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A 10th Man Perspective

Borrow ◆ Work ◆ Save ◆ Borrow ◆ Work ◆ Save ◆ Borrow

If someone wanted a concise summary of the essentials of personal finance in the 21st century, these three short sentences might fit:

You borrow for the present.
You work until you can't.
You save for the future.

A bit terse, perhaps, but it succinctly summarizes the economic arc prescribed for many Americans. They will borrow, perhaps first to get a higher education or maybe a car, and work their way up to a home mortgage. Almost all major purchases and expenses, from appliances to a new roof, a two-week cruise to Christmas presents, end up being financed.

These Americans borrow because they don't have money. The only way to borrow is to show the ability to repay; they need a paycheck. So, starting in debt, Americans go to work. Debt service becomes customary, as student loans, car payments, a mortgage (or two), and miscellaneous credit balances are embedded in the household budget.

As long as you are steadily employed and financially responsible, this approach is feasible. One challenge: most Americans won't work as long as they live; their health will decline, or their skill set will no longer be valued. A 2014 EBRI (Employee Benefits Retirement Institute) survey found half of all retirees were forced to stop working well before they wanted to.

No work means no revenue, and no ability to continue borrowing for present needs and wants. The only reasonable solution: while working, begin saving for retirement; and the sooner the better.

With a good income – and some self-discipline – additional saving objectives may be possible: college funding for your kids, a second home, other assets that allow for a greater degree of freedom during your working years and material comfort when you retire. But for many (if not most) Americans, retirement is their singular financial objective for the entirety of their working years.

Borrow. Work. Save. The specifics will vary, but look around. The principal financial topics (and advertisements) in mainstream media are focused on borrowing, employment, and saving for retirement. This is personal finance in America. But does it have to be this way?

The Duty of the 10th Man

Described as an "apocalyptic action horror film," the 2013 movie *World War Z* details a fictional global struggle against a zombie invasion. At one point in the film, an Israeli intelligence officer explains why his country had the foresight to erect a cement wall to keep zombies out:

"When nine people agree on something, it's the tenth man's duty to disagree, no matter how improbable the idea."

In the movie, the 10th Man was the one who took the zombie threat seriously. According to some sources, this 10th Man doctrine has basis in fact. After a surprise attack in 1973, the Israeli military supposedly instituted this policy to protect against "groupthink," which occurs when a desire for unanimity makes people less likely to realistically appraise alternatives. History bears this out. In times past, the Catholic Church has designated a theologian as the Devil's Advocate, whose job is to argue an opposing position even if they don't agree with it. Academic and business organizations sometimes use 10th Man principles to stimulate innovation or evaluate new opportunities.

So how might a 10th Man assess the prevailing strategies of borrowing, working, and saving for retirement? And what might he (or she) consider as alternatives?

In This Issue…

* The title of this newsletter should in no way be construed that the strategies/information in these articles are guaranteed to be successful. The reader should discuss any financial strategies presented in this newsletter with a licensed financial professional.

A 10th Man Take on Personal Finance

A pragmatic 10th Man would acknowledge that the borrow-work-save approach delivers, at least on a macro-economic level. Fractional-reserve banking under Federal Reserve control increases the velocity of money in the economy, which tends to accelerate growth; people have more money, and spend more money. Inflation, a frequent side-effect of money creation, encourages people to buy now, even if they have to borrow to do so.

The lure of having more by borrowing, and the obligation to repay, compels people to work harder. Their increased productivity puts more goods and services in the marketplace. Strong employment and optimistic borrowing is a reciprocal relationship that makes a national economy hum.

Many Americans are losing out,
by being on the *borrow-work-save* treadmill.

But retirement is a financial end game for borrowing and working: there is no way to finance it, you have to save. To support retirement, the government collects taxes (for Social Security) and offers financial incentives (tax-deductible contributions or tax-free withdrawals from qualified plans).

A cynical 10th Man might also observe that while the borrow-work-save model may work for households, financial institutions are really the biggest beneficiaries. Lenders establish lifetime customers, and financial management companies receive a steady flow of savers' deposits, which typically stay invested for a long time.

But after processing the issues pragmatically, a 10th Man committed to his duty would wonder: ***What do Americans lose when they adopt the borrow-work-save model?***

They certainly lose financial control. When a large percentage of earnings are committed to monthly debt service, there isn't much "discretionary income." And savings in retirement accounts have restrictions or penalties for improper withdrawals. Once enmeshed in this combination of ongoing debt and "locked up" savings, the financial course is set, with limited chances to run outside of it.

They also lose opportunities. By and large, wealthy Americans (i.e., the "1-percenters" that, according to the Federal Reserve, control 35% of the nation's wealth) aren't grinding along in the borrow-work-save mode. They borrow to start businesses or acquire income-producing assets, like real estate. And their work isn't for a paycheck, but as asset management, looking to increase revenues.

When you're on a borrow-work-save treadmill, you most likely don't get a chance to operate in this fashion. Not all entrepreneurs are successful, but everyone who doesn't have the chance to try can never succeed. That's a huge opportunity cost.

Some 10th Man Alternatives

It isn't enough for a 10th Man to point out flaws in an existing system. Alternatives should be presented, even if they, at first, seem impractical or outlandish. Some possible 10th Man proposals:

◆ **Penny-pinch to out-save the paradigm.** Limit lifestyle expenses, get debt-free, and then save to the max. This approach reflects the core ideas espoused in the books and seminars of many mass-market personal finance gurus.

◆ **Maximize your earning potential.** If you can't save your way off the treadmill, the alternative is to earn your way out. Get on a high-income career track, become an entrepreneur, emulate aggressive investment strategies. In other words, "Think and Grow Rich."

The above alternatives are slight modifications of the borrow-work-save paradigm, and not really new. What might a 10th Man come up with that's really outside the box? How about this one:

◆ **Save for present income.** Instead of isolating all savings in retirement accounts, start using them today, for both increased wealth and current income.

It's not a mainstream thought, but it's the 10th Man's job to think outside the box, right? And it's not a crazy idea, just one from a different era.

Consider the 19th-century steel tycoon Andrew Carnegie, estimated to be the second-richest individual in history. Adjusted for inflation, Carnegie's wealth more than doubles that of Bill Gates.

Borrowing at age 20 for his first investment (a dividend-paying stock), in 10 years Carnegie had acquired assets that yielded an income 10 times greater than his salary. By age 35, he "retired" to manage his assets and fund philanthropic projects.

Carnegie's wealth was certainly a product of his times, and depending on your view, he was either a robber baron or titan of industry in some of his business activities. But even though he started from poverty, Carnegie never got on the borrow-work-save treadmill. His approach to wealth-building was decidedly different.

Could you emulate Andrew Carnegie? Maybe, maybe not. But when is the last time someone gave you a 10th Man idea to improve your finances? If your current financial program seems like a treadmill, instead of a highway taking you to your financial objectives, it might be worth considering a 10th Man perspective.

DOES YOUR FINANCIAL TEAM INCLUDE A "10th Man"? ❖

Some people – even some "financial experts" – have an irrational dislike of annuities. Even though annuities have been used since the Roman Empire, they resolutely denigrate their purpose and insist other options are better. Why? After processing their explanations, it appears they don't want to accept simple financial concepts. Such as:

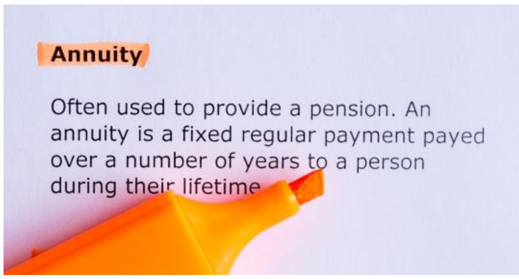
There is no free lunch.
You can't have your cake and eat it too.

As Jack Nicholson's Col. Jessup would say, "They can't handle the truth!" Okay, maybe there's a bit more to it. But as you read along, remember the clichés.

"Risk-Free" Isn't Free

An annuity is a contractual agreement to receive a series of payments over a defined period. Individuals obtain annuities from insurance companies by making either a lump-sum or a series of deposits, then selecting a payment option and start date. These payments may be for a specific term, such as 10 years, or as long as one lives. These as-long-as-you-live annuities are commonly known as life annuities.

A principal attraction of a life annuity is that recipients (referred to as annuitants) are contractually entitled to payments, no matter how long they live. This is a big deal. A 2015 survey commissioned by the American Institute of Certified Public Accountants (AICPA) found that the **greatest single retirement concern** – even among high net worth individuals **– was running out of money**. When an individual places a portion of their assets in a life annuity, the insurance company assumes that longevity risk.



A life annuity stops payments when the annuitant dies. If an annuitant dies sooner than projected, any undistributed balance is retained by the insurance company to ensure payments for those who might live beyond their life expectancy. This is a basic insurance concept. By pooling resources, everyone's risk is diminished, and every annuitant can expect a guaranteed income for life.

For annuity-haters, here's the rub: What if you're an annuitant who doesn't live to expectancy? If, for example, you give the insurance company $250,000 for a life annuity at 65 and die in an accident at 70, a good portion of the $250,000 deposit will be retained by the insurance company for someone else's benefit. Everyone wants the guarantee of a lifetime income, but no one wants to be the "loser" in a pool of annuitants.

To offset this concern, some life annuities offer a cash refund option; if the annuitant dies prematurely, the balance of the principal is paid out in a lump sum to a beneficiary. Example: If the individual in the example above had received $15,000 a year for five years, the remaining principal of $175,000 would be distributed to heirs. This feature mitigates against the risk of an earlier-than-projected demise. But the combination of a guaranteed lifetime income and refund of principal will lower the monthly income payment in comparison to a straight life annuity. Every financial guarantee has a cost, even it's for something you end up not needing. It's a characteristic trade-off at the heart of every insurance transaction.

Managed-Payout Accounts: (No, you can't have your cake and eat it too)

A review of past performance suggests it might have been possible to exceed the returns offered by an annuity through astute asset management. Thus, in hindsight, one might say, "Well, you know, they really didn't need that annuity guarantee. If only they had kept the money in (fill in the blank), there would have been more than enough income to last their entire life."

This train of thought ignores two obvious factors: no one knows *how long they will live*, and no one knows *whether past investment performance can be replicated*. Surrender of principal and potentially lower returns are the price for securing guarantees against these two unknowns.

But this doesn't stop some people from wanting to believe they can have an annuity's advantages without paying for them. A June 13, 2015, *Wall Street Journal* article titled "In Search of Steady Income" commented on the development of managed-payout funds, which are accounts designed to "take a lump sum and convert it into monthly income."

Similar to a life annuity, these accounts aim to pay a steady income over a set period. Unlike an annuity, the payments and principal are not contractually guaranteed; they fluctuate depending on investment performance. However, assets can be withdrawn from the account at any time, and any balance remaining at death can be inherited by beneficiaries.

Simply put, the managed-payout structure offers the possibility of everything in retirement income, but *guarantees nothing*. Why would this format be attractive for retirees concerned about running out of money in retirement? Per Liz Moyer, the *WSJ* reporter, "The concept can be appealing to investors who are reluctant to buy annuities, which also offer steady income, but require investors to surrender control of the lump sum."

So…when you can't accept that guarantees have a cost, you're apparently willing to believe there's a format to ensure that you won't need them. *That's irrational.*

In fact, several experts mentioned in the *WSJ* article admitted the managed-payout concept is problematic. One financial planner said he couldn't recommend the strategy because of the lack of guarantees. An investment-research firm analyst said, "Investment firms are at the drawing board trying to figure out what will resonate with investors. There are widely accepted views on how to diversify and accumulate savings. There's not a consensus on how best to help investors take out income."

The Best Solutions Still Use Insurance

As the Baby Boomers surge into retirement with lump sums from IRAs and 401(k)s instead of pensions, interest in, and use of, annuities is on the upswing. This demand is also driving some annuity innovation. An example: Some new life annuity features allow the owner a one-time option to stop payments and either suspend the undistributed balance, or receive it as a lump sum.

Like other contractually guaranteed provisions, the annuity owner pays an annual fee to retain this privilege, and the monthly payments will be slightly lower compared to a straight life annuity. The guarantees come with a cost, but the consumer has greater flexibility and knowledge in selecting benefits and paying for them.

The idea that smart people can produce guaranteed financial outcomes without using insurance is seductive, especially when looking backward at those who had it and didn't have to use it. But our present life goes forward into the future, not back to the past. Regardless how certain we are about the past, the future is still unknown, and the only reasonable way to improve financial certainty going forward is with insurance. And insurance isn't free.

When someone says, "I hate annuities," one veteran annuity expert is fond of replying, "I hate 'em, too. But I like what they do." An annuity is a guaranteed solution to retirees' greatest concern: running out of money. To be hostile about an insurance solution that answers this retirement challenge is irrational. ❖

Annuity guarantees are based on the claims paying ability of the issuing insurance company.

Ginger or Mary Ann? Elvis or the Beatles? Paper or plastic? Alongside these time-worn debate topics, Baby Boomers have added another either/or obsession: Should they start claiming Social Security retirement benefits at age 62 or wait until 70?

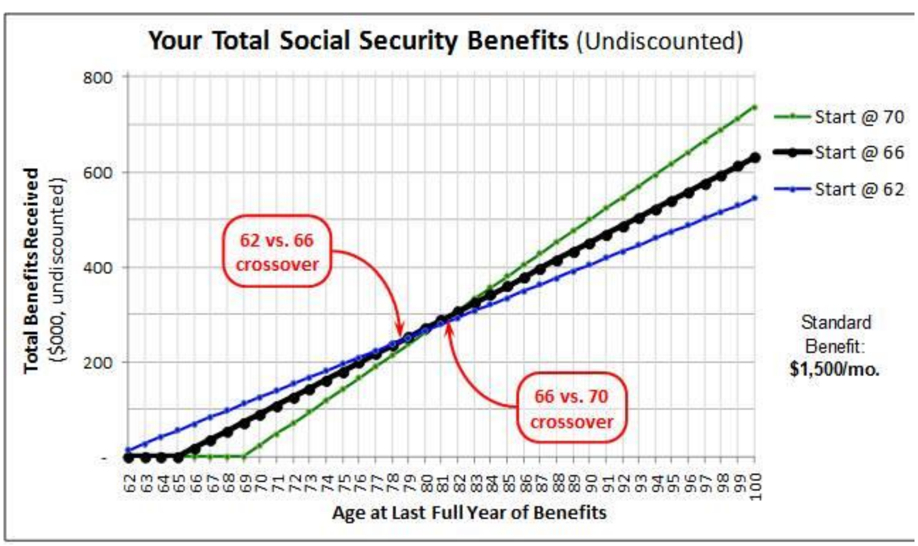
Math and econ nerds can produce a blizzard of spreadsheets, graphs and analysis supporting both positions. But some observers are not impressed, saying these elaborate calculations that supposedly "maximize" Social Security are irrelevant distractions. Brenton Smith, a risk manager who regularly writes on Social Security topics says "You have a better chance of maximizing your benefits with Tarot cards than listening to experts on the issue of setting your claiming date."

What's the fuss about?

The Options: From 62 to FRA, to 70

Fully-vested participants born between 1943-1954 can receive their full Social Security retirement benefit at age 66. This is known as one's Full Retirement Age (FRA), and serves as the baseline for calculating benefits taken earlier or later. (For those born between 1955-1960, the FRA advances two months each year, while all those born after 1960 have an FRA of 67.)

Participants may elect to receive benefits as early as 62, or defer them to age 70. For each month you receive benefits prior to your FRA, the monthly amount is decreased. For each month income is deferred past the FRA, the benefit increases. Beginning at 62 results in a 25 percent reduction compared to one's FRA benefit, while waiting until 70 increases it by 32 percent.



So….**is it better to receive smaller payments for a longer period, or larger payments over a shorter one?** According to the Social Security Administration, it really doesn't matter:

If you live to the average life expectancy for someone your age, you will receive about the same amount in lifetime benefits no matter whether you choose to start receiving benefits at age 62, full retirement age, age 70 or any age in between.

Because Social Security includes a Cost of Living Adjustment (COLA), the impact of inflation on waiting is negated; benefits withdrawn at a later date are projected to have the same purchasing power as ones received today.

The graph here, from business consultant Randall Bolton, supports the general equivalence of benefits received, regardless of when they begin, as the payment option lines converge around life expectancy.

The graph also charts the "cross-over points" for different claiming options. This is the year in which waiting becomes more profitable than taking benefits early. The cross-over between claiming at age 62 and 66 is roughly age 78, meaning, you need to live past age 78 to be better off by waiting until age 66. The cross-over for waiting until 70 instead of 66 is 83.

For Bolton, "(T)he decision about when to start your benefits hinges on how long you – and your potentially surviving spouse, in some cases – expect to be around. The longer you expect to live, the more it makes sense to hold off starting for a couple of years in order to collect the higher benefit."

But Cross-Over Calculations Are Fluid

An article by Doug Lemons, a retired Social Security Administration regional commissioner, in the January 2012 *Journal of Financial Planning* took the cross-over calculations a step further, attempting to factor the impact of taxes and investment returns. Including these variables moved cross-over points, depending on the assumptions used. Instead of cross-overs between 78 and 83 in Bolton's model, the range was 81 to 87. A February 2013 *US News & World Report* article observed that when lower rates of return are assumed, a "62-year-old claimant comes out 'ahead' by filing early."

But all these conclusions are based on guesses about the future. In the end, any maximization calculation regarding the timing of Social Security is really a bet on whether you will live longer or shorter than the average American. Cross-over calculations can establish the odds, but don't guarantee outcomes. The ultimate financial value of your Social Security decision depends on how your life plays out.

Which Brings Us to the Real World…

According to Social Security Administration statistics published in a June 27, 2015, *Washington Post* article, 37 percent of people take reduced benefits at 62, as soon as they are eligible. And most likely, they don't make this decision because of a cross-over calculation. Other factors are primary; for most, a maximization analysis is irrelevant.

Two primary deciders are **health** and **employment status**. Workers in poor physical condition are more likely to begin Social Security as soon as possible. If health is already affecting their ability to work, and is likely indicative of a shorter life expectancy, claiming at 62 is physically and financially logical.

The prospect of declining health is a factor even for those who expect to live a long time. If you claim Social Security earlier, your ability to enjoy it is probably greater. As the *Motley Fool's* Brian Stoffel put it in a March 2015 forum, "(Y)our ultimate goal should be to *enjoy* retirement – not necessarily maximize your Social Security payments. I haven't heard of many people on their deathbed saying, 'I wish I would've waited to claim Social Security.' "

A May 28, 2014, *Forbes* article cited SSA statistics, finding that "Those who work in physically-demanding blue collar jobs and those who have put in a full 35 years on the job tend to claim benefits early at age 62. Also, a greater share of those who reported being retired, unemployed or otherwise out of the labor force, claim early."

Additional external factors influencing a Social Security decision are marital status, taxes, and other retirement assets. If a spouse is still working, his/her income might cause a portion of Social Security benefits received by the other to be taxable, negating some of the benefits of an early claim. Depending on the disposition of other retirement assets, it may be desirable to take distributions from retirement accounts from 62 to 70, then receive the increased monthly benefit that comes from the deferral.

And there's still concern about the long-term viability of Social Security. SSA trustees have told Congress there is a less than 50-50 chance that full benefits can be sustained beyond 2033, at which point benefits may be reduced. A lot can change in the next 18 years, in taxes and benefits, to move that number. But right now, a female turning 62 this year has a projected life expectancy well beyond 2033. Deferring to receive potentially diminished benefits completely undoes any present maximization calculation.

As you approach retirement, you need to know your Social Security options. But because the true financial returns from Social Security can only be calculated at death, it's difficult to determine which claiming date is going to be optimal while you're alive. And other issues, financial and non-financial, will almost certainly be more important in your decision.

Your Financial Representative can help you understand your financial options, and lower retirement stress. ❖

"(Y)our ultimate goal should be to *enjoy* retirement – not necessarily maximize your Social Security payments.

- Brian Stoffel, *Motley Fool*

PREVENTING:

A combination of demographic, social, financial, and technological dynamics has spawned what some are calling a criminal epidemic: elder financial abuse.

The Baby Boomer generation is aging, dramatically increasing the number of Americans over 65. And while medical advances have extended their life expectancies significantly, many are likely to live their twilight years in a state of diminished mental awareness. At the same time, increased mobility and changing social attitudes mean they are more likely to live alone. Yet, as beneficiaries of a century of economic prosperity, this generation also holds much of the nation's wealth.

Today's communication technology makes it astonishingly easy for criminals to make direct contact with susceptible seniors. As Daniel Williams puts it in the July 2015 issue of *Retirement Advisor*: "Elder fraud didn't begin with the advent of the telephone or cutting-edge technology, but it's allowed thieves easier access to other people's money."

The Perils of Isolation

As awareness of elder financial abuse has grown, several studies have uncovered some interesting, almost counter-intuitive findings. A comprehensive 2011 study commissioned by AARP identified those at the highest risk of elder financial abuse. Three prominent factors:

- ***They were women (twice as likely as men to experience elder fraud).***
- ***They were between the ages of 80 and 89.***
- ***They often lived alone.***

The study also examined different types of fraud and scams, and found some seniors were susceptible to particular schemes. For example, investment fraud victims were more likely to be male, relatively wealthy and better educated. At first, that doesn't seem logical. A possible explanation: overconfidence in their knowledge and a lack of awareness about their declining cognitive abilities made these men easy marks.

Prevention through Trusted Disclosure

One of the more interesting observations about elder financial abuse, and deterrents to it, comes from a 2015 report sponsored by Allianz Life. An April 20, 2015, article from cnbc.com reported:

"When seniors discuss their finances with a friend, family member or professional, they are significantly more likely to take preventive measures to keep financial abuse at bay."

Those at the highest risk of elder financial abuse:

- ***They were women (twice as likely as men to experience elder fraud).***
- ***They were between the ages of 80 and 89.***
- ***They often lived alone.***

The report found that elderly respondents who discussed their finances were significantly more likely to shred sensitive financial information, regularly check financial statements, and avoid signing documents they did not understand.

Allianz acknowledges these correlations don't constitute a sure-fire method to prevent elder fraud. But having others involved makes sense, especially if the disclosure includes more than one family member, friend or trusted professional. When someone protects your interests and watches the other protectors, it's a good combination. Here are some practical steps toward establishing this hedge against financial abuse:

If you are an elderly person…

1. **Admit the possibility of diminished capacity in the future**, even if you think you're on top of things right now.
2. **Place a team around you.** Consider involving your children, and select a "point person" among the financial professionals you work with. Encourage both your children and the financial professional to be involved in your financial transactions.
3. **Put it in writing.** Documents that clearly define your wishes and designate fiduciaries are a firewall against financial opportunists.

If you have elderly parents or friends…

1. **Ask them if they have a team in place.** If they don't, ask if they want one. (If they don't, let it go. Coercion, even with good intentions, can also be elder abuse.)
2. **Consider others who should be part of the team,** especially other siblings. Taking too much initiative without the support of others leaves your motives open to suspicion.
3. **Get to know the financial professionals in your parent's or friend's life.**

- **Preventing elder financial abuse is a team effort.**
- **Who is on *your* team?**
- **Who needs you on *their* team?**

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