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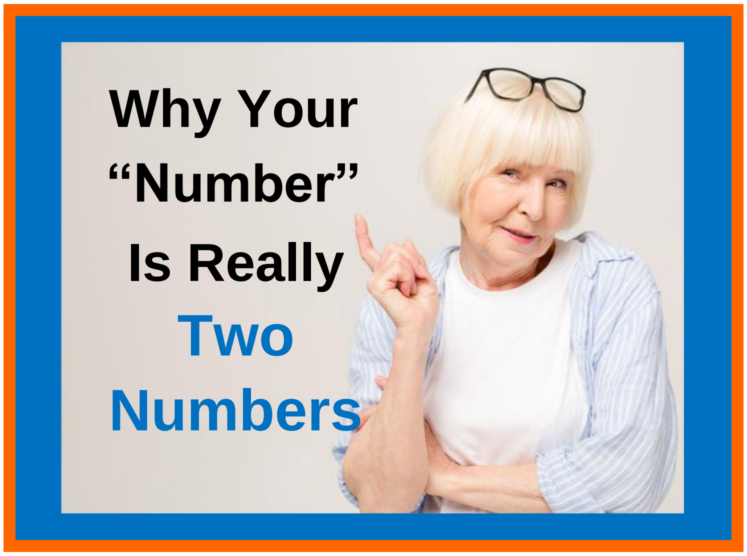

Some financial service companies make a big deal about helping you reach your “number,” the amount of money you’ll need for a comfortable retirement. From a marketing perspective, distilling retirement down to the accomplishment of a single accumulation objective is compelling. But this level of simplicity neglects some important details. Such as…

Your number is actually two numbers.

These two numbers can change, sometimes dramatically, if you decide to give up control over one of them.

This has been mentioned previously, but it bears repeating: Retirement planning is a very “young” practice. Even established formats have short histories and undergo frequent adjustments. For example, take the three-legged stool.

A retirement planning model that originated in the 1960s, the three-legged stool is the forerunner of much of today’s retirement planning, with some notable changes. The “three legs” are:

Leg #1: Social Security. The government-administered group plan funded by payroll taxes that provides a monthly income for as long as the individual lives, and extends these lifetime benefits to surviving spouses.

Leg #2: A Pension. An employer-sponsored program that also promises a lifetime retirement income, typically based on a combination of average salary and years of service. Both Social Security and pensions work on the same premise: the forfeited benefits of those who die early will subsidize the incomes for those who live a long time.

Leg #3: Individual Savings. A supplement to the regular income from the first two legs, these funds are used for irregular expenses, or left as an inheritance for heirs.

In the original version of the three-legged stool, Social Security and a pension were intended to provide enough income for a secure retirement. What individuals added as personal savings was “free capital,” money that could be used for travel, a second home, hobbies, or an inheritance.

Because of demographic shifts, particularly increased longevity, both Social Security and most employer pensions have become increasingly under-funded and unsustainable. Social Security is funded by payroll taxes, which means legislators face the politically unpopular choice of raising taxes or reducing benefits to maintain the plan’s integrity. The response has been to do nothing, and delay the reckoning.

Meanwhile, many employers have addressed their funding problems by freezing or terminating pensions and replacing them with defined contribution retirement plans, such as 401(k)s. **Consequently, the funding for Leg #2 (the pension) is now the individual’s responsibility.**

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.

This means your "retirement number" is now two numbers:

- The amount required to provide a lifetime income in lieu of a pension, and…
- The free capital for the "extras" of retirement.

Lifetime Income Planning & the Safe Withdrawal Rate

Replacing a pension is a big challenge. There are a lot of variables, and almost no certainties. How long will you live? Is this income just for your lifetime, or should it consider a surviving spouse? What are reasonable assumptions for inflation and rates of return? If investment performance doesn't match expectations, will you adjust by decreasing income or consuming principal?

To address these variables, financial professionals have devised income models, based on the idea of a Safe Withdrawal Rate (SWR). This is an amount, usually expressed as a percentage, which can be withdrawn over a given period and not cause portfolio failure; i.e., run out of money. A "safe" withdrawal rate is one with a 95% success rate based on historical returns. SWR scenarios typically project annual increases for inflation, and eventually, a draw-down of principal.

One of the most enduring SWRs is the 4 percent rule, which says you can start retirement by withdrawing 4% of your portfolio, and safely continue withdrawing this amount, plus annual adjustments for inflation, and not run out of money. The 4 percent rule was introduced in the 1990s based on historical stock and bond returns over 50 years and assumed a 30-year retirement period.

However, the mid- to late-20th century had atypically high investment returns. Concerned that future returns would not match those of the past, and with lifespans still inching up, many thought the SWR should be adjusted down.

In 2018, Wade Pfau, a professor at the American College of Financial Services, who is sort of the Albert Einstein of SWR, declared, "3 percent is the new safe withdrawal rate. The 4 percent rule may be too high for a sustainable withdrawal rate that will not deplete a portfolio over a 30-year period."

Recently, as the pandemic began to impact the U.S. economy, Pfau announced another adjustment: "I did some updates in mid-March; and for an investor taking a moderate amount of risk, I put out 2.4% as my equivalent of the 4% rule."

Lowering the SWR increases your required accumulation amount. The more you must allocate to a pension (Leg #2), the less you have available as free capital (Leg #3). Here's an example of how differing safe withdrawal rates affect these two retirement legs for a couple with $2 million accumulated for retirement.

First-year Income	Safe W/D Rate	"Leg #2" Amount *Required* for Lifetime Income	"Leg #3" Amount *Left* for "Extras"
$33,600	4.0%	$840,000	$1,160,000
$33,600	3.0%	$1,120,000	$860,000
$33,600	2.4%	$1,400,000	$600,000

Also: the success or failure of an income plan that draws down principal is highly dependent on investment results during the first 10 years of retirement; investment losses in early years can significantly increase the risk of running out of money. Especially when interest rates are low and volatility is high, the only sure buffer is to increase principal, i.e., add more to Leg #2.

An Alternative to the SWR: Buy a Pension

Just because most individuals are responsible for funding their pension doesn't mean they must also manage it to provide a lifetime income. At retirement, individuals can elect to become part of a group of retirees who pool their funds under an insurance company's management and receive monthly payments by purchasing an immediate annuity.

Instead of an individual, with uncertainties about lifespan, inflation, rates of return, etc., annuity recipients are part of a group with well-defined life expectancies. And every member of the group is "fully funded," no additional contributions are required to maintain the integrity of the plan. The combination of group participation and full funding makes guaranteed lifetime payments possible for all participants.

Besides the certainty, the cost of "buying" Leg #2 at retirement could also result in a bigger Leg #3, which means more free capital in retirement.

Use the previous example of the couple with $2 million. Instead of committing $1.4 million to a self-managed income plan based on an SWR of 2.4%, suppose a couple, both aged 67, decide to purchase a $1,000,000 immediate lifetime annuity. The annuity promises a guaranteed annual income of $51,756 for as long as either one of them is still alive. (This income remains level, there are no inflation adjustments.)

Compare this to the projected income of $33,600 at a safe withdrawal rate of 2.4% on $1.4 million accumulation, with a 2% annual increase for inflation. (Fig. 1)

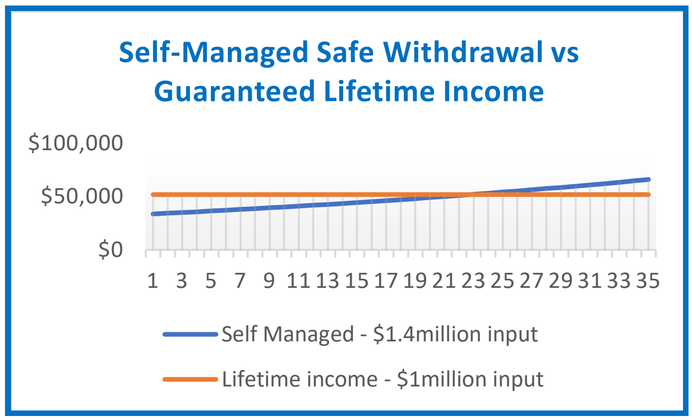

FIG. 1

Additional information:

- The historic results of a self-managed SWR option would vary depending on the actual returns and the rate of inflation. An inflation projection of 2% is close to the 30-year average and is also the Federal Reserve's target number.
- From $33,600 in Year 1, the projected increases in annual income from the self-managed option don't equal the annuity until year 23 (age 90).
- A decision to use an annuity for income leaves $1 million of "free capital," for Leg #3. This free capital can be invested, spent, serve as an inflation adjustment in later years, or left as an inheritance.

Do You Want to Manage Both Legs?

This scenario is not intended to "prove" that an annuity is the better option. If you believe that 4% is still a safe withdrawal rate, you might be able to produce a larger lifetime income (Leg #2) by self-managing the same principal or have more free capital (Leg #3). If your retirement plan involves two people, disparate ages could affect the monthly annuity payments. In other words, results will vary.

But in the context of the three-legged stool, a lifetime annuity provides income certainty, just like a company pension used to. The price of that certainty is an irrevocable decision to surrender control over a chunk of your retirement accumulation; instead of having $2 million to manage, you only have $1 million. For some, that's a big psychological hurdle.

On the other hand, if you retain control over $2 million, but $1.4 million must be set aside to provide a lifetime income, how much free capital do you really have? And how much financial responsibility do you want for the rest of your life? ❖

> Reducing retirement planning to a simple number might seem helpful during the accumulation phase. But since a primary objective of retirement planning is to provide a lifetime income, there are really two numbers, one for a pension, the other for free capital. And how you address one number can have a big impact on the other.

Annuity guarantees are backed exclusively by the strength and claims paying ability of the issuing insurance company.

Financial Insight From The Pandemic:

In 2014, Admiral William H. McRaven gave a commencement address for the University of Texas at Austin graduating class that became an Internet sensation. The speech, titled ***Make Your Bed: Small Things That Can Change Your Life … and Maybe the World*** was comprised of ten lessons McRaven learned from Navy SEAL training, and was the basis for a best-selling book.

The title is also the first lesson. McRaven explains why the military emphasizes this simple chore: "If you make your bed every morning you will have accomplished the first task of the day. It will give you a small sense of pride and it will encourage you to do another task and another and another. Making your bed will reinforce the fact that little things in life matter."

A Little Thing That Matters

Establishing and maintaining an emergency fund is arguably the "make your bed" element of personal finance. It is a little thing that lays the foundation for bigger possibilities.

Yet a discussion of emergency funds in the planning process is often perfunctory, sort of like the idea of making your bed. *You know how to do it. You know you ought to do it. If you haven't done it today, you can take care of it tomorrow, right? Okay, let's talk about buying that first home and planning for retirement!*

But the events of the past few months have shown that having adequate emergency funds isn't a trivial financial chore that can be addressed at leisure. Shelter-in-place orders and volatile markets reveal many Americans have been neglecting this fundamental financial habit, even those with investments and 401(k)s. And, all of a sudden, mainstream media commentary is all about emergency funds. It's…

"How to Build an Emergency Fund in the Middle of an Emergency" in the *New York Times, or...*

"35 Ways to Jump-Start Your Emergency Savings" in the *Wall Street Journal*.

The advice from both articles (and from other commentary) isn't innovative or insightful. Basically, it's the standard recommendation: commit to building cash reserves equal to 3-6 months of living expenses. Keep these funds in a place that is safe and accessible. It's not complicated. You just have to do it.

Why is it so hard for so many Americans to do the financial equivalent of making their bed?

Emergency fund saving is a low-reward activity – for you *and* financial professionals. With annual interest rates for savings accounts often less than 1 percent, there isn't much personal satisfaction in a yearly statement that shows less than $100 of interest on a $10,000 deposit. When you don't need them, emergency funds feel like an inefficient allocation.

It also doesn't make sense to pay a financial professional to tell you to allocate $10,000 to a savings account. There's no expert advice involved, and if the funds are included in assets under management, the fees could exceed the minimal interest earned. And bluntly, there is limited monetary incentive for financial professionals to work with clients who haven't developed the discipline to save.

There is a temptation to minimize the emergency and substitute other resources. What constitutes a financial emergency? Is it a flat tire or three months without a paycheck because of quarantine? Most of us imagine smaller emergencies, not ones that could run to thousands of dollars.

Because emergency funds can feel like dead money, it becomes easy to rationalize other financial resources as substitutes. Credit cards, home equity lines of credit, and non-qualified investment accounts become stand-ins for true cash reserves.

This approach can work, especially if the emergency needs are small or short-term. But unpaid credit card balances come with steep interest costs, home equity loans are subject to approval, and liquidating investments in a down market is usually the worst way to invest. When emergency funds are uncertain and costly to use, it exacts a long-term drag on your personal economy. You might survive today, but never get the opportunity to thrive tomorrow.

You don't have to sell the house or liquidate your retirement account, but the little things in personal finance matter. Recent events show that cash reserves equal to 3-6 months of living expenses are a legitimate benchmark, one that should be given priority. ❖

If you don't have 3 to 6 months of living expenses set aside, maybe it's time to start "making your bed" again, adding to your emergency funds on a regular basis until you've established (or re-established) this financial foundation.

In late March 2020, Congress passed the Coronavirus Aid, Relief, and Economic Security Act, or CARES Act, to provide financial relief to Americans suddenly locked down and not working. Beside authorizing Economic Impact Payments to qualified taxpayers, the legislation temporarily loosened the withdrawal rules for Individual Retirement Accounts and 401(k)s, allowing account holders to take more, or less, from these accounts without tax penalties.

These exemptions don't apply to everyone, but for those who qualify, the changes may represent a once-in-a-lifetime opportunity to reorder their personal finances and restructure their future. In a May 10, 2020, interview, Fred Reish, a lawyer who specializes in employee benefits, told the *New York Times:* "This is probably the most flexible distribution and taxation arrangement that I've ever seen for retirement plan benefits. It's really quite extraordinary."

Take More…With a CRD

Households that have been directly impacted by the coronavirus may be eligible for "coronavirus-related distributions" (CRDs) from eligible qualified retirement plans, such as IRAs and 401(k)s, from now until December 30, 2020. The IRS website (www.irs.gov) lists the eligibility requirements for CRDs:

- You, a spouse or a dependent, have been diagnosed with the virus SARS-CoV-2 or with coronavirus disease 2019 (COVID-19) by a test approved by the Centers for Disease Control and Prevention.
- You have experienced adverse financial consequences as a result of being quarantined, being furloughed or laid off, or having work hours reduced due to SARS-CoV-2 or COVID-19;
- You have experienced adverse financial consequences as a result of being unable to work due to a lack of child care due to SARS-CoV-2 or COVID-19; or
- You have experienced adverse financial consequences as a result of closing or reducing hours of a business that you own or operate due to SARS-CoV-2 or COVID-19.

If you meet any of these conditions, you have the option of taking withdrawals from your IRA, and withdrawals and/or loans from your 401(k), on very favorable terms because the CARES Act eliminates many of the penalties or restrictions associated with withdrawals from these accounts. Some major points:

- A withdrawal can be 100 percent of the account's value, up to $100,000.
- There is no 10% penalty for withdrawals made before age 59½.
- There is no 20% federal tax withholding requirement on withdrawals.
- Income taxes are still due on withdrawals but may be spread over three years, instead of being taxable in the year of the withdrawal.
- The amount withdrawn can be characterized as a rollover and can be redeposited to the IRA or 401(k) during the three-year period.

The legislation also increases the amount that may be taken as loans from 401(k)s to the lesser of 100% of the balance or $100,000. Loans must still be repaid in regular installments over a period of no longer than five years and are only available to active employees; if you lose your job, the loan becomes a withdrawal.

These provisions are in effect until December 30, 2020.

…Or Take Less…By Skipping an RMD

Another provision in the CARES Act allows retirees to forgo required mandatory distributions for 2020. While the CRD provisions are intended to help those who need cash, the waiver of this year's RMD is geared toward those who may want to delay withdrawals, possibly giving their investments time to recover from the rapid decline that coincided with the pandemic's arrival in early March. Because annual RMDs are determined by account balances on December 31 of the prior year, many retirees faced the prospect of making inflated distributions with drastically deflated assets. Although some markets have rebounded strongly since the end of March, the concern was that demanding an RMD from already-diminished accounts could put some retirees at risk of exhausting their future savings.

This option to skip an RMD applies to individual IRA accounts as well as inherited non-spousal IRAs.

A Once-In-A-Lifetime Opportunity?

The standard advice from most financial pundits is not to tap retirement accounts unless absolutely necessary. But sometimes the demands of the present take precedence. "(N)ot being evicted from your apartment, being able to buy food and put gas in your car also is important. Retirement isn't the only thing that happens in life," says Reish.

Even if you don't need to take a distribution to cover essentials, there might be other reasons to consider a CRD right now. The opportunity to reposition some or all retirement plan assets might dramatically improve your financial trajectory. For example, business owners face a plethora of post-pandemic uncertainties; using a CRD to pay down debt might mean a better chance of surviving and thriving in a new economic paradigm.

You Know the Drill: Consult With a Professional!

One concern regarding CRD withdrawals is future tax rates. In a May 19, 2020, *MarketWatch* post, Bill Bischoff presented this scenario: "Depending on future events, political developments, and the ultimate cost to the federal government of the COVID-19 crisis, there's a distinct possibility that tax rates could be higher in 2021 and 2022." If you withdraw today, but don't pay taxes until later, the true cost of the withdrawal is uncertain. Which means: Don't consider these actions without consulting a tax professional! ❖

If you're eligible for a CRD or have the option to defer an RMD, you ought to meet with your financial professionals and explore the possibilities. Remember, these relaxed distribution options are set to expire at the end of the year.

One of the dilemmas of the coronavirus pandemic has been striking an appropriate balance between the nation's physical well-being and economic interests. Broad restrictions on travel and commerce intended to protect the most vulnerable people and "flatten the curve" so that medical facilities are not overwhelmed incur significant economic costs in terms of layoffs, lost revenues for business, and diminished standards of living. The public debate, amongst both politicians and the general population: At what point do these costs of prevention outweigh the benefits?

For policy experts, one of the key measures to answer this question is determining the statistical value of life. This assessment is very similar to Lifetime Economic Value, a metric used to determine how much life insurance one should have. In developing policies and regulations, various branches of the United States government – including those making recommendations for lockdowns, social distancing and the like – use value of life calculations to weigh the costs and benefits of imposing new standards.

What is the value of an American life?

An April 15, 2020, *Wall Street Journal* article, "Economics vs. Epidemiology: Quantifying the Trade-Off," states:

Federal Regulators put the statistical value of a life at around $10 million.

A month later, a *New York Times* article by Austin Frakt, a Boston University professor and research scientist, went into greater detail, noting that different government agencies use different values of life:

- Consumer Product Safety Commission: **$8.7 million**
- Environmental Protection Agency: **$7.4 million**
- Department of Transportation: **$9.6 million**

Regardless of which number is used to quantify the value of a life, readers probably have two responses:

Can you really put a value on a human life?
And if you can, aren't these numbers a bit high?

Greg Ip, the author of the *WSJ* article, addresses the first question: "Every life is priceless, of course, but people implicitly put a price on it – think life insurance." And he notes that more detailed studies of lifetime economic value "assign a lower value to older people and a higher one for the young," because younger people have a longer time to live and produce value.

Ip notes a similarity to life insurance. In fact, the idea that value of life declines with age is reflected in the underwriting guidelines shown below (used by a highly rated American life insurance company). For equivalent income or net worth, the maximum amount of life insurance that can be purchased (assuming the applicant is insurable) declines with age.

Age	Maximum Life Insurance
18-40	30 times income
41-50	20 times income
51-60	15 times income
61-65	10 times income
66-70	1 times net worth
71-80	1/2 times net worth
81+	case by case

As for the government's values being a bit high, the chart is also helpful. A 35-year-old with a $250,000 annual income theoretically qualifies for $7.5 million of life insurance, which is pretty close to the EPA's number.

You might argue that not every 35-year-old is earning $250,000 a year, which is true. But the life insurance metrics are based on the economic value of ***one individual*** for a particular group of beneficiaries. The government's measures of human life value reflect an individual's potential value to ***everyone*** – as an employee, a consumer, a taxpayer. On average, the statistical value of every American life is somewhere between $7-10 million.

You're Worth It

Much of our human value resists quantification. How do you price love, wisdom, encouragement, compassion? But our lives also have an economic value that is both substantial and worthy of protection.

Lifetime Economic Value is not a contrived concept designed to get consumers to buy more life insurance; it is a logical extension of a basic insurance principle that coverage should reflect the value of the asset being insured. The strategy of only buying enough life insurance to meet the survival needs of beneficiaries short-changes everyone. ❖

Don't underestimate your economic value. If you have the health and resources, insuring for the full value of your life is the optimal solution. You're worth it. Even the government says so.