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NOVEMBER 2019

The Desirable Borrower

Personal finance has an uneasy relationship with debt and borrowing. From a consumer perspective, being debt-free is lauded as a financial ideal. On the other hand, most consumers can't make timely financial progress without borrowing, particularly at the beginning of their financial lives.

Lenders have a similar ambivalence: to make money, they need to attract borrowers. But they also need borrowers who repay their loans; too many bad borrowers will sink their business.

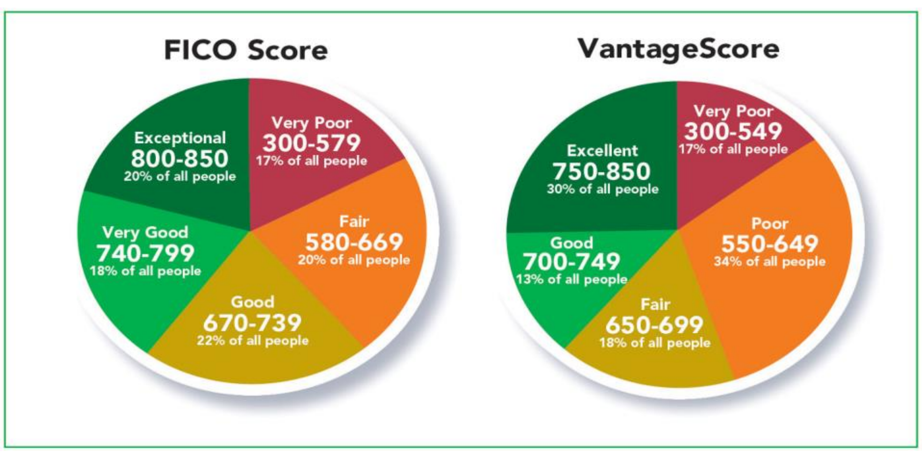
For both consumers and institutions, the ideal loan scenario isn't one of desperation. Rather it's one where a borrower doesn't need to borrow – but might benefit from doing so. It's a renter who can afford a slightly larger monthly payment, turning rent checks into equity-building mortgage payments. Or a worker, who instead of driving a paid-for vehicle that's one malfunction away from becoming too costly to repair, could have reliable transportation with warranty protection. It's a traveler who doesn't have to carry cash, but uses a credit card and pays off the balance each month.

Your Credit Score

How do lenders identify desirable borrowers? They rely on credit scores, numbers that define the relative creditworthiness of potential borrowers and determine the appropriate rate of interest for different types of loans.

Lenders may have specific in-house criteria for evaluating potential borrowers, but most lenders also use independent credit evaluation services. The two primary providers of consumer credit scores are Fair Isaac and Company, or FICO, and VantageScore, owned by the three major credit bureaus, Experian, TransUnion and Equifax.

Both credit score models grade creditworthiness on a scale of 300 to 850, with scores above 750 usually qualifying borrowers for the best rates. The pie charts below show the slight differences between the two credit bands, and the percentages of Americans in each category.



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.

What Is Considered in Your Credit Score?

Several elements are evaluated in the calculation of your credit score:

Payment History – 35% This is the most important factor in calculating credit scores. A long-term record of regular payment is a strong predictor of future creditworthiness.

Credit Utilization – 30% Credit utilization is the percentage of available credit that is currently outstanding. Paying off credit cards each month or maintaining small balances relative to your spending limit results in a better score. The credit scoring services view consumers who habitually max out credit cards as borrowers who cannot handle debt responsibly.

Length of Credit History – 15% Longer credit histories give lenders a better picture of long-term financial behavior. A current mortgage with a long, consistent payment history is a prime example of a favorable credit history. For this reason, borrowers may find it to their advantage to maintain long-standing credit-card accounts, even if they are used infrequently.

New Credit – 10% Taking on additional debt can actually be an indicator of financial progress, such as securing a mortgage for a first home. New types of debt are often seen as characteristic of a mature borrower. (However, opening multiple credit lines at the same time will not improve your score; instead, it might suggest you are in financial trouble.)

Credit Mix – 10% This category is somewhat vague, but experts say that repaying a variety of debt indicates a borrower can manage different types of credit. According to FICO, borrowers with a good mix of revolving credit and installment loans generally represent less risk for lenders. "People with no credit cards tend to be viewed as higher risk than people who have managed credit cards responsibly. Having credit cards and installment loans with a good credit history will help your FICO score."

Expanding Your Profile to Boost Your Credit Score

To become a trusted borrower, you need a good history, with the types of debt that banks and other lenders understand. But some people, even those with a comfortable level of wealth, may not have much history; maybe they don't have credit cards, or their residence was acquired by inheritance, or they use accumulated cash reserves to buy automobiles. All of these conditions point to financial health but wouldn't appear on a credit report. How can lenders evaluate these "thin-file" consumers, i.e, those whose conventional credit history is limited?

One option increasingly offered by credit-reporting services is an analysis and verification of financial activity that traditionally isn't listed in a credit report. For example: utility bills and monthly cell phone payments aren't usually considered debts, but timely payment on these accounts is a positive from a credit score perspective.

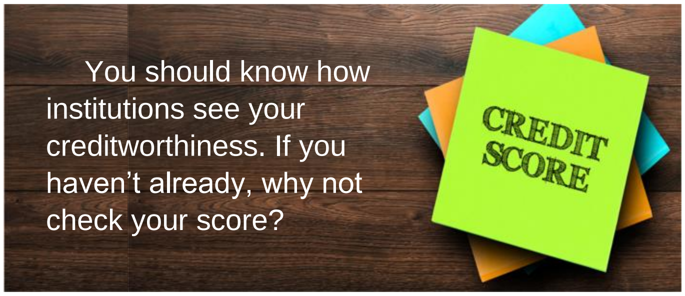
To this end, several companies have been promoting the possibility of instantly boosted credit scores for consumers who give the credit bureau access to their bank records so that additional positive financial behavior can be documented. In the six months since this option debuted, Experian said that two out of three consumers selecting this option saw their FICO scores go up, with the average increase of more than 10 points. For approximately 13% of users, this increase moved them up a credit category, i.e., they went from "fair" to "good," or from "good" to "very good." Experian estimates this analysis could positively impact up to 100 million consumers' scores.

Know Your Score

Many consumers only think about their credit score when they apply for new debt; another credit card, a car loan, a mortgage. If they're approved, the score must be okay, and they don't give it another thought. But even if you're not in the market for additional financing, it is prudent to check your credit score, and the history attached to it, at least once a year. Because, per the Federal Trade Commission's website (ftc.gov):

You're entitled to one free copy of your credit report every 12 months from each of the three nationwide credit reporting companies.

Order online from annualcreditreport.com, the only authorized website for free credit reports, or call 1-877-322-8228. You will need to provide your name, address, social security number, and date of birth to verify your identity. ❖



"In an ideal world…"

When someone starts a conversation with ***"in an ideal world…"*** you can be pretty sure that whatever follows isn't likely to occur. For example:

In an ideal world…

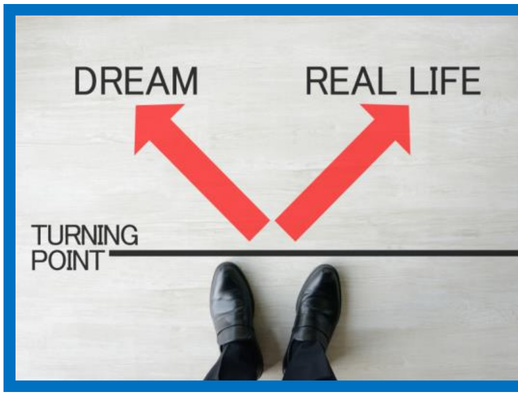
…Every college graduate finds employment in their chosen field.
…All drivers obey the posted speed limit.
…The Detroit Lions go to the Super Bowl at least once in a century.

Those are nice ideas. But we all know that some PoliSci majors are going to work as baristas, no one drives the posted speed limit, and as for the Lions making the Super Bowl, well, that's just crazy.

So, it's interesting when an August 2018 article in a prominent personal finance magazine (*Kiplinger's*) begins a discussion of life insurance with:

In an ideal world, you buy life insurance when your kids are young or you've purchased your first home, and you need the coverage only for about 20 years. By the time your policy nears the end of its term, your kids are on their own, your house is mostly paid off, and you've accumulated enough money in retirement savings for your spouse to pay the bills if anything happened to you.

Wait a minute. This sounds exactly like the *recommended strategy* for life insurance that this publication has promoted to the general public for the past 30 years. Why does the article begin with ***"In an ideal world…"?*** Because what has been recommended, while once seeming like a great idea, apparently hasn't always worked so well in the "real world." The following paragraph explains:



But these days, many people in their fifties are still supporting grown kids who graduated with student-loan debt, or they've refinanced their mortgage and locked in a new 30-year term. They may have been divorced and are now supporting a new set of kids. Or they still haven't saved enough to retire comfortably. Their coverage is about to end, but they still need the security that term insurance provides.

"*What to Do When Your Term Life Insurance is Expiring*" goes on to explain the challenges of keeping a policy in-force past its original term (the premiums "jump enormously," and may increase annually), and offers some alternatives (if you are still healthy, you could apply for either a new term policy or switch to a permanent policy, like whole life). Apparently, the ideal-world idea that "you need the coverage only for about 20 years" simply hasn't worked in the real world. But it sure sounded good.

A Mea Culpa – And a Better Approach

A fundamental concept in insurance – of any kind – is the acknowledgment that we don't live in an ideal world. Stuff happens, unpredictably. That's why it's prudent to allocate some resources to risk management.

So, when a strategy for life insurance is based on "in an ideal world…" it isn't surprising that it requires this follow-up article (which is essentially, "What to Do Now, Since Our Ideal Recommendations Didn't Work Out").

The magazine doesn't admit that its idealistic premise of only needing life insurance for 20 years hasn't withstood the test of time and unforeseen events. But there's a mea culpa of sorts later in the article, under the heading "A Strategy for Younger Buyers." *(psst…"mea culpa" is Latin for "my bad").*

The section lists some different strategies, such as longer terms, conversion options, layering policies, and blending term and permanent coverage, all with the aim of providing coverage for longer periods, under varying circumstances. And it recognizes the importance of starting from a pragmatic instead of idealistic paradigm: "The decisions you make when you buy life insurance in your twenties or thirties can help you avoid scrambling to find coverage before your policy term expires." Because y'know, sometimes things don't go as planned.

The Seduction of Ideal Scenarios

This misguided belief that real-world success in personal finance can be achieved by pursuing ideal scenarios isn't exclusive to life insurance planning. It's pretty easy to find financial strategists touting other ideal plans that are susceptible to real-world turmoil.

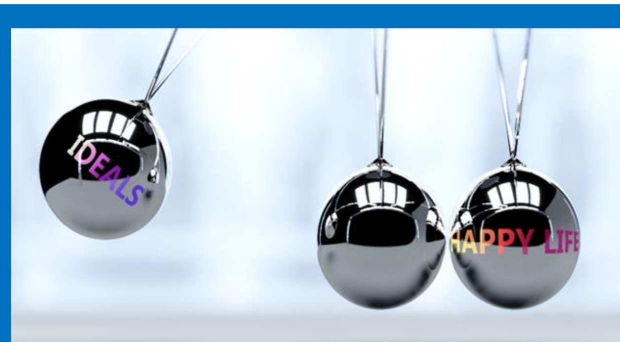
It's the investment guru (or your next-door neighbor) who says, "In an ideal world, the best retirement accumulation results have been achieved by remaining fully invested in the stock market (or real estate, precious metals, or whatever) for 30 or 40 years." That declaration might be historically accurate, but it's also an "in an ideal world…" statement that glosses over the real-world issues that can derail success.

This criticism can seem dismissive of new ideas, or progress. It's not; innovation is good, and so is the desire to discover better methods and outcomes. But many ideal-world strategies (and their proponents) often neglect or minimize the practical value of having options in case things don't go as planned. That's the problem with "in an ideal world…"

There's a well-known personal-finance guru with a nationally syndicated radio program who proclaims it is reasonable to "expect to make a 12% return on your investments," because he is "using a real number that's based on the historical average annual return of the S&P 500" for the past 80 years. Because this expert feels the long-term results are almost inevitable, there really isn't a need for alternatives. The dismissive comment on his website: "Don't let your opinion about whether or not you think a 12% return is possible keep you from investing."

Remember the issues that undid the ideal scenario for term life insurance? Adult children at home, divorce, second families, refinanced homes, insufficient saving. Any one of those same challenges could prevent you from executing an ideal-world investment strategy as well. In the real world, stuff happens.

Who knows? Twenty years from now, you might see an article, "What to Do When Your 30-year Plan Hasn't Earned 12%." And if you had taken practical steps to mitigate against the possible underperformance of this ideal plan, you might find the title amusing. Because, you know we don't live in an ideal world. ❖



Are your financial strategies based on an ideal world, where everything needs to go according to plan? Or do you have the flexibility to succeed under a variety of circumstances?

Insurance is a decision to pre-pay a modest fee for something you hope never happens: You pay a premium hoping you'll never have an automobile accident, your house will never burn down, and you will never be incapacitated and unable to work. Given this framework for insurance, it's understandable that finding the lowest cost for coverage is often the predominant economic consideration.

But there are occasions where the greater emphasis should be *obtaining the **best** insurance*, rather than paying the lowest premium. This focus on insurance quality is essential when considering disability coverage, particularly for those with "specialized incomes," i.e., business owners, self-employed professionals, or anyone whose income is dependent on sales, billable hours, or some other volume-of-work measurement (number of patients seen, inspections completed, etc.). For this subset of income earners, having an individually-owned disability insurance policy is the preferred approach to income protection. While other forms of disability insurance may offer some measure of income protection, they also leave the specialized income earner exposed to significant risks. Consider the following issues:

An employer can drop or change group coverage. A recent insurance industry publication highlighted the decision of a major player in group insurance to implement rate increases of 15 to 18 percent for long-term disability insurance (LTD) in response to increased claims. Raising premiums has ripple effects – including the decision of some employers to cancel their group disability plan. At a recent conference call, the company's commercial markets president acknowledged, "We did not renew our largest account, effective January 1, after being unable to agree to terms."

Imagine your disability insurance was provided by this group plan. You now face two unpleasant scenarios: higher premiums for the same benefits, or no coverage at all. One of the frequently stated drawbacks of group insurance is the lack of *portability*, i.e., you can't take it with you when you change employers. But group coverage isn't *permanent* either. Both the employer and the insurance company have unilateral authority to discontinue the coverage.

Less-than-comprehensive coverage. It's not just the loss of personal control that makes group disability coverage problematic for specialized incomes. Group plans are less likely to offer favorable own-occupation definitions and residual benefits, features that can make a big difference in helping those with unique income arrangements weather the economic turbulence of a disability. While it may be possible to cobble together a disability insurance program that relies on a combination of Social Security Disability Insurance (SSDI) and group coverage, the consequences of buying disability protection "on the cheap" can be significant if a debilitating incident occurs.

WhiteCoatInvestor.com is a website started by an emergency physician to provide a forum for medical professionals to discuss various financial issues. Deciding what type of disability insurance to buy is a frequent and ongoing topic. In a recent post, a young ER doctor explained his decision to buy a modest amount of individual disability coverage, and supplement it with a group plan. In the 20 comments that followed his post, the overwhelming advice from other doctors: **you shouldn't rely on group coverage**. Here are two posts offering personal experiences:

Comment #1:

I too am an ER Doc and was employed by a stable group that had been around for 28 years. I had been with the group for 16 years when suddenly and without warning our group was forced to split into 2. We parted amicably, but my smaller group ended up joining a larger regional group. A good group, but a different group with very different benefits. Don't skimp on your individual disability insurance, assuming that your company can and will provide group insurance forever.

Comment #2:

You can rationalize all you want, but why not protect as much of your income as you can? It's nice to think you don't need all your income, but as my husband and I have found since his permanent disability 8 years ago, we really wish we had purchased an individual policy instead of having to rely on his group policy and SSDI - because all the associated costs of a disability are EXTRA and don't fall under income replacement… like paying for a caregiver or medical equipment/medicine not covered by insurance. He was highly compensated and young (mid-40s) and cannot work again - with group and SSDI we've lost over half his income, his bonus, cost of living increases AND contributions to his 401K. Now tell me again why you shouldn't protect as much of your income as you can?

A Checklist for Specialized Incomes

If you have a specialized income, the following is a short list of essential features that should be a part of any quality individual disability insurance discussion.

- Non-cancellable, guaranteed renewable
- Own-occupation definition
- Cost-of-living adjustments
- Residual and Partial Benefits
- Recovery Benefits
- Proportionate Benefits
- No limitations on Mental & Nervous disorders

The specifics will vary depending on the policy, and the devil is in the details, so be prepared for an in-depth evaluation. ❖

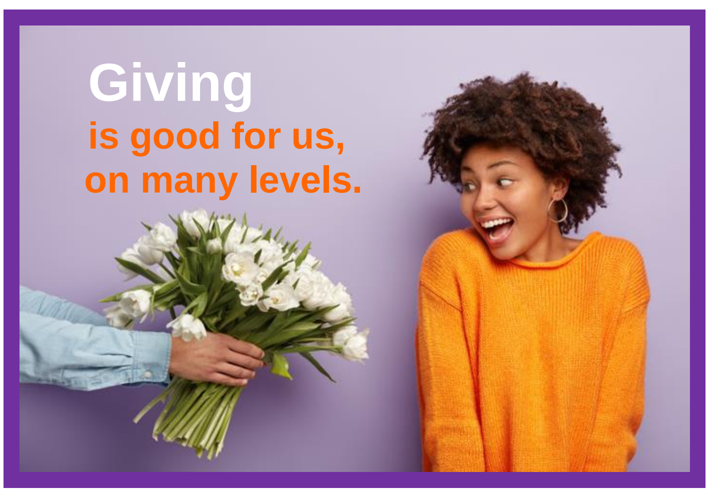
Taking the time to obtain quality disability coverage today offers you the prospect of much greater peace of mind for the rest of your working years.

Thanksgiving traditionally prompts us to an attitude of gratitude, to reflect on our blessings, and to consider ways to share our good fortune with others. Coming at the end of the year, Thanksgiving may also be a convenient time to consider strategic charitable giving.

The new tax laws that became effective in January 2018 significantly changed the deductibility of charitable donations for many households. Some of the incentive to give has been diminished because most donors will not receive the same tax breaks on their donations.

At the time of the change, charities expressed concern that the reduction or elimination of tax deductions would mean a decrease in contributions. And in fact, giving did appear to decrease.

Citing data from Giving USA, a June 2019 report on the PBS program "Making Sen$e" said individual giving declined 1.1% in 2018 (adjusted for inflation, the decrease was 3.4%). This decline was the first since 2013, and a sharp reversal from the 5.7% increase for 2017 (which may have been helped by donors taking advantage of the old deductibility rules before they expired). But "no one really knows how big a role tax deductibility plays in a decision to give."



In contrast, there is plenty of research that supports the intangible benefits of giving. Simply put, giving is good for us, on many levels.

The Holistic Case for Giving

An Internet search for the "benefits of giving" is filled with 5, 6, 8, and 10-item "listicles." Among the most common benefits:

- **Giving makes us feel happy.** A 2008 study by Harvard Business School professor Michael Norton found that giving money to someone else lifted participants' happiness more that spending it on themselves – *despite the participants' prediction that spending on themselves would make them happier*.

- **Giving is good for our health.** A number of studies have linked generosity to better health, even among the sick, elderly, and those with chronic illnesses. Givers are found to experience reduced rates of stress and lower blood pressure compared to those who do not give.

- **Giving promotes cooperation and social connection.** It's karma, man. Several studies suggest that when you give to others, your generosity is likely to be rewarded down the line, sometimes by the person you gave to, but also by someone else.

  Charitable exchanges promote communal trust and cooperation, and tend to make our social connections deeper and more positive. Sonya Lyubomirsky, in her book *The How of Happiness*, writes that "Being kind and generous leads you to perceive others more positively and more charitably."

- **Giving evokes gratitude – for the giver and the recipient.** Whether you're on the giving or receiving end of a gift, that gift can elicit feelings of gratitude. And research has found that gratitude is a catalyst for increased happiness, improved health, and stronger social bonds.

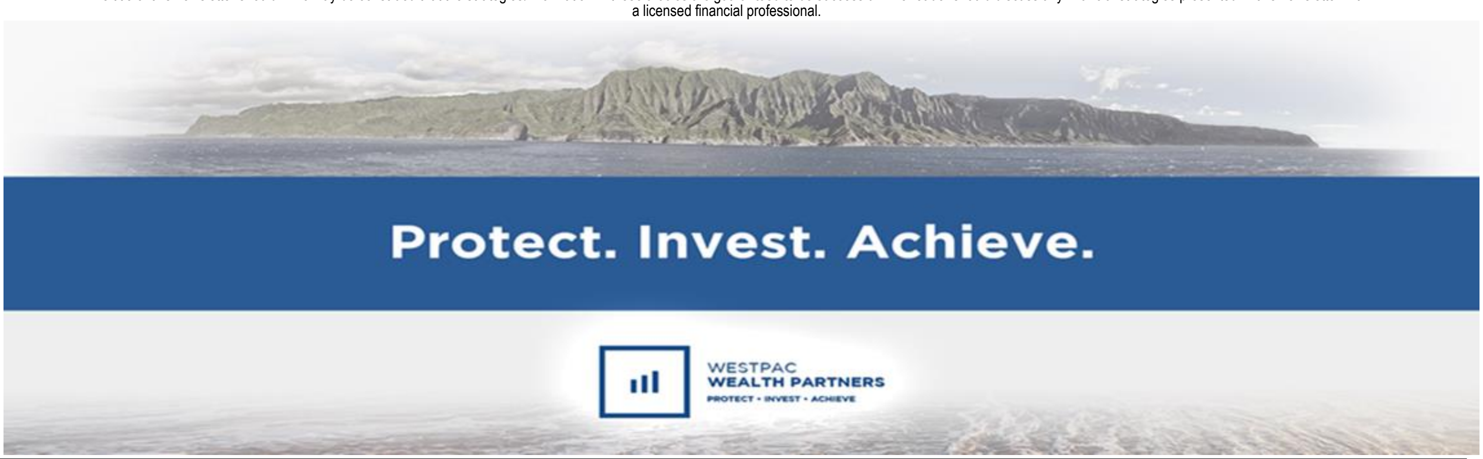
- **Giving is contagious.** There is a ripple effect. A study by James Fowler of the University of California, San Diego, and Nicholas Christakis of Harvard, shows that when one person behaves generously, it inspires *observers* to behave generously later, toward different people.

The Bunching Strategy: Being Strategic with Your Giving

There's an old financial adage that says it's never a good idea to make investment decisions based solely on tax considerations. The same holds true for giving: You should give for reasons other than deductions. But if you do plan to give, there may be some tax advantages if you give strategically.

One strategy for charitable giving is called "bunching." To surpass the standard deduction threshold and make your donations deductible, you compress several years of giving into one year. In the following year or two, you reduce donations and take the standard deduction. Then you repeat the process. By making two years' worth of contributions in one year to exceed the threshold for deductibility, your giving is not only greater in that particular year, but also more efficient. Because of the tax deduction, it doesn't cost you as much to give more.

If you are contemplating significant charitable contributions before year-end, you might want to consult with a financial professional to be sure you are maximizing the deductibility of these gifts. But remember: Even under the new rules for deductions, giving is still good for you. ❖



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