

# Creative

wealth maximization strategies\*

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## On FIRE for Retirement



"Wealth isn't an abundance of money – it's an abundance of time. When you accumulate a lot of money, you actually accumulate a large store of time to use however you please."  
- J.D. Roth

bigger houses or nicer cars, but to buy time and freedom. Readers were encouraged to equate dollars to "hours of life energy." If you make \$300 a day, you should ask: "Is a \$150 pair of shoes worth a half day of my life?"

This change in attitude toward time and money motivates people to rein in discretionary spending and focus on greater saving. The combination of frugal living and a high rate of accumulation enhances the possibilities for an early retirement.

It may sound extreme, but really FIRE isn't much different than the standard retirement formula. It's just a very literal application of the advice from a nationally-syndicated columnist and financial advisor who says: "*Save until it hurts. And then save some more.*" But while true FIRE practitioners may save a lot, whether they save until it hurts is another matter.

### What It Takes to Catch FIRE

Several articles on the FIRE phenomenon have noted that its followers have several things in common: **The most prominent characteristic is they are high earners.** They are predominantly professionals or entrepreneurs who make a lot of money. Because they are high earners, they can save 70-80 percent of their annual income and still afford a reasonably comfortable standard of living; an individual who earns \$250,000/year and saves 70 percent still has \$75,000 left to live on. Perhaps that's not enough to "live large," but according to current research, it's right at the threshold that supports an "emotionally satisfactory" standard of living in the United States. For high earners, living frugally does not equate to poverty.

Contrast that with someone earning \$50,000/year. Saving 70 percent of income leaves only \$15,000 to live on, which is almost impossible unless some essentials are subsidized (i.e., they're living rent-free in their parents' basement). And even with assistance, it's doubtful that many people can, or want to, sustain this level of delayed gratification, or would look forward to an early retirement at this standard of living. For FIRE to work, you have to be making a fairly good income, and committed to saving most of it.

### Have you heard of the FIRE movement in personal finance?

FIRE is an acronym for "Financial Independence, Retire Early." Sometimes referred to as simply FI, it is a concept that is apparently catching on with a growing number of Millennials. Through frugal living and prodigious saving (such as 70 percent of annual earnings), FIRE adherents strive to accumulate enough assets to retire as soon as possible. How soon is as soon as possible? The most idealistic scenarios aim to complete the process in five to ten years, meaning an early retirement can begin at 40, 35 or even 30.

The FIRE idea may be new to Millennials, but it has a long history. Andrew Carnegie, the late 19<sup>th</sup> century steel magnate and philanthropist, used the same approach to retire from regular employment when he was in his 20s. And even in its current form, FIRE is almost 30 years old.

In 1992, Vicki Robin, a 47-year-old actress/artist/free spirit, co-authored "Your Money or Your Life." Based on her experiences in living off a modest inheritance since her early 20s, the book was a best-selling primer on how to "transform your relationship with money." Robin, today regarded as an icon of the FIRE movement, emphasized that the most valuable use of money was not to acquire

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Another commonality among FIRE fanatics: **they usually don't have children.** Or if they do, it's usually *after* marrying another highly-compensated FIRE-inspired saver, and *after* several years of mega-accumulation so that a glide path to early retirement is already established. In the FIRE paradigm, children come *after* retirement (because as any parent can tell you, “frugal child-raising” is an oxymoron).

One other thing: In FIRE terminology, “retired” doesn't mean not working. Rather, it means the freedom to work when you want, at what you want. Two typical FIRE “retirement” activities: real estate projects, and “monetizing” your FIRE experience – through a website, blog, or putting yourself out as a FIRE coach. Steve, a FIRE blogger who retired at 35, explains his lifestyle:

*We aren't just “retired early” and sitting on the beach, are we? Of course not. We're still active. In fact, I'm busier than I was before calling it quits because I'm now doing things that I actually enjoy. Every day.*

Even with these qualifications, it's easy to see the attraction of the FIRE ethos. The conventional mantra of working and saving for 40-50 years to provide a 20- to 30-year retirement is doable, but it's a long slog. And the longer it takes, the more that can happen to disrupt it – a layoff, a disability, a divorce, a bad financial decision. FIRE says if you have the income-producing potential, get the saving done first and fast. Don't wait until age 65 – or later – to start living the life you want.

### Implications for Personal Finance

If you're someone with the income and aspirations to pursue a FIRE track, a lot of conventional retirement guidance does not apply. For example...

**The benchmarks are different.** The financial service industry has tried to ingrain rules of thumb in the public consciousness, like a retirement accumulation target (equal to 20 times current income), or a safe withdrawal rate (4 percent annually, with inflation adjustments). These numbers assume a retirement that begins around 60 and lasts until 90 or a little longer. But when you “retire” at 40, benchmarks for saving, investing, and withdrawals need to be re-defined.

**Retirement is a time for accumulation.** Unlike a conventional retirement model where you work and save to stop working and spend, a FIRE retirement usually suggests continual wealth-building. A decade of intense saving might produce a sizable nest egg, but if you stop collecting a paycheck at 30, you're facing six decades of inflation and other uncertainties. To remain financially stable, your principal probably has to keep growing. That likely means additional savings as you go.

**Your retirement costs may be higher, not lower.** Frugality may be sustainable when you are motivated to achieve financial independence as soon as possible. But is that how you want to live the rest of your life? Unlike the conventional wisdom that says living expenses generally decline in retirement, those who practice FIRE-level frugality may find their expenses increasing, simply because they no longer want to deny themselves the financial rewards they sacrificed to obtain.

**You can't go “long” with all your investments.** If you're aiming to retire in 10 years, you don't have a 30-year horizon to level out volatile investments. Some of your savings may be needed sooner than later, and that necessity could change your allocation strategies.

**401(k) participation has to be reconsidered.** Qualified retirement plans are intended for distributions after age 59½;

One approach emphasizes the destination, the other sees the journey as equally important.

under most circumstances, early withdrawals incur tax penalties. If you're going to retire at 40, getting savings from a 401(k) is going to be financially punitive. You'll need a different mix of accumulation vehicles.

### Can You Get Burned (out) with FIRE?

The FIRE program is an extreme application of delayed gratification. Forgoing immediate pleasure for the hope of even greater or longer-lasting enjoyment is a critical behavior for financial success. But just because delayed gratification is good, it doesn't always follow that more delayed gratification is better. Jordan Peterson, a clinical psychologist and best-selling author of “12 Rules for Life” notes that “Delayed gratification is not always the right answer. The environment has to be stable enough so that the probability you will get what you've delayed for is high.”

In personal finance, particularly retirement planning, there is a constant tension between enjoying today or holding off for what might be a better tomorrow. If the only objective in personal finance is retirement, then “save until it hurts” is spot on. But retirement isn't the only reason to save, and the only time to spend isn't at the end of your life.

There might be great “time-and-freedom” value in buying a vacation property now, while your kids are still young, instead of waiting until retirement. And there's the risk that something could make your tomorrows irrelevant; what would be the point of saving until it hurts if you're diagnosed with cancer at 62?

FIRE tries to address this uncertainty by getting to retirement – however it's defined – as soon as possible. But even this approach has risk.

Imagine saving for retirement as a long cross-country trip. You can rent the most gas-efficient car, drive through the night, get your meals from fast-food drive-through windows, and arrive early. Besides reaching your destination ahead of schedule, you may be able to extend your stay by continuing to live as cheaply as possible.

Or...you can get a roomier vehicle and take time to enjoy the trip. Instead of pushing through to your destination, you travel at a leisurely pace, maybe take a side trip or two, and arrive a bit later. You won't have as much time to spend at your destination, but you'll have a lot of other experiences.

One approach emphasizes the destination, the other sees the journey as equally important.

Saving is good. Saving is essential. And pursuing a FIRE strategy for retirement could be the catalyst for developing some very productive attitudes and habits about money. But make your focus wider than retirement. A happy financial life balances the present and the future. ❖

Looking for ways to get FIREd up about your financial life? Ask your financial professionals about strategies that go beyond retirement saving.



## Are You a SITCOM? Acronyms That Define Your Financial Status

As mentioned in the article above, the FIRE community is often defined by income and the configuration of your family unit. Using acronyms, here are some common identifications, culled from a list provided by the website [budgetsaresexy.com](http://budgetsaresexy.com):

- **DINKs** – “Dual Income No Kids”
- **SINK** – “Single Income No Kids”
- **DINKY** – “Dual Income No Kids Yet”
- **DINKER** – “Dual Income No Kids Early Retirement”
- **DINKWAD** – “Double Income No Kids With A Dog”
- **DINKYANDE** – “Dual Income No Kids Yet And No Dog Either”
- **SIK** – “Single Income Kids”
- **SILK** – “Single Income Lots of Kids”
- **DEWK** – “Dually Employed With Kids”
- **SITCOM** – “Single Income Two Children and Oppressive Mortgage”
- **MUPPIE** – “Middle-aged Upcoming Prosperous Professional”
- **KIPPERS** – “Kids In Parents’ Pockets Eroding Retirement Savings”
- **SINBAD** – “Single Income No Boyfriend And Desperate”
- **GLAM** – “Greying Leisured Affluent Married”
- **PODWOG** – “Parents of Dinks WithOut Grandchildren”
- **WOOF** – “Well Off Older Folk”

## Paid-Up Whole Life Insurance – with Just One Payment



**Y**ou may know that whole life insurance is called “whole life” because the policy is structured and priced as if the coverage will remain in-force for the insured’s lifetime, no matter how long that is.

You may also know that the premium schedule for a whole life policy can be shortened to a specific period instead of spreading over the insured’s whole life. Much like the payments on a mortgage with a shorter term, the premiums for a policy paid up in 10 or 20 years will be higher than those for a regular whole life policy. But the cash values will also accumulate faster, and at the end of the term – not at age 100 – the policyowner will have a paid-up life insurance benefit.

But did you know that you can buy a paid-up life insurance benefit with just one payment, similar to paying cash for a house? Single-premium whole life provides a paid-up life insurance benefit from just one premium. Changes in tax law have decreased the use of single-premium policies, but a lump-sum transaction can be one of the most efficient ways to pay for whole life.

### The Basic Concepts of Single-Premium Policies

The premium in a single-premium policy represents a present value calculation of a future death benefit. For example, a 35-year-old male in good health might pay a single premium of \$150,000 for a \$500,000 paid-up life insurance benefit.

Like other versions of whole life insurance, single-premium policies accrue cash values and can earn dividends. But because of the large up-front payment, these accumulations can be dramatically accelerated, compared to policies which receive smaller premiums over a lifetime.

### Avoiding MEC Status

If you understand the financial mechanics and tax advantages of a whole life policy, it’s easy to see the wealth-building and wealth-preservation efficiencies of a single-premium approach. However, single-premium policies have some unique IRS restrictions.

Since 1988, tax law classifies all single-premium policies as Modified Endowment Contracts (MECs). These policies differ from other versions of whole life in that

- Distributions from cash values are taxable on a last-in-first-out basis (LIFO) instead of first-in-first-out (FIFO).
- Policy loans are realized as ordinary income.
- Distributions in excess of basis (the amount of the premium) are subject to a 10 percent tax penalty for policy owners under age 59½.

To avoid the MEC status of single-premium policies, other whole life formats must stay within several IRS-defined guidelines regarding the proportion of cash value to death benefit, the annual premium, and how quickly a policy can be considered paid-up. One of these MEC standards is the 7-pay Test, which caps the amount of premium that can be paid into a flexible-premium policy over a period of seven years.

### A Single Payment, But Non-MEC Tax Treatment

A policyowner who wants to allocate a lump-sum to whole life insurance without MEC restrictions is forced to spread the premiums over at least seven years. This exposes the unused portion of the lump sum (the amount that hasn’t yet been used to pay premiums) to a variety of risks. If kept in a low-yield but safe account, the principal has inflation risk. If placed in a non-guaranteed account, there is investment risk.

Some insurance companies offer an intriguing option: A pre-paid premium account. To fund a 10-pay whole life policy, the policyowner agrees to deposit a lump sum with the insurance company, which the company then uses to pay annual premiums for the next ten years. The unused portion of this account is credited a pre-determined, guaranteed, rate of interest, usually at very competitive rates (as of May 2018, one insurance company was paying 3.05%). This interest is factored into the amount needed for future premiums; in effect, the policyowner receives a premium discount for placing the lump-sum with the insurance company.

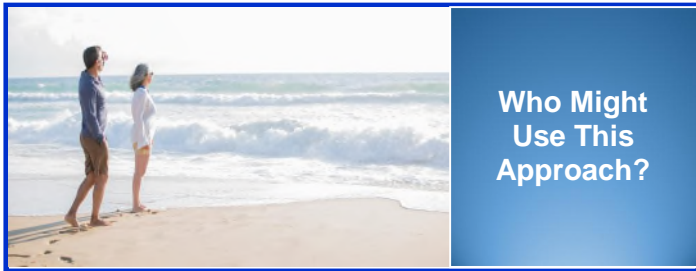
The interest credited to the pre-paid premium account is taxable to the policyowner. And if the policyowner elects to

surrender the policy or discontinue the funding agreement, withdrawals from the prepaid premium account may be subject to surrender charges, similar to those for Certificates of Deposit or Deferred Annuities.

Here's an example with real numbers:

A 35-year-old male in excellent health is approved for a \$500,000 10-pay Whole Life policy. The annual premiums are \$14,686, or \$146,860 for the ten-year period. The policyowner pays the first-year premium, then deposits another \$114,078 in the insurance company's prepaid premium account to pay the remaining nine years of premium. These two payments equal \$128,763, a discount of \$18,093\* (or 12.3%) compared to paying the premiums out-of-pocket.

With one payment, the policyowner has guaranteed the funding of a 10-pay whole life policy, while retaining the most favorable tax treatment for cash value distributions and loans.



If you see the value of integrating whole life insurance into your financial plans, the combination of a shorter premium period and a prepaid premium account may be a good fit for...

- Someone who receives a lump-sum (such as a bonus, a large commission, or proceeds from the sale of an asset) and wants to secure all the benefits of a permanent life insurance policy with one transaction.
- A policyowner interested in converting some or all of a qualifying term insurance policy to whole life.
- Parents or grandparents who want to transfer assets and insurability to children and grandchildren.
- Anyone who wants to turn a chunk of cash into a guaranteed financial asset with multiple applications for beneficiaries, estate planning, end-of-life medical expenses, supplemental retirement income, etc.

If this concept piques your interest, why not ask a financial professional to prepare an illustration tailored to your unique circumstances? It's probably the best way to see how you could benefit from a lump-sum transaction for whole life. ❖

\* The discount associated with the prepayment of premiums is considered taxable income to the policyowner. The taxable income, which is equal to the difference between the annual premium shown in the contract and the discounted premium applied to pay that premium, will be reported annually to the policy owner and to the IRS on a form 1099-INT.

Prepayment interest rates are based on current factors. Prepaid premiums cannot be withdrawn except upon surrender of the contract and are subject to a surrender penalty. A Modified Endowment Contract (MEC) is a type of life insurance contract that is subject to first-in-first-out (FIFO) ordinary income tax treatment, similar to distributions from an annuity. The distribution may also be subject to a 10% federal tax penalty on the gain portion of the policy if the owner is under age 59 ½. The death benefit is generally income tax free.



In another example of unintended consequences, privacy laws and identity theft have made it harder to prove who you are, and your relationship to others. To prevent false benefit claims, institutions are imposing stricter documentation standards, while at the same time, privacy laws make it more difficult for these documents to be accessed.

Vital records documents consist of birth, death, marriage and divorce certificates. State governments archive these vital records and issue certified copies. Vital records are kept in the state where the event occurred, i.e., if you were born in New Jersey, married in New York, and divorced in Florida, there are three states holding one of your vital records.

The procedures for accessing vital records vary. Some states have a central clearing house for all document requests, while others archive records at the county level. Several states coordinate the release of certified documents through on-line services, while others process all requests locally. In some instances, it is possible to retrieve a certified copy in person, but others will only respond to written requests. In almost all cases, a fee is charged.

Having a certified copy of your vital records may seem like no big deal. But consider some of the reasons you might have to prove you are married, or *were* married. For example,

- If after marriage you plan to legally change your name, you'll need a certified copy of your marriage certificate for Social Security, for bank accounts, your employer, and ownership agreements (like a car title).
- For you or a spouse to be added to an employer's health insurance plan, many companies require a marriage certificate to validate the addition.
- If you and your spouse apply for a mortgage, lenders may ask for a marriage certificate (because the before- and after-marriage information allows them to check your credit histories both jointly and separately).
- If a surviving spouse (or surviving *former spouse*) is entitled to retirement benefits, either from Social Security or an employer's pension plan, a certified copy of marriage will be required to validate the claim.

It must be emphasized that most verifications require a **certified copy**. Especially for those who were married several decades ago, it is quite likely that even if you have an original marriage certificate in your possession, it is *not* certified. A certified copy of a marriage certificate issued by a Vital Records Office will have a raised seal, be signed by the Local Registrar, and be printed on security paper.

## Don't Have Them? Get Them. Now. (Please)

Unless you're recently married, or in the midst of one of the events mentioned above, you probably don't have an urgent need for certified documentation. It would be easy to say, "Ah, I can do that later." But procrastination could be costly. Here's a real-life example (with the names changed, of course).

John and Mary were married for 62 years when John passed away this March. Both John and Mary had careers, and each was receiving a Social Security benefit based on their individual work histories. John's benefit was \$1,700/mo., while Mary's was \$1,200.

As soon as the funeral home notified the Social Security Administration of John's passing, his benefit was suspended. Mary has continued to receive her \$1,200 benefit, but as a surviving spouse, she can claim John's monthly benefit and surrender her own. To validate her claim to John's Social Security, she must provide documentation of her marriage.

John and Mary lived in Illinois but were married in Pennsylvania, where certified copies of John and Mary's marriage are archived at the county level and can only be accessed by a written request. This process is complicated by Mary's physical disabilities. She has vision and hearing limitations, requires assistance to manage her financial affairs, and is not capable of completing the request on her own.

When Mary's claim is processed, SSA will back-date the change in benefits to John's date of death and make up the difference. But right now, during a period of personal transition, she will have at least four months of decreased income because she still doesn't have the documentation to begin the claim process.



**TO-DO:** If you don't have certified copies of your vital records, why not put it on your to-do list the next time you meet with your financial professionals? Especially if one of these professionals offers an on-line vault

for storing personal records, this is a great opportunity to get assistance with the request process, then scan and store a digital copy. And you'll get a tiny endorphin rush from completing a small but essential task on your financial checklist. ❖



**E**conomist Joseph Schumpeter is perhaps best known for the phrase "creative destruction," a "process of industrial mutation that incessantly revolutionizes the economic structure from within, incessantly destroying the old one, incessantly creating a new one."

When you analyze some of the benchmarks that are used to measure the American economy, you'll see ebbs and flows, with a general upward trend. But if you go behind the graphs or the lists, you see the magnitude of creative destruction that accompanies these changes. Industries and companies rise and fall, often very quickly. There is very little stability or permanence. For example:



### The DJIA

The Dow Jones Industrial Average is an index of 30 stocks that provides daily, monthly, yearly and decades-long snapshots of the U.S. economy. When first compiled in 1898, the DJIA was comprised of 12 stocks. In October 1928, the index expanded to 30 publicly-traded companies.

Over the past century, the composition of the index has changed more than 50 times (the most recent addition was Apple, which replaced AT&T in 2015). Of the 30 companies in the current index:

- Less than half were members 30 years ago
- Only five have maintained a place in the index for 50 years
- And only one – General Electric – had been on the list since 1928, and was just replaced.



### The Fortune 500

Another historical record of the U.S. economy is the Fortune 500. Compiled every year since 1955, the list ranks the largest 500 U.S. companies based on their revenues. Over 64 years, only three companies – General Motors, Exxon, and Walmart (the 2018 No. 1 company) – have held the top spot. And as soon as you get beyond top tier, you find significant turnover – every year.

Per Mark Perry from the American Enterprise Institute:

"(F)ewer than 11 percent of the Fortune 500 companies in 1955 have remained on the list during the 63 years since. More than 89 percent of the companies from 1955 have either gone bankrupt, merged with (or were acquired by) another firm, or they still exist but have fallen from the top Fortune 500 companies (ranked by total revenues) for one year or more."



### The Unprecedented Stability of Life Insurance Companies

In free markets, creative destruction is a fact of life; there are very few products or industries that can withstand it. But perhaps one segment of the economy that comes the closest is life insurance. Look at the longevity of four of the largest, highly-rated mutual life insurance companies in the U.S. today:

<b>New York Life</b>	- founded 1849
<b>Massachusetts Mutual Life</b>	- founded 1851
<b>Northwestern Mutual Life</b>	- founded 1857
<b>Guardian Life</b>	- founded 1860

Consider the technological, social, and political changes, both in the U.S. and globally, since the Civil War. Then consider that these companies have an almost unmatched record for consistent financial performance, both in terms of paying dividends to policyholders, and delivering on their insurance promises.

What accounts for this stability in a world awash in creative destruction? In part, it's the long-term promises life insurers make. As economist L. Carlos Lara explains it,

“The life insurance sector is completely different from the commercial banking system and Wall Street. Fixed within life insurance policies are long-term, intangible financial promises not found in any other form of financial product. In effect, life insurance companies are obligated to fulfill their promises as written in their contracts now, or 65 years from now. In fact, no other financial product contains guarantees and options of such potentially long durations as those found in life insurers.”

If policyholders didn't believe that life insurance companies will fulfill their promises now or 65 years from now, life insurance wouldn't exist. But because life insurers do fulfill their promises and manage their assets, so they can continue doing so in the future, the industry has remained financially strong and profitable in every economic circumstance for more than 150 years. Creative destruction in life insurance may have changed the type of policies being offered, but it hasn't changed the underlying fundamentals.



When making an apples-to-oranges comparison to other investments, some financial gurus may dismiss life insurance policies because they believe these other products can produce higher returns.

Fair enough. But stability and guarantees have their place in accumulation plans as well. And when it comes to those qualities, life insurance, a product that is neither a bank instrument or a Wall Street investment, is arguably the best option.

Creative destruction isn't needed when the current product continues to perform at the top of its class. ❖

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