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Is Family Caregiving in Your Future?

Of all the facts and statistics on which to base predictions, one of the most reliable is demographics – numbers relating to the structure of populations. Demographics can be accurate indicators of future events because population trends occur in slow motion; they build gradually, and once started can be resistant to change.

One significant demographic trend is the declining birth rate in developing countries. The social and economic impact of having fewer children is not crystal clear, but the changes, both good and bad, will be difficult to undo or alter. It literally takes the passing of a generation for demographic trends to change.

So, consider this demographic-based prediction from Stipica Mudrazija, a senior research associate at the Urban Institute:

Over the next fifty years the number of older Americans with disabilities is projected to increase by about two and a half times. The increase will likely be particularly prevalent among the oldest-old adults (people ages eighty and older). Their numbers will rise at a faster pace than those of any other age group, and their long-term services and support needs are generally higher than those of the younger population.

On the other hand…

The number of potential caregivers will increase more slowly.

The prediction:

These demographic trends, coupled with older adults' preference to age in place and receive care from family and friends, suggest that the United States can expect a substantial increase in the share of working-age adults who provide essential care to their frail parents and other family members.

Future cohorts of family caregivers will likely include a higher share of workers and people with higher earning capacity. Insofar as some of them will stop working or scale back their work effort because of caregiving activities, future levels of related forgone earnings—that is, work-related opportunity costs—could increase substantially.

The first wave of this caregiving trend is already surging through the United States. Every five years, the National Alliance for Caregiving conducts a survey regarding the state of caregiving in the U.S. Its most recent report, released in 2016, contained the following statistics:

- Roughly 1 in 6 Americans is providing care for an adult (age 18 or older) with a disability or illness.
- The average age of a caregiver is 49.
- 60 percent of caregivers are female.
- 82 percent of caregivers are taking care of one person.
- 85 percent provide care for a relative, with 49 percent caring for a parent or parent-in-law.

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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 presented in this newsletter with a licensed financial professional.

These caregiving responsibilities impose a financial toll. A 2018 General Accounting Office study found that "68% of working parental and spousal caregivers said they were subject to at least one of eight different effects on their jobs because of providing care to a loved one." These included

- Transitioning to part-time employment.
- Decreasing work hours
- Taking a leave of absence
- Warnings about subpar performance or attendance
- Quitting work altogether
- Retiring early
- Turning down promotions
- Losing employer-sponsored benefits

Not only does income decrease for caregivers; expenses go up. A 2016 AARP study showed that 78% of family caregivers incur out-of-pocket costs, which typically equaled 20% of a caregiver's income. In addition, caregiving families may also need to relocate or reconfigure housing arrangements.

Becoming a family caregiver has huge financial and lifestyle ramifications. But because this trend is just beginning, there isn't much of a personal finance template for addressing it.

What's the Plan?

The biggest challenge in a family caregiving scenario is the coordination of two or more households with distinctly different priorities and resources. With these disparities, caregiving may become asymmetrical, where one party feels neglected or at a disadvantage. This can lead to conflicted feelings, especially for caregivers. In a survey conducted by Pew Research, nearly one-third of family caregivers (32%) said that helping aging parents was stressful. However, 88% of those caregivers also saw their efforts as rewarding.

Finding practical solutions to the financial issues of caregiving can go a long way toward easing the emotional stress. This requires forethought, and occasionally, some out-of-the-box thinking. Instead of simply absorbing these losses if a caregiving scenario arises, families might want to pre-emptively consider options that could lessen the economic impact. For example:

A plan to compensate caregiving family members. Some caregiving arrangements are acts of charity because those needing care don't have the financial resources to pay for help. But even if funds are available, family members may feel uncomfortable asking to be paid. Addressing payment options ***before care is needed*** and putting these options in writing can alleviate the awkwardness.

Most likely, this compensation won't replace a caregiver's work income, but some pay is better than none, and it acknowledges the caregiver's sacrifice. (Note: these payments are taxable events. IRS Publication 926, "Household Employer's Tax Guide," details the unique reporting requirements. Which means: consult with a tax specialist.)

Alternately, caregiving family members could be compensated at the distribution of the estate. Assets or life insurance proceeds initially divided equally between two beneficiaries could be adjusted to a different percentage favoring the adult child who provided care.

The Demographics Say You Should Prepare for Caregiving

The dominant focus in personal finance is the single economic unit – the individual, the married couple, the family with minor children. But these single entities are often financially and relationally intertwined with others, and events in one economic unit can impact those connected to it. Caregiving is one of those events, one ever more likely to affect the finances of several households. Given the probabilities, prudence compels you to consider how your economic unit might respond to a caregiving scenario, and who else it might affect. ❖

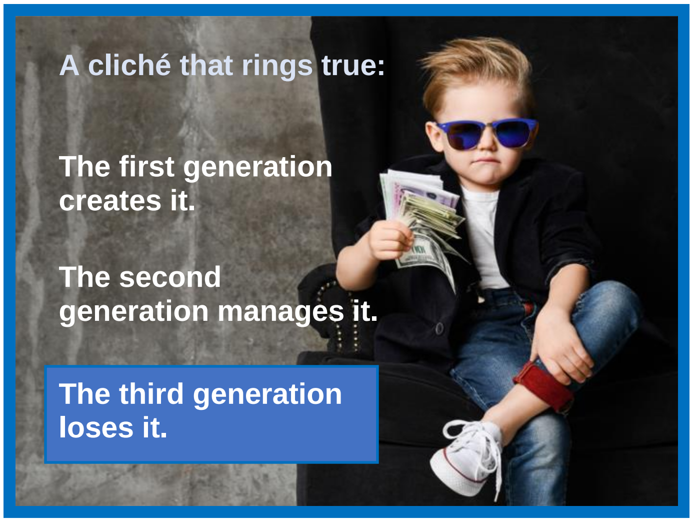
Fortunately, because demographic trends move slowly, many Americans may still have time to incorporate family caregiving into their personal finance plans.

But while demographics creep along, they rarely go away. Better to address caregiving now than hope it never becomes an issue.

After 70 years of changing the world to meet their needs and interests, the Baby Boom Generation (those born between 1946 and 1964) are poised for one last hurrah: As their numbers diminish, the Boomers will precipitate a massive wealth transfer. In an October 2018 *ThinkAdvisor* commentary, Matt Sommer, an investment company retirement strategist, gives some perspective to the magnitude of this event:

While the 'Me Generation' will likely spend some of its collective fortune, there will be plenty left to pass along to their heirs. Between 2031 and 2045, as much as 10 percent of U.S. wealth could change hands every five years.

Unfortunately, if history is any guide, much of this transferred wealth will be squandered, often before the passing of the following generation. There is a cliché that explains this failure:



A 20-year study by the Williams Group, a consulting firm that specializes in wealth transfers, found that "the failure rate for a family's successful intergenerational transfer was a staggering 70 percent." Why does this happen?

Timothy P. O'Hare, in an October 2016 article for worth.com, says the fail rate isn't because of poor advice or inadequate strategies. Rather, the core issues that disrupt wealth transfers are poor family dynamics, primarily "a lack of communication and trust among family members."

By the time an intergenerational wealth transfer becomes a serious topic for discussion, the three generations in the cliché are adults. The first generation is typically past 70, and aware that the wealth they've accumulated will outlast them. Their children, the second generation, are approaching 50, while many grandchildren are just entering adulthood.

The first generation typically starts a business or other wealth-generating activity, and the second generation often grows up observing the process at close range, perhaps even joining the enterprise. But some first-generation wealth-builders never see their children as worthy successors, even if these children are mature adults with established careers, inside or outside of the family business.

The third generation is likely to be further disconnected from the wealth-building experience and consequently less appreciative of the effort that created the abundance. The hard-working, high-achieving grandparents fret that financial windfalls to successive generations may result in an over-emphasis on material possessions, a lack of appreciation for the value of money, spendthrift habits, and a lack of initiative.

These concerns leave many first-generation wealth creators ambivalent about wealth transfers. Not sure if an inheritance would be good for their heirs, they may procrastinate, or perhaps even worse, make a plan for the distribution of assets without the involvement of prospective heirs.

This "accidental" approach to inheritance, which leaves heirs without a clear understanding of their responsibilities and resources, is not only a missed opportunity, but financially destructive. With or without a plan, there will still be assets to inherit. And unless there are specific instructions that disinherit future generations in favor of a charity or some other non-family entity, heirs will still receive something, even if they have to fight for it in court. This is wasteful and does nothing to instill healthy values and habits. Because more than money, it's the effective transference of *values and principles* that is key to successful generational transfers.

An Intentional Approach to Inheritance

The Survey of Consumer Finances (SCF) is a triennial statistical report on the financial conditions, attitudes and behaviors of American households. Culling data from a section titled "Inheritances and Charity," Sommer identifies what he believes are the key factors in successful wealth transfers: the beneficiaries know what they will receive, and they know why. This conclusion came from the responses to two questions:

1. Do you expect to receive a substantial inheritance or wealth transfer in the future?
2. How important is it for you leave an inheritance?

According to Sommer, the behavior trait most associated with passing on wealth "is an individual's own expectation of receiving an inheritance." Those who expected an inheritance were nearly 16 percentage points more likely to leave money to their heirs. Meanwhile, individuals who received an inheritance were seven percentage points more likely to want to do the same for their own kin.

To simplify: **Those who know they are getting an inheritance are more likely to want to give one as well.** They not only look forward to receiving wealth from the previous generation, but they want to perpetuate it.

Here's an insight: The sooner families make inheritance a topic of discussion the better. For the first generation, an early start on inheritance planning means more time to educate and motivate successor generations. For the second and third generations, early involvement in a wealth transfer results in a longer gestation period. There is more time to appreciate the value of an inheritance, imagine its use, and anticipate the blessing of receiving it.

Early-stage inheritance planning is not about assets or numbers. Rather, many inheritance consultants recommend that families establish a "financial code of conduct," often in the form of a mission statement that articulates values and priorities. This process might include conversations about family obligations, principles of business, charitable giving, the intermingling of personal funds with inherited wealth, joint ownership of real property, etc.

Additionally, the first generation may consider introducing younger family members to their team of financial professionals, as these professionals may become trusted mentors for successor generations. ❖

A consistent, long-term, intentional approach to inheritance solidifies its value for future generations, and also increases the likelihood that this process can be perpetuated.

The longer your heirs see your vision, and can blend it with their own, the more likely your wealth will not be squandered. If you expect to leave an inheritance, why not start the discussion today?

Cash Value Loans?[1]

***Question:* Why does the insurance company charge you interest to borrow your cash values?**

This is a “gotcha” question critics of cash-value life insurance often raise. If the cash values in a life insurance policy belong to the owner of the policy, it seems unfair, even unethical, for the insurance company to charge interest to access them. For cynics, these transactions are a conspiracy to defraud the consumer.

Cash value loans aren’t a conspiracy. They just aren’t understood very well by most consumers – and even some so-called “financial experts.” When you get how they work, there isn’t a “gotcha” moment.

The Mortgage Analogy

Although the analogy isn’t exact, a mortgage and a cash value life insurance policy have many things in common.

In a mortgage, the borrower takes ownership of real estate immediately while paying for it over time. When the mortgage is paid off, the individual owns the property “free and clear.”

Likewise, a policyowner takes ownership of a specified amount of money (an insurance benefit) by paying regular premiums. Depending on the type of contract, a life insurance policy can eventually be “paid up,” i.e., no more premiums are due, and the policyowner holds the insurance benefit free and clear.

Just as you build home equity by making monthly mortgage payments, cash values increase with successive premiums. This growth is not linear; to compensate the lender for the risk of advancing the money to buy the property, mortgage payments are weighted toward interest at the beginning, and equity grows slowly. Like a lender, an insurance company has the biggest risk at the beginning of the policy’s life; if you make only three months of premium payments on a $1 million policy and then die, your beneficiaries still receive the insurance benefit, and the insurance company takes a big loss. Consequently, cash values accumulate slowly at the beginning of an insurance contract.

The Cost of Converting Equity to Cash

Another similarity between a cash value insurance policy and a mortgage is the way that equity can be accessed. With a home, the owner can tap the equity through refinancing the existing mortgage, or by establishing a home equity line of credit.

If your home is worth $250,000 and you owe $90,000, you have $160,000 of equity in the property. A bank might typically offer a home equity line of credit equal to 80% of the value of the house ($200,000) minus what you owe ($90,000), which leaves $110,000 available as a line of credit. The lender charges interest on amounts drawn against the line of credit and sets the repayment terms.

If you are tracking the parallels between a mortgage and a cash value life insurance policy, a question should pop up:

“So…If I own the equity in my home, why do I have to pay interest on ‘my money,’ when I take a home equity loan?”

Hmm…That’s a gotcha question. Why *do* you have to pay interest on *your* money?

Here's why: While your equity has a dollar value, it isn’t money. **The interest charged on a home equity line of credit is the cost of converting your home equity into cash.** In theory, you could “spend” your equity by taking pieces of the house and exchanging them for other goods. Two bricks for a loaf of bread. A light fixture for a pizza. But most grocery stores don’t accept bricks as payment, and not every pizzeria wants light fixtures — like everyone else, they prefer cash.

Your house is worth more than the sum of its parts. If you attempt to gradually access the wealth in your house by dismantling it bit by bit, the value would drop significantly on what was left. A home equity line of credit not only allows you to convert a material asset to cash, but also preserves its value, instead of gradually destroying it.

The same concepts apply to life insurance cash values. The cash value in your policy has a dollar value, but the asset isn't the same as cash — it's part of an insurance benefit. If you want to convert it to cash, but keep the insurance in force, there is a “conversion fee” just like the bank charges for a line of the credit, with a few notable differences:

- The repayment schedule is set by the policyholder, not the bank.
- The insurance company cannot deny access to cash values; a bank can refuse to extend a line of credit.

When you see the similarities, it is ironic that many consumers (and “experts”) who never think twice about how a home equity line of credit works get lathered up about the same features when they are part of an insurance policy. Especially when the terms, access and repayment of a home equity line of credit are more restrictive than those for cash value loans.

A sideways thought: Both home equity and cash values can be great resources for financial emergencies or opportunities. But recent tax changes have eliminated the interest deduction for home equity lines of credit. Given the flexibility and favorable terms for cash value loans, if you had extra savings to allocate, would you make extra principal payments to increase your home equity, or extra premium payments (in the form of paid-up additions[2]) to boost your cash values? ❖

Gotcha thinking, right? Consult with your life insurance professional about ways to optimize your cash values.

(See next page for important disclosures)

1 Policy Benefits are reduced by any outstanding loans and loan interest. Dividends, if any, are affected by policy loans and loan interest, If the policy lapses, or is surrendered, any loans considered gain in the policy may be subject to ordinary income taxes. If the policy is a Modified Endowment Contract (MEC), loans are treated like withdrawals, but as gain first, subject to ordinary income taxes. If the policy owner is under 59½, any taxable distribution from the policy may also be subject to a 10% federal tax penalty.

2 Paid-up Additions (PUA) are purchases of additional insurance (death benefit) that have a cash value. These purchases are made with dividends and/or a rider that allows the policyholder to pay an additional premium over and above the base premium. This creates the growth of death benefit and cash values in a participating whole life policy. Adding large amounts of paid-up additions may create a Modified Endowment Contract (MEC).

What aspect of your personal finances is most deficient, and needs to improve? For many middle-class or upper-middle-class households, the answer is "saving for retirement." Despite incomes that place them in the top quartile of all Americans, many struggle to fund a retirement.

In a November 2015 *Quartz* article titled "America is Full of High-Earning Poor People," Allison Schrager used data from the Federal Reserve to prove her point:

> (U)pper-middle-class individuals aged 40 to 55 with household incomes ranging from $50,000 to $100,000…had fewer assets than ever (assets exclude a house, car, or business, but include retirement funds). (E)ven a high earner who worked for many years typically had only $70,000 in financial assets.

The Simple Prescription That Doesn't Work

Seeing this deficiency, the response of many financial professionals and policymakers is simple: Tell Americans that retirement saving has to be a priority. This means:

"Sock away as much money as possible for retirement!"

"Maximize your retirement plan contributions!"

There. Problem solved.

Except it isn't. Because that's what the "experts" have been saying for years, and if anything, retirement savings for the average upper-middle class household (adjusted for inflation and the fact that very few workers have employer-sponsored pensions) are lower today than they were twenty years ago.

If you're not saving enough, the reasons probably run deeper than you simply haven't made it a priority. And the solution is probably not going to come from compartmentalizing your retirement issues to the exclusion of everything else.

You Can't Separate Retirement from the Rest of Your Finances

Compartmentalization is a way to deal with conflicting issues that compete for our attention and resources. A classic example of compartmentalizing is a business owner who makes a conscious decision to not bring work home at the end of the day so that they can completely engage with their family. At the same time, they do not allow family issues to intrude during their workday; the two spheres never intersect.

Short-term, compartmentalizing may be effective in managing two divergent obligations, like work and family. Long-term, it can leave one aspect of life disconnected from the others.

For those experts who see a fully-funded retirement as the ultimate objective of personal finance, it's easy to recommend a compartmentalized approach. Whatever else is going on in your financial life (debt, a new house, college for kids) should not affect your retirement saving.

There is a rationale for this approach. The tax advantages and distribution penalties associated with qualified retirement plans are intended to compartmentalize this money; it's for retirement. But most Americans, even those with high incomes, can't compartmentalize retirement, simply because they don't have enough money to adequately fund every compartment.

Fix Your Issues, Fund Your Retirement

A five-year study by Financial Wellness, a California think tank, tracked the financial progress of 2,400 employees whose employers offered ongoing coaching services for all aspects of their financial lives – things like cash flow, building an emergency fund, debt management, as well as retirement saving. A key finding:

> **Workers who received advice on all money matters impacting their lives did a better job saving specifically for retirement.**

And the improvement was significant: "Among employees who have had access to ongoing coaching for all aspects of their financial lives, the average retirement-plan contribution rate climbed to 9.4% of pay in 2018, up from 6.3% in 2013."

Greg Ward, the director of Financial Wellness, offers this explanation: "Those with the most financial stress have issues at a foundational level, and are the ones who have more trouble saving." If you address these other financial issues, like paying off student loan debts or saving for a house, a byproduct can be more retirement saving.

This suggests that instead of compartmentalizing retirement, an *integrated* approach might be more successful.

For General Assistance, Consider Asking Your Specialists

For a bunch of middle-class and upper-middle-class families, a 50 percent increase in retirement-plan saving would make a substantial difference in their long-term financial well-being. So where can you get ongoing coaching for all aspects of your financial life? A good place to start might be the financial professionals who may already provide some compartmentalized services.

Many consumers see their financial professionals as specialists. As in: "That's my insurance guy, she handles my investments, this firm does my taxes, and I have two attorneys – one for business, the other for personal.”

It might surprise you, but the financial professionals you value for their specialized expertise may also be good resources for evaluating and integrating your personal finances. Because in order to give you the appropriate insurance and investment products, tax preparation, and legal advice, these financial professionals must know how their niches in the financial service industry intersect with each other. This includes a general knowledge of basic financial philosophies and the pros and cons of common management strategies in personal finance. In fact, many of these financial professionals may have software or other planning tools to help you develop a big-picture approach to your finances.

You need a team of financial professionals to provide specific products and services. But don’t compartmentalize them or their work; many operate from a holistic perspective. You might benefit from picking their brains about better ways to increase cash flow, pay for big-ticket items, reduce debt, or set your budget priorities. ❖

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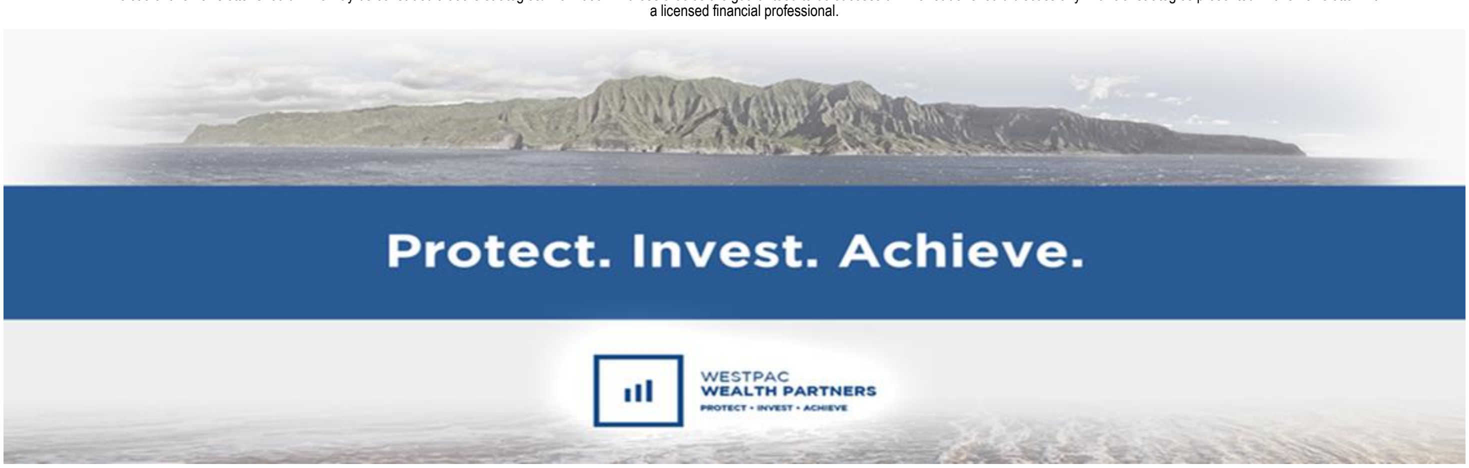
You might benefit from picking their brains.



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