



March 2018

## RE-INVENTING PERSONAL FINANCE

(even though nothing has changed)



“We have now sunk to a depth at which restatement of the obvious is the first duty of intelligent men.” - George Orwell

### “What is Reverse Budgeting?” (Aw, you probably know.)

Reverse Budgeting is a strategy that addresses two fundamental issues in personal finance: The need to save for the future, and the psychological challenges that accompany that task.

If everyone understood their personal finances as a business (which it really is), and if we saw ourselves as business owners (which we really are), then we would do what good business owners do: prepare a budget to analyze costs, set limits on spending, and maximize profits. And once completed, we would live by it, at least until circumstances proved the budget needed to be adjusted.

But most of us resist this level of detail and management. As Peter Lazaroff, a *Wall Street Journal* personal finance writer says, “Traditional budgeting forces you to make every decision as if you live in a spreadsheet. But guess what? You don’t live in a spreadsheet.”

With Reverse Budgeting, you simply decide how much you’re going to save each month or pay period, and have that amount automatically deposited – into a savings account, retirement plan, mutual fund, insurance policy, whatever. And then you can spend the rest of your income however you want.

Reverse Budgeting is, to use present vernacular, a way to “hack” our human tendency to be overwhelmed by details and the tyranny of the urgent. It removes the angst that comes from making, keeping, and constantly adjusting a budget, and makes the most important thing – saving for the future – as easy as possible.

About three thousand years ago, King Solomon purportedly looked at the world around him and made this timeless declaration: “*There is nothing new under the sun.*”

To which the hipster millennial responded, “*Oh yeah? What about Twitter?*”

Of course, even the hipster knows Solomon wasn’t talking about technological change, but the essential elements of life, the fundamental things we must do to stay alive, to interact with others, to care for those we love, to find meaning. Over the centuries, across all cultures, those things don’t change.

Something else that might appear to have changed, but really hasn’t: Personal finance. When you get to its essentials, the issues of personal finance today are the same as they’ve always been: to protect one’s assets (both human and material), to save for the future, and perhaps to leave a legacy for those who come after us.

But some people, especially those with a marketing bent, want to put a different wrapper on timeless ideas and present them as “hidden secrets,” or “amazing breakthroughs!” And thus, we have “Reverse Budgeting.”

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\* 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

## Reverse Budgeting in History – From the Ant to the Savage Circles

There is a financial planning organization that, according to its webpage, claims to have invented Reverse Budgeting. Saying their innovation was “born” out of a desire to see their clients spend their money “without feeling guilty or irresponsible,” the firm has even trademarked the phrase **Reverse Budget™**.

But Reverse Budgeting is truly nothing new under the sun. It has ancient roots, going back at least to Solomon. Except a marketing guru of his day might have called it the “Ant Plan.”

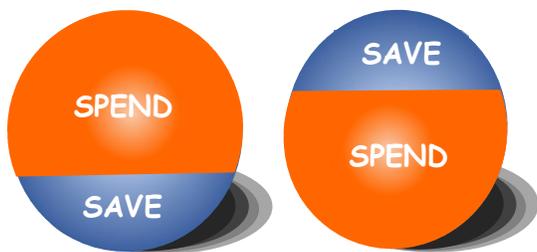
Aesop was a slave and storyteller believed to have lived in ancient Greece around 600 BCE. One of his most familiar fables is “The Ant and the Grasshopper,” about an ant who saves diligently while a happy-go-lucky grasshopper sings and plays, only to face starvation when winter comes and he has nothing stored up to eat. Even though ridiculed by the grasshopper for his reluctance to enjoy the moment, the ant overcomes distractions to focus on the most important thing: saving for the future.

Of course, in agrarian societies, “the future” wasn’t 30 or 40 years in the distance; it was each winter. You didn’t save for retirement, you saved to make it to the next harvest. But even in “modern times,” Reverse Budgeting has had a previous incarnation, under a different name.

From the early 1960s until his death in 1993, John Savage was a prominent figure in the financial services industry, known for simple diagrams that explained the fundamentals of personal finance. One of Savage’s best-known illustrations was the Two Circles.

Savage would draw two circles side by side. In the circle on the left, he would write “spend” and underneath write “save.” In the circle on the right, he would reverse the order.

“There are two kinds of people in the world,” Savage would say. “Those that spend first, then save what is left over. And those that save first, then spend what is left over.” And after a dramatic pause, he would ask, “Guess who are the better savers?” Two circles, three sentences, one conclusion, mic drop. That was Reverse Budgeting, 1970s-style.



REVERSE BUDGETING (1970s-STYLE)

### New Versions of Old Truths Are Okay

Even if it’s not really new, it’s probably good that Reverse Budgeting has been introduced. Most of us need regular reinforcement, to keep hearing the old stuff we already know. And sometimes the best way to do that is to make what seems old look like something new. Because right after Solomon noticed there was nothing new under the sun, he also said:

**There is no remembrance of former things; nor will there be any remembrance of things that are to come by those who will come after.**

The Ant Plan, the Savage Circles, and even the Reverse Budget, will probably be forgotten by the next generation, only to reappear as another “new” idea. But innovation is just a different iteration of the same good idea.



### Making Saving Habitual (it might require a budget).

William James, a late-19<sup>th</sup> century philosopher often referred to as the “father of American psychology,” is someone of whom there is little or no remembrance today by most Americans. But James had a great respect for the power of habits:

**“All our life, so far as it has definite form, is but a mass of habits – practical, emotional, and intellectual – systematically organized for our weal or woe, and bearing us irresistibly toward our destiny, whatever the latter may be.”**

Of course, since there’s nothing new under the sun, James was echoing back to Aristotle, who said:

**“We are what we repeatedly do. Excellence then, is not an act, but a habit.”**

By starting with saving and making it automatic, Reverse Budgeting provides a practical, emotional and intellectual structure for wealth accumulation to become habitual. And once established, there’s only one thing that might derail this habit: an unrealistic saving target.

A decision to save 20 percent of take-home pay is admirable. A decision to save 20 percent, then finding it doesn’t leave you enough money to pay your basic living expenses, let alone any incidentals, is foolish, and going to fail.

Which is why, at least once, you should construct a realistic budget, if only to see how much you can save habitually. After this sustainable saving becomes a habit, it can be gradually increased – maybe without making another budget.

To restate the obvious one more time: **“There’s nothing new...”** well, you know the rest. The basics of life, and personal finance, don’t change. And habits shape your destiny.

**How robust are your saving habits?  
Strengthen and protect them,  
because they will bear you  
irresistibly toward your financial  
destiny. ❖**



## AUTO-ENROLLMENT: A “Nudge” Toward More Debt?



“*Nudge*” is a 2008 best-seller by Richard Thaler and Cass

Sunstein about how well-designed policies by governments and businesses can influence behavior and, according to the book’s subtitle, improve “decisions about health, wealth and happiness.” One of the prominent “nudges” promoted in the book is automatic enrollment in employer-sponsored retirement plans for new hires, for the purpose of increasing long-term saving. In many instances, not only is enrollment automatic, but so are annual increases in contributions.

When automatic enrollment is the default option, Thaler and Sunstein say employees are more likely to save for retirement, simply because most will not take the time to undo the decision. And as automatic saving becomes routine, they adjust their budgets accordingly, because they don’t miss the money they never really had.

At first glance, auto-enrollment seems like a no-brainer, a way to help employees “save first.” But when you go deeper, there are indications the outcomes may not be entirely positive.

It turns out that auto-enrollment *does* increase participation in retirement saving. And workers do adjust for this saving, but perhaps not always in the way that the “nudge” intended. Summarizing a recent study by academic economists at Yale, a January 5, 2018 *Wall Street Journal* article concluded:

**“Automatic enrollment has pushed millions of people who weren’t previously saving for retirement into 401(k)-style plans. But many of these workers appear to be offsetting those savings over the long term by taking on more auto and mortgage debt than they otherwise would have.”**

Auto-saving nudges people to more debt? That doesn’t sound good. Yet, according to the researchers, this additional debt may not be that bad. Apparently, even simple nudges can be complicated.

### Good Intentions, Sledgehammer Execution?

Saving for the future is a critical, if not *the* essential, activity in a personal financial plan. If there is no saving, there is no plan. But when individuals (or their employers, through auto-enrollment) make a qualified retirement plan their primary saving destination, they may end up funding one of their last financial events (retirement) to the detriment of other intermediate financial issues.

• **“Todays come first, tomorrows come next.”** It’s true that the biggest saving project for most people – i.e., the one that costs the most and takes the longest to fund – is retirement. But it’s not the only project. Accumulating money for a down

payment on a home, for a child’s college education, for business opportunities or emergencies, are saving projects common to many households. For both practical and psychological reasons, some of these other projects may need to be addressed before saving for retirement – even if it means opting out of auto-enrollment.

The financial imbalance that comes from saving for tomorrow without taking care of today shows up in the high percentage of 401(k) participants who periodically raid their retirement accounts, either through loans or early withdrawals, to pay for things that could have (and perhaps should have) been saved in something other than a retirement plan. The loan repayments and penalty taxes that result are costs that could have been avoided if saving wasn’t tilted toward retirement accounts by auto-enrollment.

#### • What about the debt?

The study finds that those who are auto-enrolled appear to carry more debt, particularly larger mortgage and car payments. One obvious reason: by saving in retirement plans, where pre-retirement withdrawals are difficult and costly, there isn’t as much available for down payments. The result: bigger loan balances.



But consider: If your retirement account investments earn  $X$  percent this year, but you’re paying an average of  $X+I$  percent interest (in car payments, on a personal loan, or for outstanding credit card balances), are you gaining or losing ground? How do you weigh saving versus debt reduction?

The authors suggest the higher-saving-with-higher-debt condition reported in the study can, in some cases, be a positive, because the mortgages are considered “good debt.” If a home’s value increases over time, a higher mortgage balance may be a shrewd leverage play, where a smaller deposit secures an appreciating asset, and what could have been a larger down payment ends up deposited elsewhere (like the retirement plan), diversifying the asset mix.

But there are opportunity costs that compound against you by continuing to pay interest. It is reasonable to question whether more money should be allocated to debt reduction instead of retirement. Or at least used to increase liquid cash reserves.

• The study also suggests that **auto-enrollment doesn’t necessarily get people to save more**; it just changes the destination for those who already have the habit. John Friedman, an economist at Brown University, told the *WSJ*: “A big question is whether auto-enrollment makes you save more overall. My reading of the paper is that no, it doesn’t.” If this conclusion is true, it brings into question whether auto-enrollment is really worthwhile. Sure, it gooses retirement plan participation, which might please some policy wonks. But are individuals really better off if the default over-emphasizes retirement saving at the expense of other necessary and intermediate saving projects?

Auto-enrollment is a well-intentioned concept, one that is partly responsible for Richard Thaler being awarded the Nobel Prize in Economic Sciences last year. But the application is perhaps a bit heavy-handed, because the assumption is that retirement should be the highest saving priority for all employees. You need to ask yourself, “Do I want to be nudged into a 401(k) right now? Or should my saving be allocated elsewhere?”

A focus on retirement saving by policymakers is understandable. And encouraging saving as a habit is good. But saving in the wrong place is not. It matters where savings are deposited.

Throwing all of one's savings into a retirement plan is like building a house without first setting a foundation. To continue the analogy, the likely result of an over-emphasis on retirement saving is costly tear-downs (through loans and early withdrawals) and retrofits (buying life, disability or long-term care insurance later in life at higher prices). ❖

It appears that real savers, ones that have taken responsibility for their financial futures, don't need a nudge to save. Instead, they would benefit from guidance toward a balanced approach to saving for both today and tomorrow.



## “TOO LATE SMART” ABOUT LIFE INSURANCE?



There may  
be hope.

“**We are too soon old, and too late smart.**” This folk saying encapsulates consumer behavior regarding life insurance. The young, for whom life insurance is the cheapest and easiest and to obtain, often put off buying it. Meanwhile the old, who are the most interested in having life insurance, often find they can't get it or afford it.

This is a dilemma, for individuals and insurance companies. The prospect of paying premiums for perhaps a very long time prompts some young, healthy individuals to forgo life insurance altogether, or to wait until later and hope for continuing good health, or to minimize their present costs with term life insurance. The hazards of the first two options are obvious – there is no life insurance, and no guarantee that it will be available later. And while term insurance provides temporary protection, being healthy enough to qualify for it also means the insured will likely live longer than the term period.

At the same time, life insurance companies have challenges in selecting who to insure and how much to charge for coverage. There is an economic imperative to collect enough in premiums so that they can pay claims as they occur. But since older, less healthy individuals are closer to dying, the costs of covering this

demographic must be amortized over a shorter period, which means premiums will be higher. And because the metrics for mortality are so unyielding, it's not possible for insurance companies to have an occasional “sale” on life insurance. Insurance companies end up pricing themselves out of the market for those most interested in their product. That's a tough business model.

## Who Really Wants Life Insurance?

One possible solution is for insurance companies to do a better job approving insurance for those who really want it. According to a December 17, 2017 *ThinkAdvisor* article by Allison Bell, “The world's biggest life and health insurers may be putting more energy into developing new underwriting strategies for older, sicker people than younger, healthier people.”

A Global Life and Health Underwriting Survey, published by Reinsurance Group of America in December, 2017, found that insurance companies are attempting to expand and improve their underwriting practices for the following segments of the population:

1. **High net worth individuals**
2. **The mass market/mass affluent**
3. **Seniors/retirees**
4. **Impaired lives, i.e., those with chronic conditions or other characteristics that hurt their insurability.**

When you see the list, it makes sense. The high net worth and mass affluent are likely to have the assets and income to use life insurance for tax advantages, estate planning, increased spendability of other assets, and other wealth-maximizing strategies. And a high percentage in this demographic is old enough to soberly recognize that their eventual mortality isn't so far in the distance that they can dismiss it with “I'll deal with this later.”

Seniors and retirees, told by many financial experts that they wouldn't need life insurance when they stopped working, are finding out otherwise. In some instances, they didn't recognize the value-add of life insurance – as a permission slip, legacy asset, etc. – until they actually retired. For others, their projections of saving enough to self-insure haven't been realized; they still need the income replacement or asset protection that a life insurance benefit provides.

As for the impaired lives, these people have a greater awareness of imminent mortality, and the economic impact on surviving loved ones if they should die soon – or perhaps live a long time in a diminished capacity before passing.

These cohorts tend to see life insurance as something intended to be in-force until their death. They want the financial certainty that a guaranteed death benefit provides.

## Big Data and Predictive Analysis

The prevalent underwriting paradigms for life insurance today begin with age and gender, then sift further by tobacco use, health history, vocational and recreational activities (like sky-diving), and financial condition. How to go even deeper? Use Big Data to predict longevity.

Sometimes called predictive analysis, this process sifts mounds of data about population, geography, income, and other arcane categories to find unique correlations to insurability. This methodology has been used to set rates for other types of insurance, such as property and casualty, but is less prominent in life insurance evaluations.

It is possible that predictive modeling could uncover groups of older, less healthy individuals with longer life expectancies, giving life insurers the financial incentive to approve coverage, perhaps at prices lower than what would be assessed under current underwriting standards.

### Three Takeaways

1. **If you're in one of the four groups mentioned above, a permanent life insurance benefit, and how it might fit your unique financial circumstances, should be a regular topic of discussion with your financial professionals.**
2. **If you have been rated or declined for life insurance in the past, it might be worth revisiting your insurability. Who knows what may have changed?**
3. **But even if underwriting at older ages improves, the best strategy for life insurance is still the same: Secure the maximum amount of life insurance today, with options to decide later how much you will keep for the rest of your life. Too many people get too late smart about life insurance. Don't be one of them. ❖**

**A**lmost every discussion about preparing a will, trust or other



## THREE STEPS TO PREVENTING THE LOST ESTATE PLAN

estate planning documentation begins with *"I know I/we should do this, but..."* followed some very logical explanations for why it hasn't happened yet. And eventually, most of the time, for those that truly need to do it, a legal professional is retained, documents are prepared and signed. A sigh of relief follows, knowing what should have been done a while ago can finally be checked off the list.

And then, all too frequently, the plan is either left incomplete, or lost. Just because the documents have been signed (**that's Step 1**), doesn't mean your estate plan is finished. You still have two steps left.

### Step 2: Complete the Transfers

In many cases, you will need to transfer ownership or retitle assets to match the estate plan's directives.

An internet search with the phrase "failure to transfer assets in an estate plan" produces a cascade of commentary from law firms. Here are comments from the first three hits:

- *"The most common estate planning omission I encounter is the failure to transfer probate-type assets to a revocable trust."*
- *"Sometimes people fail to transfer some or all of their intended trust assets into their trust."*
- *"Many people will use a revocable trust as their primary estate-planning document but fail to fund the trust."*

And of course, just in case there is any doubt that this job is on you, there's a disclaimer:

- *"It should be understood that it is not your attorney's responsibility to fund the trust unless this was stated in the fee agreement."*

Transferring or retitling assets isn't difficult, but it can be tedious, especially if there are a lot of accounts to be changed. And getting the details right is essential. If necessary, get professional assistance. But complete the transfers.

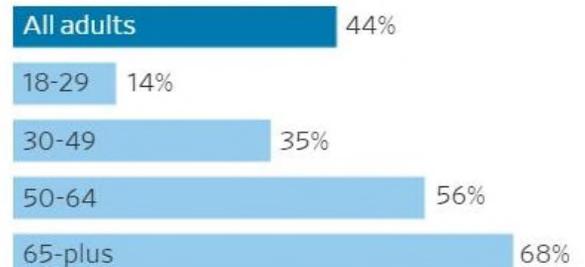
### Step 3: Make Sure the Plan Can Be Found

After executing the agreements and taking the time to retitle assets, it seems obvious most people would make sure their plans are readily accessible at their deaths. But ask any financial professional, and they probably have a story about heirs or executors being unable to locate estate documents. As personal finance writer Glenn Ruffenbach remarked in a February, 2018, *Ask Encore* column...

*"One of the most important things about an estate plan and associated documents is remembering where they are."*

### A Lack of Planning

Asked whether they have a will that describes how they would like their money and estate to be handled after their death, only about half of surveyed adults ages 50 to 64, and about two-thirds of those age 65 and older, said they have such paperwork.



Source: Gallup Poll

Several circumstances common in later life can be a catalyst for misplaced estate plans. Individuals may not consolidate their affairs in one physical location. Important papers get tossed in a desk drawer, locked in a safe, stashed in a safe deposit box, and while someone knows where some things are, no one knows where everything is.

Relocations – to a condo, apartment, or retirement facility – can disrupt a previous orderliness. Cardboard boxes with vague descriptions are stacked in closets, or stowed in an adult child’s basement, and finding the documents becomes a treasure hunt.

Third, diminished mental capacity may affect recall. The reality of estate plans is that most provisions are executed after the death of the grantors, but there may be a period when the grantors are still alive yet less competent in the management of their affairs. This is a moment of great vulnerability for the estate.

There are several practical measures to ensure that estate plans are protected and can be retrieved.

- **Make copies, including electronic ones.** The gold standard for document redundancy is the original, a paper copy, and two digital copies, one on a portable device (like an external hard drive), and the other on a cloud-based storage system. Many financial service companies offer their clients complimentary access to a digital vault, where important documents can be stored securely in an electronic format. Keep the paper original in a consolidated file, and give the paper copy to an executor for safe-keeping.



- **Prepare a brief letter of instruction for heirs and executors**, informing them of the location and/or contact information for your documents, accounts, financial professionals, and passwords. You don’t want to provide details in the letter, just instructions on how to access this information when the time comes.

Review and update this letter once a year – on January 1, a birthday or anniversary, or whenever you have a review with your financial professionals. Instruct the recipients of the current letter to contact you if they don’t get their annually updated version. This routine will prompt you to remain engaged with your estate plans. Not doing it can be an alert to your heirs or executors to check on your well-being, both physical and financial.

- **Designate professional support today.** Even if heirs and executors can locate your plans, they are probably going to need professional assistance in liquidating or transferring assets, settling obligations, paying taxes, and completing other transactions. A trusted professional who has established a personal relationship with you and your heirs can continue to look to your best interests, even after you have passed.

**If you’ve done the hard work of establishing a good estate plan, don’t let it be undone because no one can find it. Take the last step. Ensure your financial legacy will be fulfilled by making sure the right people can find your plan and execute it. ❖**

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