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December 2014

YOU *may not* RETIRE on your OWN TERMS

(Even if you're saving a lot of money)

When the discussion turns to retirement planning, two prominent factors, **age** and **dollars**, are typically front and center. Determining the age at which one would like to retire, and the amount of money that will be needed to make retirement feasible are reference points to determine *projected annual rates of return*, and the *amounts that must be contributed* in order make a plan work. In theory, this approach brings focus to your financial objectives, and moves you toward a profitable outcome. Going forward these targets may be adjusted, but at some point, the age and dollar numbers will reach a point where retirement is desirable and doable. "I am ___ years old and I have accumulated $_________. I think I'll retire."

But what if the decision to retire doesn't hinge on these factors? Empirical observations and comprehensive surveys strongly suggest that "real-world" factors are much more likely to trigger a decision to retire, regardless of whether one's financial objectives have been met. Consequently, it might be more accurate to say many Americans won't choose when to retire. Instead, these other non-financial issues will make the decision for them.

A short list of issues that often trigger retirement decisions:

- Your employer
- Your job skills
- Your health
- Your spouse
- Your kids
- Your parents

As the demographic bubble that is the Baby Boomers surges into retirement, it is apparent these issues greatly impact retirement planning – and dealing with them isn't resolved with a simple adjustment of the age-dollar model. For perhaps the last two decades, many under-funded Baby Boomers declared they would compensate for their current lack of savings by simply resetting the age at which they intended to retire. Their mantra: "Oh well, I guess I'll just have to work a few years longer."

Except it turns out many of them can't work a few years longer. Referencing a 2013 Mature Market Institute survey, an October 13, 2013, *US News & World Report* article declared:

Even people who wanted to work longer found they could not swing it. Among the first wave of baby boomers to hit retirement age, more than half (54 percent) quit working before they planned…The reason they are retiring? A majority of those polled say it was job loss or health-related issues.

A similar study in 2013 by LIMRA Retirement Research echoed the findings:

Nearly half of all retirees had to leave the workforce early and for factors that were beyond their control. (F)or 49 percent of retirees, their retirement date was dictated by job loss due to layoffs, employer buyouts, negative work environment or because of health issues.

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There are many non-financial issues that could quickly undo an accumulation plan for retirement.

Connecting the dots, these factors can cause havoc for retirement programs based on age-and-dollar targets. In an August 16, 2013, article for *BenefitsPro,* Paula Gladych summarizes: "Retiring early can have a negative effect on a person's standard of living. There are fewer years to earn and save money for retirement."

Hmmm. Forced early retirement would most definitely affect age and dollar calculations. That's obvious. What is perhaps the most startling statistic from the Mature Market survey: **Only 4 percent of those surveyed say the primary reason they retired was because they had enough money and could afford to.** If the success rate for age and dollar retirement planning is just 4 percent, perhaps some other approaches need to be considered.

Oh, by the way…there's more

It's not just personal issues of health and employment status that impact your decision to retire. It's also the conditions of those around you, particularly your family. And it often starts with your spouse. In a July 27, 2014, *USA Today* article, Nanci Hellmich reported on the difficulties couples encounter when their work status and financial perceptions are running on different tracks: "Most conflicts about retirement timing arise when one partner is forced to leave a job unexpectedly because of a firing, layoff or downsizing, and that partner wants the working partner to retire, too."

If one person still wants to work, or feels they need to, the challenge often isn't primarily financial, but relational. One partner may resent the other's commitment to work, while the other bristles at the amount and costs of the first partner's free time. As a psychologist commented in the article, retirement becomes a "power struggle" over whose needs and wants will prevail. And often the compromise that follows includes either a career change, or the still-working spouse opting for retirement as well.

The relational factors extend to both children and aging parents. "Family & Retirement: The Elephant in the Room" was a 2013 study conducted by Age Wave about "family interdependencies and the challenges Boomers face in balancing them with their own retirement plans." Among the real-world issues that were found to impact retirement:

Providing financial assistance for other family members. About 60 percent of the Boomers surveyed said a member of their family is the "family bank," someone they can turn to for financial help. The average financial assistance provided to family members during the past five years was $15,000 – and significantly higher for those with more money.

Sacrificing retirement for family. Half of respondents over age 50 said they would make major retirement sacrifices to help family members. Some might keep working, others said they would retire early to care for aging parents or to be near children and grandchildren.

Divorce, remarriage and blended families. For a number of sociological reasons, "gray divorces," those which come late in life, are on the rise. The financial impact of separation is substantial: Average household income drops 40 percent for women, 25 percent for men. Subsequent remarriages create new family dynamics, and the study found nearly two in five people age 50 and older are now part of a blended family. And nearly one-third of Boomers with stepchildren said the couple had different financial priorities for their own children in contrast to those of their spouse.

In conclusion, the study found "the vast majority of people age 50+ have not prepared for potential family events and challenges that could affect their retirement planning."

Retirement planning that accounts for the real world

If these statistics are accurate (and empirical observations and anecdotal evidence would seem to support their validity), American retirement planning should expand beyond a simple age and dollar calculation. Since there are **many non-financial issues that could quickly undo an accumulation plan for retirement,** "insurance" planning probably becomes a larger component. **What steps can be taken to insure that some retirement benefits will be available – under all circumstances?**

Besides a shift (or expansion) of the factors and products that should be considered, prospective retirees may want to selectively broaden the group of people involved in their retirement discussions. Retirement isn't just a personal decision, but often a family decision, and frequently an extended- and blended-family decision. These interdependencies need to be integrated at both a financial and relational level. This isn't just for informational purposes; in some cases, integration of financial plans can lead to better benefits for everyone.

Are your retirement plans primarily an age-and-dollar calculation?

How well could you adjust to a "forced retirement"?

Are there extended family relationships that need to be considered in any retirement discussion?

Asking these types of questions (and working on the answers) might better prepare you – and those you love – for a retirement that may arrive when you don't expect it. ❖

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Buckets:

Does a Macro Approach Fit a Micro Issue?

One of the biggest challenges in designing financial programs for individuals is their individuality. People have different skills, needs, interests, objectives and current circumstances; personalized financial planning is a micro issue. And every plan is unique.

In contrast, governments and financial corporations operate on a macro scale. Their financial perspectives, issues and strategies are quite different than individuals'. Institutions don't interface with individuals in a one-on-one format; their relationships are shaped by demographics and transactions with large numbers of people. So how do institutions shape their programs, products and services to respond to individual needs and preferences?

Governments use statistics to classify groups of citizens, then address the perceived needs of the group. In some instances this results in a change in tax policies (allowing or eliminating deductions), or the creation of new programs (IRAs, Pell Grants, etc.). The ability to use these benefits may be prohibited by income levels or some other broad metric, which narrows the range of citizens who can benefit from these changes. But though they narrow it down, the approach is decidedly macro.

The macro response to individuality by financial institutions is to offer more options, and recommend participation in everything, or at least as many things as your budget allows. Instead of saying only a subset of Americans are eligible for a special plan, financial institutions attempt to make many financial products and services available to everyone. You could call this a **bucket approach to personal finance** – because that's what the financial institutions call it. Here's a blurb from the website of a prominent brokerage company:

If you're like millions of other American investors today, you're probably a "bucket investor." Most likely, you have some money in a retirement account, another pile in a college savings fund and a third stash set aside for emergencies. If you're a retiree, you may have a cash bucket for expenses for the next three to five years plus an investment bucket for long-term growth.

Putting your money in buckets has become a popular planning tool for investors and financial advisers alike — nearly a third of financial professionals now use some variation of the strategy for their clients, according to the Financial Planning Association.

The bucket approach seems simple: if you can cover all the financial bases – for insurance, retirement, healthcare, etc. – you should be safe. But the bucket approach is often impractical and inefficient for most Americans.

Unless one has unlimited resources, it is hard to fully fund everything. In fact, Americans today have less real income available for meeting long-term financial objectives than 10 years ago. *The Wall Street Journal* noted that the Census Bureau reported on September 16, 2014, that the 2013 median household income of $51,939 was 8% below its pre-recession level.

Following the same track, a July 2014 survey published in *USA Today* determined that "living the American Dream" required an annual income of at least $130,000. If median income is $51,939 and the American Dream (as defined by the researchers) requires $130,000, do you think there's going to be enough money to fill every bucket?

To illustrate, the American Dream scenario consisted of only two saving components: A maximum contribution of $17,500 to a 401(k) and $5,000 allocated to two accounts for college savings. But if these two financial decisions consume almost 25 percent of one's after-tax income, what's left to insure human life value, finance a home remodeling, plan for long-term care, build emergency cash reserves and leave an inheritance? And if you can't fill all the buckets, which ones will have to be neglected?

Further, what happens if the hypothetical family of four featured in the *USA Today* example has to relocate because of a job loss, decides to start a business, or has children who don't want a college education? It might be cost-prohibitive to liquidate either the 401(k) or the college savings accounts. Given the wide range of unknowns and the likelihood of change, it's quite possible, even probable, to believe that narrowly focused financial decisions (i.e. "buckets" of narrowly focused financial products or strategies) will inevitably deliver less-than-optimal results.

Is "Better Than Nothing" a Good Measuring Stick?

Promoters of the bucket approach to personal finance will often concede its drawbacks. However, they contend that the value of the bucket approach is motivating people to take action, and doing something is better than doing nothing. There is psychological satisfaction in taking action to address a concern; in most circumstances, being pro-active is better than doing nothing. Most of the time, any decision to save or insure will yield positive results. So…

Concerned about retirement? Here's a bucket called IRA.

College funding? Fill a 529 bucket.

Worried that end-of-life expenses might impoverish a surviving spouse? Try a Long-Term Care Insurance (LTCI) bucket.

Want guaranteed income for life? Better find an annuity bucket to supplement Social Security.

IRA

College Fund

LTCI

Annuity

Can't find what you need? Be patient, we're making a bucket for that as we speak.

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However, what if doing something gets in the way of ***doing something better?*** Psychologically and financially, someone who has filled his/her life insurance bucket with term insurance and their retirement bucket with a 401(k) may not be receptive to considering alternatives. "I'm all set. I've got the buckets!"

Having a lot of buckets (or even a few buckets selected haphazardly) and attempting to fill most of them is not really a coordinated plan. It's just a bunch of buckets.

The successful use of financial instruments comes not from simply owning these products, but in which ones are selected, and how they fit within the parameters of your current circumstances and objectives. Not every product is suitable for every person. You can't expect that having a lot of buckets will in itself lead to financial success.

Additionally, many buckets come with restrictions on contributions and/or distributions; you can only add so much, and you can only withdraw under certain circumstances. So even if the particular bucket delivers some benefit, its value is finite; you may not be able to get more of what's good for you.

A "Better" Bucket Method

Financial progress doesn't require a lot of buckets. You need the **right** ones, and you need them filled to the brim, with the option to pour over into other buckets as future circumstances permit. One or two large, multi-purpose accumulation buckets, whose use can be determined at a later date, are usually more efficient and valuable than multiple, narrowly focused and underfunded accounts.

The essence of efficient planning is not striving for higher returns, but eliminating actions that deliver minimal benefits. The "savings" that result should directly and indirectly boost overall performance from your financial decisions.

Consult your professional resources to identify the buckets appropriate for your situation, and determine ways to maximize their value. You probably can't fill them all, but you should fill the ones that deliver the greatest benefits. ❖

The Responsible Approach: *Transferring Responsibility*

In October 2014, Motorola Solutions, Inc. and Bristol-Myers Squibb Co. announced they had paid a large insurance company to take over their pension plan obligations. For 38,000 retirees, checks will no longer come from their old employer, but from the insurance company.

For the companies, eliminating the need to fund pension benefits improves the corporate balance sheet, and removes the uncertainty connected with future funding obligations.

For retirees, this transaction has a negligible impact. Benefits remain the same, and since future payments are now guaranteed by the insurance company instead of being dependent on annual funding contributions by the former employer, they may even be more secure.

But for companies that have pensions, and for those who are relying on them, each pension termination indirectly impacts the security of their own plan. Here's why:

Through yearly fees to the Pension Benefit Guaranty Corporation, employers with pension plans provide funds to *insure ongoing payments to retirees if a pension encounters financial difficulties.* Created by the Employee Retirement Income Security Act of 1974 "to encourage the continuation and maintenance of private-sector defined benefit pension plans," the PBGC is a government agency not subsidized by general tax revenues. Instead, it is funded primarily by insurance premiums from employers that sponsor insured pension plans. Currently, an employer pays $49/yr. for each employee covered by the company pension plan. Because the past recession resulted in a substantial increase in claims from failed pensions and subsequent concerns that the PBGC may be underfunded, Congress authorized an increase to $64 per employee for 2016.

When companies decide to terminate their pension plan, they also stop paying into the PBGC (for Motorola and Bristol-Myers, the savings in fees was estimated at $6.5 million). And as fewer companies participate, the risk of pension failure is spread over a smaller group – usually not an optimum insurance paradigm.

On one hand, the PBGC doesn't have to worry about backstopping a pension that has been off-loaded to an insurance company. On the other, many of the companies who have opted to terminate their pensions were well-funded, and thus low risks to require a PBGC bailout. They had enough pension assets to directly transfer their obligation to an insurance company without adding additional cash to the deal. As insurers are actively seeking to assume healthy pension plans, an October 6, 2014, *Wall Street Journal* article commented that this trend "could weaken the government's ability to protect the payouts other employers have promised millions of workers."

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Recognizing a Sea Change in Retirement

For many workers, a discussion of pension plan solvency seems irrelevant because their employer doesn't have one. But the decision by multiple companies to end their pensions has applications for everyone saving for retirement.

Absent a pension, the prevailing retirement program is a defined contribution plan like a 401(k), where the employee accumulates a retirement account balance, principally by deferring a portion of his/her earnings, with the employer perhaps providing some matching contributions. Upon retirement, the employee is responsible for converting this balance, however large or small, into retirement income.

Unlike a defined benefit pension, where an employee could assume a specific lifetime income based on average salary and years of service, the projected income from a defined contribution plan is an open-ended question, even in retirement. How much can be drawn from the accumulation on an annual basis? What type of assets, or combination of assets, should be used for these purposes? Who makes these management decisions, especially if one's mental faculties begin declining? While there may be opportunities for larger distributions through superior management, a defined contribution plan places greater responsibility on the individual, and typically introduces greater financial uncertainty.

On a smaller scale, these questions of risk, responsibility, and guarantees mirror the dilemmas of company pension plans. And perhaps the solution for individuals is the same as many companies have elected: to pass the risks to an insurance company in exchange for a guaranteed income.

In pension plans, the company bears the investment and life expectancy risks while agreeing to provide retirees guaranteed benefits. The longer companies remain in business, the greater their "legacy costs," and the harder it becomes to project the appropriate level of funding to meet not only today's pension payouts, but anticipated future disbursements. In contrast, a benefit secured through an annuity with an insurance company, either for a group of retirees or an individual, is based on a one-time, paid-in-full transaction. This arrangement is less risky for both the recipients of the guaranteed income and the insurance company.

You Don't Have to Go It Alone

When Ken Hevert, a vice president for one of America's largest brokerage companies tells *USA Today* that "The overarching reality is that more Americans understand that saving for retirement is their responsibility," he's partly correct. The quickening pace of closing pensions and the rise of defined contribution plans means the responsibility for funding retirement has shifted to individuals. No matter how many years you've worked, there's not going to be a monthly check waiting in your mailbox unless you've built up an accumulation to fund it. The responsibility to save is on you.

But in the process, many Americans may find it to their advantage to transfer some of the responsibility for generating retirement income to insurance companies. Going forward, more retirement discussions are likely to include strategies that replicate a pension, i.e., a stream of lifetime income payments, using annuities or similar instruments. Sometimes the most responsible option is transferring the responsibility to those best-suited to perform the task. And insurance companies are well-equipped to deliver guaranteed benefits. ❖

For most employees, self-employed individuals and small business owners, the fiscal year ends on December 31. And as the year comes to a close, a review might determine that transactions completed before year-end could provide financial and/or tax advantages. For example:

- A business owner might decide to incur anticipated expenses before the end of the year if the purchases can offset income, thus lowering income taxes for the present year.
- Similarly, it might be desirable to make charitable contributions before December 31.
- Although annual contributions for most individual retirement plans can be deferred until April 15 of the following year, some small business retirement plans require all contributions to be made within the calendar year. Thus any 2014 contributions must be made by December 31.
- They don't have a December 31 deadline, but individuals contemplating a conversion of existing IRA accounts to Roth IRA Accounts may find it beneficial to execute this transaction before the end of the fiscal year in light of the tax that accompanies the conversion.

Completing a year-end transaction means not only beating the deadline but also having the money to do it. If your business or personal checkbook is flush with cash, this may not be a problem; in fact, it's probably one of the reasons you are considering getting something done before December 31. However, quite often the "excess" is no longer constituted as cash, but has already been re-allocated/spent on other needs or opportunities.

While a lack of liquidity might preclude a year-end transaction, there are scenarios where borrowing before December 31 might make sense. For example:

If you know an office copier will need to be replaced within the next six months, and the company's budget anticipates a replacement, the tax advantage of borrowing to buy the machine now may offset the interest costs incurred while repaying the loan over the next year.

Similarly, if your personal budget includes regular giving to a favored charity or religious organization, the tax benefit of a large year-end donation might be worth carrying some debt for a few months, even through a high-interest credit card. In fact, many credit card issuers make charitable giving a part of their

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marketing strategy. Here's a blurb from a December 13, 2013, article on creditcards.com regarding the idea:

"If your tax situation, and your heart, dictate that you want to donate this year, most charitable agencies large and small heartily accept credit card donations. Large charities such as the United Way have dramatically expanded their humanitarian reach by letting supporters make pledges through one-time or monthly payments charged directly to a credit card. Even the Salvation Army accepts credit card gifts."

Is it worth it?

Beyond the immediate benefits, there are several contingent factors when deciding to borrow for year-end transactions.

- First, someone must be willing to lend you the money.
- Second, you have to be able to repay the loan.
- Third, the cost of borrowing must be low enough to justify the decision.

Since one doesn't usually associate low-cost borrowing with credit cards, it might be preferable to set aside the ease of swiping plastic to consider other sources. Even for unsecured debt, a bank might offer more favorable terms for a one-time transaction than a revolving credit account. And if it can be secured with other collateral, even better terms might be available.

A loan from a 401(k), or similar retirement plan might also be a resource for year-end funding. These loans are subject to limits, and must be repaid in five years, but the terms may be even better than those offered by a bank, particularly if the loan can be repaid quickly.

You might also want to consider using cash values from a life insurance policy. Because the policy owner has the privilege of accessing the cash values at any time*, qualification is a non-issue. In general, the interest cost for borrowing cash values will be comparable with other collateralized loans, and the repayment terms are typically quite flexible. For a borrower who anticipates repaying the loan within a short time, cash values may be an attractive funding option.

Standard words of caution: Make sure you understand the true costs and benefits of borrowing for a year-end transaction, particularly in regard to tax consequences. Expert assistance is advisable, particularly for loans from retirement plans and insurance policies, because you don't want to jeopardize existing financial assets just to chase a one-time tax break or financial opportunity. On the other hand, careful planning might yield significant advantages from a creative use of resources already at your disposal.

* 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 59 ½, any taxable distribution from the policy is also subject to a 10% tax penalty.

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