “defeasance” strategies are just rationalizations that more debt is okay if you can afford it. It's a discussion that sidesteps the most important issue: **borrowing always incurs a cost. That cost negatively impacts your wealth, especially if you borrow for non-essentials.**

Necessary, Affordable, or Good?

Debt is often necessary, especially at the beginning of your financial journey. You might have to borrow to get a college education, secure reliable transportation, buy your first house. Your net worth will be negative, and your only financial asset will be income from your current employment. In these circumstances, borrowing is intended to lay a foundation for wealth building, to earn more money, to stabilize your material world.

But because so many households start with debt, they often become dull to the impact of interest, in terms of reduced cash flow and lost opportunity costs. When they achieve financial stability (i.e., they pay their bills, set aside money for the future, have a positive net worth), they often see additional debt as an “affordable” way to upgrade their lifestyle today, instead of saving and buying later.

This attitude not only downplays the negative financial impact of debt, it also violates standards for “good” borrowing. In the real estate example of defeasance, the loan makes it possible to acquire what the buyer hopes will be an appreciating asset. Using debt to acquire wealth-building assets is good. Using debt to acquire non-appreciating assets erodes wealth – not good, even if you have the liquid assets to repay the debt. A car, even a really nice one, is usually not an appreciating asset. The more you drive it, the less it's worth.

Be Careful.

Some debt is necessary. Some debt can be good, in that it helps you acquire other wealth-building assets. But non-essential debt is wealth-destroying, even if it is defeased, or collateralized, or affordable. ❖

Do you have non-essential debts that are eating into your future wealth and well-being? Do you have a plan to reduce or eliminate these obligations? Perhaps it's something to discuss in your next meeting with a financial professional.

Backhoes and Life Insurance: When “Simple” Becomes “Simplistic”



The word “simple” has marketing magic. In a world that seems evermore complex, the prospect of something “easily understood, uncomplicated” is appealing, especially if it promises to turn a challenging decision into a no-brainer.

You can see “simple” in the proclamations from some popular financial pundits who offer simple solutions for personal finance. “Don’t let so-called experts confuse you with their details. Just do this, and it’ll be fine.”

Of course, simple can become *simplistic*, “treating complex issues as if they were much simpler than they really are.” And when that happens, simple might have another meaning: “unsophisticated” or “of low or abnormally low intelligence.” You don’t want that kind of simple. For example...

“Life Insurance Has One Job”

There’s a personal finance guru who styles himself as a no-nonsense “outsider,” who gives straight talk and simple solutions. One of his publications, touted as a “complete guide to money,” distills life insurance to a single sentence: “Life insurance has one job: It replaces your income when you die.”

That’s a simple statement. But is it also simplistic? Let’s dig into that question – with a backhoe.

The Backhoe Analogy...

A backhoe is a tractor-mounted mechanical bucket attached to a hinged boom. A primary use for this tool is excavation – moving dirt for basements, digging ditches, etc. But a backhoe can also be used as a crane, a shovel, a very large hammer, a compacter. By swapping out the bucket for other attachments, these applications can be further expanded. (For some amusing backhoe creativity, search YouTube for “backhoe video tricks”.)

Suppose you want to start a construction business and are looking to buy a backhoe. You contact an industry consultant for advice. With a wave of his hand, he says “A backhoe has one job: it digs a hole for your basement when you build a house.”

This is good advice? A used backhoe can easily cost \$20,000, and new ones start at \$50,000. If you’re going to spend that much money, wouldn’t you be interested in knowing other uses for a backhoe, and whether those options might be profitable for your business? Of course, you would.

...and Life Insurance

If you’re thinking about getting into the “construction business” of building your personal financial plan, it might be worthwhile to dig a little deeper into life insurance as a tool, instead of accepting a declaration that it has “one job.”

Life insurance is a contract to deliver a specified amount of money at the death of an insured individual. One use of life insurance can be to replace income when you die. But it is not the only use. Over the past two centuries, the guaranteed death benefits of life insurance have regularly been used for other purposes, such as

- a permission slip to spend down other assets
- a funding mechanism for buy-sell agreements
- a guaranteed inheritance for beneficiaries¹
- a collateral assignment to secure a loan
- a source of cash to preserve the value and ownership of illiquid assets in estate planning

When other “attachments” are added, such as cash values, waiver of premium², conversion privileges, loan provisions and dividend options, the uses of life insurance are further expanded.



When other “attachments”
are added, the uses of life
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The Cost of Limiting Life Insurance to Just One Job

The one-job approach to life insurance recommends buying a term policy. This is because income replacement is supposedly limited to a specific period (your working years), and term is the cheapest way to acquire temporary protection.

Just like buying a backhoe has an opportunity cost (because it’s money that can’t be spent elsewhere), there are opportunity costs with term insurance. Here’s an example:

- A healthy 40-year-old female buys \$1,000,000 of life insurance for a 20-year term with level premiums. Prices will vary by insurer, but a \$1,000 annual premium is plausible (and makes for easy math).
- Statistically, the odds of a death occurring during the 20-year period are very low; some actuarial studies say more than 90 percent of those insured at standard rates will live past 60.
- Anecdotally, financial professionals will tell you that the likelihood of a term life insurance policy paying a death benefit is less than 1 percent. People either outlive the term or lapse the policy before the term ends.

If the likelihood of a financial return (via a death benefit) from term insurance is almost nil, it is reasonable to consider what those premiums could have been worth if invested for 20 years. At a return of 6 percent each year, here are some numbers:

1. **20 years** of \$1,000 annual premiums earning 6 percent produces a hypothetical lost opportunity cost of **\$38,993**.
2. **Even though** the term insurance expires after 20 years and no additional premiums are paid, opportunity costs continue to accrue. If the woman lived to age 85, the cumulative opportunity cost at 6 percent would be **\$177,393**.

- Over periods of 30 years or more, some stock market indexes have a historical average annualized return of 9-10 percent. If the 45-year opportunity cost was calculated at 8 percent instead of 6, the cumulative opportunity cost would be **\$365,549**.

Any opportunity cost is a hypothetical calculation dependent on the projected rate of return. But whatever number you might choose, the idea remains the same: The true costs to a simple approach to life insurance are greater than \$20,000 in premiums.

Complex? Yes. Incomprehensible? No.

Life insurance is a complex financial product; even the simplest of policies is built on a combination of actuarial and financial projections. But life insurance is not a new or untested financial instrument; most forms of life insurance – term, whole life, etc. – have a long history. Despite the “one-job” declarations from the “simple” pundits, financial professionals continue to use life insurance to provide a broad range of financial benefits.

For consumers who lack confidence in their financial knowledge, providing a simple rule for life insurance might seem helpful. But making life insurance too simple is irresponsible and may, in some instances, actually be detrimental to your financial well-being. ❖



Be willing to dig into life insurance. It may be a complex product, but with some professional assistance, you may find that it can have multiple jobs in your personal economy – and do them well.

1 All life insurance policy guarantees are subject to the timely payment of all required premiums and the claims paying ability of the issuing insurance company.
2 Waiver of Premium rider incurs either an additional premium or cost.



A Retirement Investment That Yields 3x Happiness

“While we may all want to know the secret to a long life, I often feel we’d be better off devoting more time to figuring out what makes a good life, whatever span we’re allotted.” – Gerald Baker

Increased lifespans have skewed the generational characteristics of populations, particularly in first-world countries. In 2019, for the first time ever, there were more Americans over age 60 than under age 18.

Longer lifespans are an unquestioned good, but longer lifespans do not always equate to longer periods of good health or greater happiness. What can be done to make these “bonus” years enjoyable and fulfilling?

A growing body of evidence says one of the best prescriptions for enjoying your latter years is staying connected to younger generations. According to longevity expert Marc Freedman:

“The real fountain of youth is in the same place it’s always been. The real fountain of youth is the fountain with youth.”

Freedman, the author of “How to Live Forever: The Enduring Power of Connecting the Generations,” asserts that interaction with children and young adults has tremendous benefits for both young and old, but especially for the older generation.

This is not a unique insight. In a November 2018 article for *Quartz*, Jenny Anderson cites an ongoing research project started more than 80 years ago by psychiatrist George Vaillant, which finds that interpersonal relationships play a huge role in physical and mental well-being. “(T)hose in middle age or older who invested in nurturing the next generation were three times as likely to be happy as those who fail to do so.” That’s a pretty big happiness multiplier.

Freedman argues that the technologies, industries and institutions that were in many ways responsible for longer lifespans have also resulted in much greater “age segregation,” where people live their lives primarily among those their own age. Instead of extended families living and working together in small communities or neighborhoods, the generations are siloed with their age-based peers, in schools, jobs and retirement communities, making American society one that is “arguably, the most age-segregated in the world.”

This need for intergenerational connection is not a one-way dynamic. Anderson says that the “two largest groups in society who report being the loneliest are the young and the old.” Which is why Freedman believes the “needs and assets of older and younger people are complementary.”

Maybe You Should Coach

If you’re skeptical about intergenerational connections being a fountain of youth, consider the phenomenon of elderly coaches, particularly in college athletics. The evidence may be entirely anecdotal, but this group of older Americans seems to validate the benefits of remaining connected to younger generations.

Mike Krzyzewski, the winningest coach in college basketball, is 73 and still leading one of the nation’s most successful big-time programs. Harry Statham and Herb Magee, the two coaches just behind Krzyzewski in career victories, coached until they were 80 and 78, respectively.

John Gagliardi, the college football coach with the most victories at 489, coached at St John’s College in Minnesota until he was 85. The two coaches just behind him, Eddie Robinson and Bobby Bowden, coached until they were 78 and 80.

A common denominator for these long-time coaches: daily engagement with 18- to 22-year-olds, season after season. They live in an environment where the fountain of youth keeps refreshing itself.

Implications for Retirement

Remember the conclusion from the eight-decade study: Those in middle age or older who invested in nurturing the next

generation were three times as likely to be happy as those who fail to do so.

If this statement is true, three times more happiness is a statistic that ought to reshape some retirement planning conversations. In discussions about down-sizing, or relocating to a warmer climate, children and grandchildren are obvious factors; for some retirees, staying connected with their adult children is an essential relationship.

Even for those who don't have family-based inter-generational connections, the possibilities are greater than you might imagine. With the benefits of intergenerational contact in mind, some retirement communities are operating as "shared sites," inviting young people to regularly socialize or even live amongst the senior residents, where for example, residents volunteer to be surrogate grandparents. Freedman tells of a senior living community in Cleveland with an artist-in-residence program that provides free housing for graduate music students, who agree to perform for the residents and participate in meals and other activities.

The study also mentions "those who are invested in nurturing the next generation." Athletics might not be involved, but if you are nurturing the next generation, there's some coaching going on. ❖



Let's conclude with two unusual, but relevant, retirement questions:

- **Where will you find your inter-generational connections?**
- **How can you invest in the next generation?**

Your answers might yield three times the happiness. That's hard to quantify on a spreadsheet, but a pretty big deal.

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