# Creative
wealth maximization strategies*

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## A Moat around a Pup Tent

*Imagine putting a Moat around a Pup Tent!*

A **moat** and a **pup tent** are two things we normally don't associate with each other. The pairing is almost an oxymoron (like "jumbo shrimp"), and the mental image brought to mind seems ridiculous, because for most of us, a moat belongs around a castle, not a pup tent. But by the time you finish this article, a moat and a pup tent may be permanently – and logically – linked in your consciousness. You're about to experience the power of *context*.

### Peeking behind the Curtain of Behavioral Finance

***Why is it so hard to do what's good for us?***
***More to the point, why is it so hard to keep doing it?***

These are the kinds of questions behavioral scientists ask. Although humans are certainly capable of rational thought, and may be aware of their self-interests, they have a maddening tendency to do a lot of dumb and even self-destructive things. This irrationality shows up in money-related issues as well.

Behavioral finance attempts to use insights from psychology to understand and influence our economic actions. Besides trying to understand our motivations, it also considers external factors that might be manipulated to "nudge" us toward good decisions. In general, behavioral finance concludes there are three basic ways to alter individual behavior:

1. Make rules
2. Educate
3. Change the context

**Making rules** is a "because-we-say-so" approach. It's what parents do with children, and governments legislate for their citizens. In almost any social environment, some rules are necessary: they bring order, set expectations, and protect us from chaos. But while rules may seem like simple, straightforward responses to behavior challenges, they may also cause unintended consequences. Worse, poorly-considered rules can actually encourage negative behaviors. (For example, some historians argue that Prohibition encouraged alcohol abuse and created vast profits for organized crime. Oops.)

Instead of commanding better behavior and enforcing compliance, an alternative strategy is **education**. Just getting the facts out can often be enough to sway behavior in a positive direction. In 1964, the US Surgeon General issued a report that concluded cigarette smoking was directly linked to lung cancer. One year later, surveys showed that 42% of American adults smoked; by 2011, only 19% did. Unfortunately, "just the facts" doesn't always lead to change. We may know that fast food is nutritionally deficient, but knowing may not deter us from eating it, especially when we are hungry and in a hurry.

**Changing the context** is strategically ordering information to influence behavior. Depending on our awareness of what's going on and how we feel about it, we might label context-changing "persuasion," or "propaganda," or "advertising." It's as simple as a politician

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repeatedly characterizing “taxes” as “revenues,” and as subtle as the color schemes and background music retailers use to boost sales. It’s deciding whether an appeal to opportunity or security will yield better results.

Context-changing has infinite possibilities, and it’s the place where financial behaviorists focus a lot of their efforts. But a multitude of contextual messages can also distract, confuse, and immobilize us. The challenge is providing a context that both clarifies and motivates.

## Financial Protection: Why Don’t We Do It?

Protection in personal finance is an essential component of wealth accumulation that people ought to do, but many don’t. Or if they do, it’s often incomplete, uncoordinated, and random. **Protection broadly encompasses three categories: insurance, cash reserves, and legal documents, and studies consistently report that the American public is under-insured, lacks adequate cash reserves, and often neglects to prepare and update legal documents crucial to controlling and preserving their wealth.** And the neglect of financial protection is not a “new” trend; whatever the underlying reasons, it is an ongoing challenge for American households. From a financial behaviorist’s perspective, what can be done?

## Rules?

Many financial risk issues in personal finance are already subject to rules. When an individual dies without a will, the state imposes its own standards for the settlement of debts and distribution of assets. Workers’ Compensation and Social Security programs tax workers and employers to fund disability insurance, income for dependents, and retirement checks. Life insurance and retirement accounts require beneficiary designations. Many states mandate minimum levels of insurance coverage for vehicles using public roads. With the Affordable Care Act, the federal government has made health insurance mandatory, and the recently-proposed “myRA” accounts intend to encourage cash reserves.

A general shortcoming in these “rules” is they default to minimum levels of financial protection; given the infinite range of incomes and circumstances, a government cannot (and should not) demand or provide full financial protection for everyone. Insisting on minimum levels of protection may protect the poorest from greater suffering, but it does not provide true financial protection, the kind that makes it possible to succeed in spite of financial tragedy.

## Education?

Knowing these minimum-standard rules are inadequate doesn’t seem to compel individuals to pick up the slack. A recent statistic from LIMRA, a life insurance research and consulting organization, determined ownership of individual life insurance is at an all-time low in America. Repeated surveys indicate most American households are 60 days from bankruptcy if their income is interrupted. A 2013 Wells Fargo study found more than a third of Americans believe they will never save enough to retire. There are plenty of facts about the problems American households face in regard to financial protection, but this education doesn’t seem to be prompting action.

Maybe it’s time for a change in context.

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## Financial Protection?

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## About That Pup Tent…

The moat-around-the-pup-tent analogy seems absurd if you believe the moat exists to protect the dwelling. A castle is a “big” asset, a moat is “big” protection for it. A pup tent? It could be protected with a waterproof canvas bag. A moat is overkill.

But what if the moat’s primary purpose is to protect the ***inhabitants***, not the dwelling? *(Ah…the change in context!)* Whether they live in a tent or a castle, don’t the lives and the potential of the inhabitants merit “big” protection? In this context, a moat isn’t overkill, but essential.

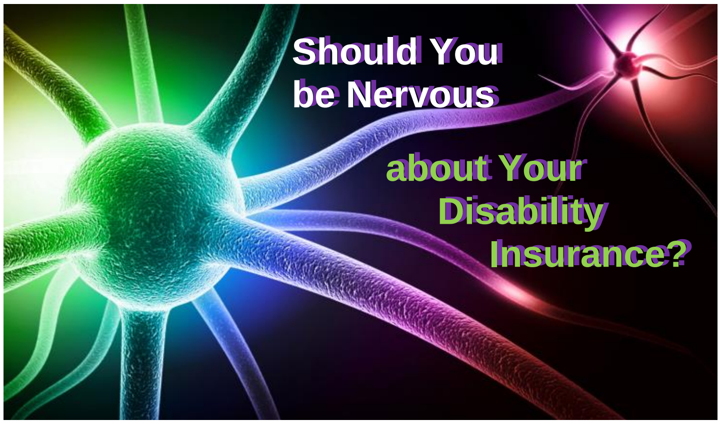
A lot of information from the financial services industry makes *asset accumulation* (i.e., “building castles”) a priority. But it’s crucial to understand that castles don’t get built without builders; **human capital is the essential wealth-building material**. Human capital provides the income to acquire assets, and the prospect of future income shapes plans for how these assets will be configured. Even if your assets are at a “pup tent” level, the moat of protection around your income potential should be as comprehensive and substantial as the future castle you hope to build.

There is another way in which the moat around the pup tent analogy makes sense. In financial terms, human life value is generally the greatest at the beginning of one’s working years, simply because there is more time to earn and accumulate. And most people don’t start their work life with a “castle” of already-accumulated assets; they are relying exclusively on their earning potential to build future wealth.

Considering these realities, establishing a robust financial moat (through life and disability insurance, cash reserves, wills and trusts) should be a financial priority – *ahead of asset accumulation*. This can be psychologically challenging, because we often associate insurance with costs, cash reserves with low returns, and estate documents with dying. As a result, there is the tendency to build a castle, then add moats to match the size of our current assets.

This is a context issue. If you understand the moat-around-the-pup-tent concept, it should be clear that a “protection first” philosophy toward wealth accumulation offers a greater chance of long-term success in light of the unforeseen real-world financial challenges we all experience. Whether your current financial assets are at pup tent or castle levels, a moat to protect the asset builders is essential. ❖

**Do your financial priorities reflect a “protection first” context?** A moat around a pup tent makes sense if you understand how important it is to protect the financial potential of those who want to build castles.




Securing disability income protection can be a detail-intensive process. The critical features in any disability income protection policy – group or individual – are the contractual provisions that define the circumstances under which a claim will be paid. And unlike life insurance, where the circumstances of death are well-defined and rarely contested, the definitions of disability may vary significantly depending on the company.

This variety in definitions can make it difficult for prospective buyers of disability insurance to make apples-to-apples comparisons between insurers. They must evaluate own-occupation definitions, the parameters of partial and residual benefits, the premium differences for term-specific versus lifetime benefits, and any individual exclusions that may arise from the application process. Since most consumers are not disability insurance experts, substantial education is usually required to select a disability plan that matches one's circumstances. (To get an idea how much discussion these disability details generate among professionals, browse an online forum like whitecoatinvestor.com.)

## A Critical Detail inside the Definitions

Besides getting familiar with the basics of disability insurance, prospective policy owners should examine the contract language regarding a specific type of disability: **one occurring as a result of a mental or nervous disorder.** There are several compelling reasons to pay special attention to this provision in any disability program you are considering.

- Statistically, a disability resulting from a mental and nervous (M&N) disorder is your biggest risk. A report released in October 2013 by the Anxiety and Depression Association of America found "that major depressive disorder is the leading cause of disability in the US." The U.S. Department of Labor website (dol.gov) concurs, stating major depressive disorder is "the leading cause of disability in the U.S. for ages 15-44."
- Because mental/nervous disorders are harder to verify than other disabling events, many insurance carriers restrict their coverage for these types of disabilities. Typically this means a cap on how long benefits will be paid, with a common limit being 24 months. So, even if you own a policy with lifetime benefits, payments from a disability claim as a result of depression will only be made for 2 years. Quite often, this limiting provision will also include substance abuse and addiction-related disabilities.

  *(It is important to note most policies distinguish between M&N disorders and organic brain diseases, such as Alzheimer's or dementia. The brain diseases are classified as "normal" disabilities, and benefits are paid accordingly.)*
- Further, the policy language may state that if an incident of disability is determined to be "caused by, resulting from, or contributed to" a mental or nervous disorder, the insurance company may apply the limitation in a more expansive context. This is a critical distinction, because as disability attorney Mindy Chmielarz writes in a May 2012 article, "Depression is found to occur at a higher rate among people with a serious illness, chronic pain, or significant physical limitations." For example, if an insurer concludes depression was an integral factor in a worker experiencing debilitating back pain, it might seek to limit benefits for the back-related disability to 24 months.
- Combine the historical prevalence of M&N factors in disability with the possibility of diminished benefits, and it is easy to see the possibility of litigation to resolve a claim – by both the insured and the insurer. From the claimant's perspective, even successful litigation delays benefits and adds stress.

## Addressing the Risks of Mental & Nervous Disorders

From a business perspective, there are logical reasons for these restrictions. Disability insurance fraud is an ongoing challenge for insurance companies, and disabilities which involve mental and nervous conditions are among the most difficult to verify. Investigative procedures to substantiate claims and legal challenges are costly, time-consuming, and impact premium pricing for everyone. At the same time, insurance companies also recognize that highly-compensated professionals (who often work in high-stress occupations) are a large target market. In the past, an indication of a latent M&N condition typically resulted in applicants being denied coverage. The 2-year limitation allows more professionals and self-employed individuals to obtain broader disability protection, while limiting the insurance company's exposure should a claim arise from a difficult-to-prove (or disprove) M&N condition.

**Managing your ongoing medical history is prudent.** If you have taken the time to examine your disability insurance, there should be an awareness of the extent to which insurance companies rely on medical documentation to guide their decisions, both to insure and pay claims, especially when mental and nervous conditions are involved. If a disability is not primarily the result of an M&N condition, it is important to clearly document it. On the other hand, M&N episodes should be treated by qualified specialists. As Ms. Chmielarz says, "An individual who treats only with a primary care physician who briefly notes depression in the record and prescribes an antidepressant, most likely, will not be considered depressed by the insurance company."

**The provision limiting benefits for M&N conditions to 24 months is not universal.** While most group disability plans impose the 24-month limiting condition, select insurance companies offer individual policies with **no benefit restrictions** for disabilities resulting from mental and nervous disorders. If such a policy promises lifetime benefits for incidents of disability, there are no caveats. However, approval of a "no limits" policy is contingent on the applicant's individual health history. In exchange for expanded coverage, applicants should expect a higher level of screening during the application process.

**If you want disability insurance without limitations, there is strong incentive for healthy applicants to secure coverage promptly.**

**If you want disability insurance without limitations, there is strong incentive for healthy applicants to secure coverage promptly.** Waiting runs the risk of developing conditions or experiencing episodes that could result in declined coverage or specific exclusions. The sooner you have the insurance (including options to obtain more in the future under the same insurability status), the better.

For young, newly-minted professionals, the cost of obtaining top-level disability may seem daunting. To address affordability issues, several insurance companies offer a menu of premium schedules – from annually adjusted increases, to 5- or 10-year term periods, and fixed for the life of the contract. There may also be the option to change premium schedules over time.

For a number of reasons, it is common for professionals and highly-compensated employees to have a mix of disability insurance, perhaps a combination of individual and group policies, or individual policies with different companies. ❖

**A review of your current coverage and its M&N provisions by a disability insurance professional can be a starting point for ensuring that you have the best protection against the most prevalent cause of disability.**

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**At what point does a possibility become a probability?**

For example, when the weatherman says there is a "chance of precipitation," how high does it have to be for you to grab your umbrella? 50 percent? 70 percent? If recent information regarding retirement in the United States represents a coming trend, it may be wise to make sure some financial umbrellas are on hand.

## The Changing Realities of Retirement

Retirement is a relatively young financial concept. The idea that people would work for 30-40 years, then retire and live on their savings for another 15-20 years was impossible to comprehend before the 20th century. Even in the industrially-developed countries of the late 19th century, most of the population didn't live long enough or accumulate enough assets to make this possible.

The first generation to experience modern retirement was born around 1900. In the U.S., this generation saw Social Security implemented during their early working years, rode the prosperity of the Baby Boom after World War II to steady employment and generous pensions – and then benefited from medical advances that allowed them to enjoy their good fortune for a longer time. It was a pretty attractive model, but in retrospect, the sample size was relatively small. As more Americans from successive generations approach retirement age, updated data suggests they are more likely to encounter new and daunting challenges to their financial well-being. Among the findings:

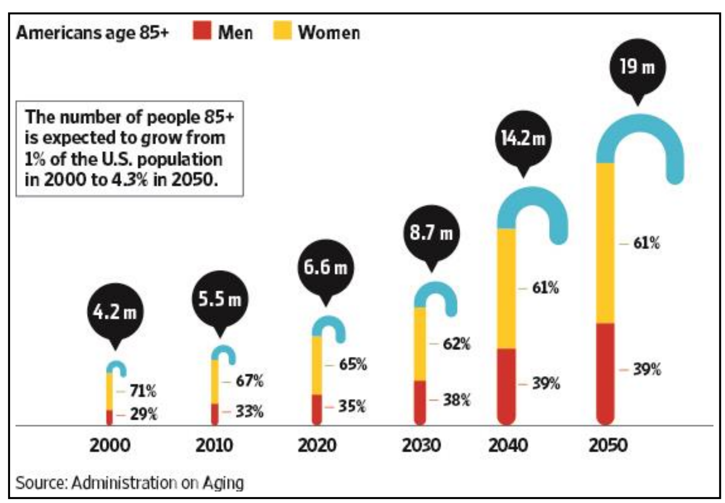
**Americans are living longer, but not necessarily healthier, lives.** Life expectancy has improved steadily, even in the past 20 years. According to a 2013 OECD (*Organization for Economic Co-Operation and Development*) report, U.S. life expectancy rose three years to 78.2 years in 2010 from 75.2 in 1990. However, the report also found the number of years of living with chronic disability, an indicator of quality of life, increased as well. On average, Americans lived in good health (i.e., without short- or long-term disabilities), for just 68.1 of those 78.2 years. This gap of 10.1 years between total life span and a healthy life span rose from 9.4 years in 1990.

An in-depth explanation of these statistics comes from a March 2014 study published by the Journal of the American Medical Association (JAMA). While medical advances have improved the outcomes for many life-threatening conditions like heart attacks, strokes and certain cancers, Americans have been slow to adopt better health habits that tend to ensure a longer quality of life. The prescriptions of "better diet, smaller food portions, increased physical activity, quitting smoking and better management of stress" are lifestyle issues that generally cannot be filled by medical procedures.

**If you live to 70, there is a high probability you will experience a retirement "shock" in the next nine years.** In a November 2012 report from the Society of Actuaries and the Urban Institute titled "The Impact of Running Out of Money in Retirement," the authors identified four "shocks" likely to disrupt retirees' financial stability: severe disability, cognitive impairment, death of a spouse, or entering a nursing home. For 70-year-old men, the likelihood of one of these shocks was 67 percent. For women, it was even higher, at 76 percent.

Any one of these events could cause significant disruption in retirement - physically, emotionally, and financially. So it is sobering to project that 2 of 3 men and 3 of 4 women will encounter these shocks in the decade after their 70th birthday.

**As we get older, retirement increasingly becomes a women's issue.** Longevity and the demographic bump of the Baby Boomer will dramatically increase the percentage of Americans over 85 in the next four decades (see chart). Right now, women over age 85 in the U.S. outnumber men 2-1.



Although demographic trends project the percentages will narrow a bit over the next three decades, the vast majority of older Americans are, and will be, women. If you combine this demographic imbalance with the findings about the gap between life span and healthy lifespan, as well as the likelihood of a retirement "shock event," it results in a troubling conclusion: The realistic probability of elderly women having to manage their retirement finances by themselves – after experiencing a financial shock.

### Shock Absorbers

Given the possibilities/probabilities of longer lives that include retirement shocks, it should prompt both retirees and those on the cusp of retirement (and their children) to consider protective financial measures.

**Develop a team of assistants.** You may have done a great job managing your money and building your wealth over the past 50 years, but what happens if your "shock" is a cognitive decline? The probabilities of aging may require financial management to eventually become a group effort. And "group" probably doesn't mean just one other person. A better way to protect your interests is by giving several parties responsibilities, in a checks-and-balances format. This team may consist of family members, financial professionals, and trusted friends. The designations should be in writing – as part of power-of-attorney documents, or similar authorizations used by financial institutions.

**As you get older, make it simpler.** Scientists who study cognitive decline identify two different types of intelligence – fluid intelligence (the ability to learn and process information quickly) and crystallized intelligence (your at-the-ready knowledge of your world). Some studies indicate fluid intelligence declines as early as middle age (45-49), but crystallized intelligence increases until around 65. To a great degree, crystallized intelligence compensates for losses in mental fluidity. The same researchers determined that "financial literacy declines in later life and investment skills deteriorate sharply around age 70." We can expect to retain comprehension of financial basics, because they have "crystallized" in our perceptions, but complexity and change may be problematic.

A simpler approach promises less confusion and anxiety, and not just for you. Delegating complex financial decisions to someone else puts pressure on them to perform in your stead, a responsibility they may not be qualified for, or want to take on.

**Make guarantees part of your program.** One of the attractive features of the "first-generation" retirement model was the (almost) certainty of a lifetime pension and Social Security payments. Although hindsight might argue the returns could have been greater if allocated elsewhere, those monthly checks provided a secure financial foundation for retirement. Regardless of the "shock" one might encounter, and the subsequent costs, these baseline financial items were not affected.

Retirees can achieve similar baseline guarantees with insurance vehicles. Annuities can provide a lifetime stream of payments. And life insurance designed to remain in force can minimize or eliminate many of the financial and estate challenges encountered at death. ❖

> It is impossible to predetermine whether these possibilities of old age and retirement will happen to you. But the potential hardships in these scenarios should prompt retirees and those who love them to have plans in place now for a smooth transition toward a simple, safe, team-directed approach to personal finances.

## The Legacy of Oseola McCarty

When a movie carries the tagline "based on a true story," it usually means one plot element is true, but other essential aspects of the story (such as characters, dialog, and events) have been "re-imagined" for dramatic effect. But some true stories are so fantastic they don't need dressing up. And instead of being the basis for a Hollywood screenplay, they become legends. This is the legacy of Oseola McCarty.

In 1995, 87-year-old Oseola McCarty of Hattiesburg, Mississippi walked into the Trustmark Bank for an estate planning discussion. Ms. McCarty had never married, had no children, no family to assist her, and limited financial understanding. In trying to simplify her estate decisions Paul Laughlin, her banker, came up with a novel idea. According to a December 13, 2013, article by John Koten, the meeting went like this:

> First, he handed the woman 10 dimes, each representing 10 percent of her estate. He then gave her five slips of paper with beneficiaries' names she had selected and asked her to divide up the coins. The elderly woman slowly deposited one dime for her church, and one each for three cousins. Then, after a pause, she put the remaining six dimes on the slip designated for the University of Southern Mississippi."

The six dimes represented roughly $150,000. Ms. McCarty wanted her bequest to be used to fund scholarships, preferably for African-American students from southern Mississippi who could not otherwise afford a USM education. Following discussions with university officials, a scholarship fund was established, and the donation announced to the public.

Two items made this gift stand out. At the time, Ms. McCarty's donation was the largest by an African-American to USM. But more than the size of the donation, it was Ms. McCarty's life story that garnered global attention.

Born in 1908, Oseola McCarty was raised in Hattiesburg by her grandmother and aunt, who made a living cleaning houses and taking in laundry. When Ms. McCarty was in the sixth grade, her aunt was hospitalized and needed homecare. Ms. McCarty dropped out of school to care for her aunt and take up her laundry work. She never resumed her education, working as a washerwoman for more than seven decades before arthritis forced her to retire in 1994.

Ms. McCarty's material circumstances were below modest. Her earnings were minimal, she never owned a car, and lived alone in a home given to her by her uncle in 1947. She generally shunned extravagance, even refusing to subscribe to a newspaper. Her social life revolved around her work and her church. But even before she dropped out of school, Ms. McCarty's mother had taught her to save money. And from the very beginning, Oseola McCarty was a magnificent saver. As she told one reporter:

> "I commenced to save money. I never would take any of it out. I just put in…It's not the ones that make the big money, but the ones who know how to save who get ahead. You got to leave it alone long enough for it to increase."

Then, after a lifetime of saving, the woman who'd had so little decided to give it away. The magnitude of her generosity was stunning. It inspired others to give – more than 600 people donated an additional $330,000 to increase the scholarship fund. With prudent management, the fund has grown, and over the past two decades, 44 students have received scholarships. McCarty received honorary degrees from USM and Harvard, and was in a special White House Ceremony with President Clinton. She is enshrined in the Philanthropy Roundtable's Hall of Fame (to read her story, see www.philanthropyroundtable.org).

"It's not the ones that make the big money, but the ones who know how to save who get ahead. You got to leave it alone long enough for it to increase."

Ms. McCarty passed away in 1999. But her example is recalled in every USM bequest. Writes Koten:

> "Today, when a Southern Miss alumnus names the school in a will, he or she is inducted into the McCarty Legacy Society. Its logo is a tree with six dimes at the end of its branches."

Most conversations regarding financial planning are heavily egocentric – it's about you, your money, your retirement, your future, and your family. But it would be a mistake to ignore the lasting impact an estate gift might have on people whom you may never know, and how far the impact of that gift might reach into the future. ❖



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