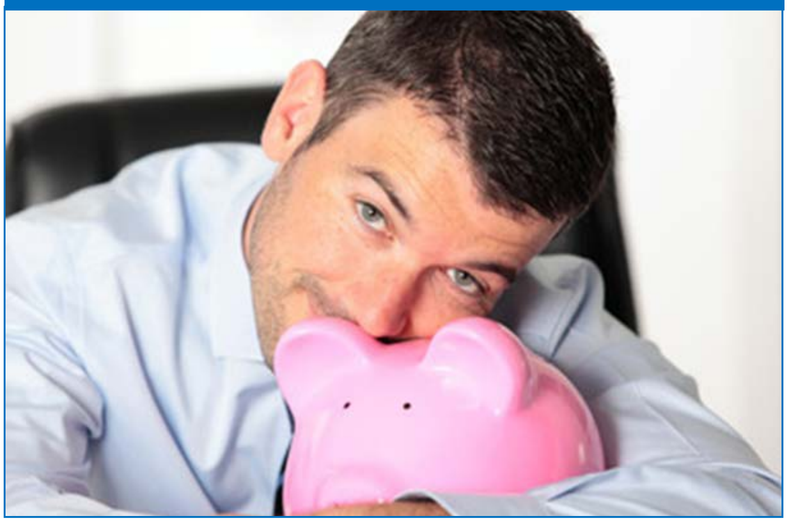
Creative

wealth maximization strategies*

November 2016

Life Satisfaction from Cash on Hand



It's time for another "Person A / Person B" comparison. These hypothetical individuals are the same age, work for the same company, and earn the same incomes. Here are abbreviated net worth statements for each of them:

A COMPARISON:	Person A	Person B
Home Equity	$250,000	$250,000
401(k) Retirement	$350,000	$250,000
Vacation Home Equity	$200,000	$200,000
Taxable Investments	$170,000	$50,000
Bank Account Balance	$30,000	$250,000
Net Worth	**$1 million**	**$1 million**

Persons A and B are millionaires; the only difference is how their paper assets are allocated. In line with conventional financial wisdom, Person A has made retirement savings a priority, and also built a sizable after-tax portfolio, both of which are allocated to instruments that have historically yielded higher returns when held over long periods. Person B also has a retirement account and investments, but the striking difference is $250,000 allocated to a savings account, which at today's interest rates, is earning less than 1 percent annually.

While both might have $1 million today, most observers would predict that, over time, Person A's net worth will exceed Person B's. But who is more likely to be happier about their financial condition? Research says it's probably the one with the bigger bank account.

That's the conclusion from an April 2016 research article, "How Your Bank Balance Buys Happiness: The Importance of 'Cash on Hand' to Life Satisfaction," by two American, and one British behavioral scientists. Joe Gladstone (the British one) summarized the findings in a September 11, 2016, interview with the *Wall Street Journal*, saying, "When it comes to happiness, a bank balance may be more important than overall wealth."

Apparently, there's something psychologically pleasing about having a comfortable amount of money in a checkbook or savings account. Behaviorists call this a "hedonic effect," and the survey showed that, even for very wealthy individuals with lots of savings and investments, more money in their checking account seems to increase their happiness.

The researchers speculate this is due to two factors. The first is exposure. Bank accounts tend to be accessed more frequently than retirement or investment accounts. If one's bank account is healthy, regular balance checks are positive reinforcement. (The

In This Issue…

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frequency of contact goes both ways; if the balance is low, it may be a stressful reminder of deficiency.)

Further, because money in a bank account is readily available, it is considered more "real." People know it can be spent immediately and they can readily imagine spending it for a particular item or experience. In contrast, the hedonic effect of deposits to retirement and investment accounts are much more abstract. There may be some peace of mind in saving for the future, but how and when this money will be spent is vague and unclear.

In the summary of their report, the researchers conclude:

"Our results suggest that having readily accessible sources of cash is of unique importance to life satisfaction, above and beyond raw earnings, investments, or indebtedness. Therefore, to improve the well-being of citizens, policymakers should focus not just on boosting incomes but also on increasing people's immediate access to money."

Think about that last phrase: "increasing people's immediate access to money." Does that sound like something you're likely to hear from a financial "expert"? Mostly, there's a hue and cry about Americans not saving enough, and the necessity of tax incentives, automatic withholding, and mandatory enrollment to nudge/force them to do what's really good for them. You can almost imagine the behaviorists, policymakers and financial institutions as a bunch of scolding elementary school teachers, saying things like, "the sooner you get started, the better," then adding with a bit of condescension, "maybe it's just best to take the responsibility out of your hands." Where's the hedonic effect in that?

> Are there strategies that not only address retirement,
> ***but also increase your immediate access to money?***

But maybe retirement saving isn't about your immediate well-being; it's about having enough money to *continue being* when you can no longer work. And since retirement is a vaguely imagined idea of the future, perhaps it's foolish to consider any hedonic effects, and better to compel people to do it. "It's tough love, but you'll thank us later," right?

Still, the psychological satisfaction of a large bank balance points to the benefits of balancing present and future financial interests. While delayed gratification is essential to saving, happiness can never be over-rated. And it's worth considering that the satisfaction that comes from a growing bank balance may actually motivate people to save ***more***. As those balances grow, people might find it psychologically enjoyable – instead of their duty – to transfer portions of their account to longer-term investments.

Indirectly, this perspective is supported by data showing the prevalence of loans drawn against retirement accounts. Following what Gladstone says is the "conventional wisdom of investing as much of excess money as possible," many who put retirement first find themselves repeatedly treating their retirement account like a bank account – but one with the financial and psychological burdens of loan payments and tax consequences.

Would a Balanced Approach Make You Happier?

A constant message from the financial service industry is "You need to plan for retirement, and we're here to help you." But what if there are strategies that not only address retirement, ***but also increase your immediate access to money?*** Not so you can blow it, but to improve your well-being. Think about it for a moment: Are you happy with the size of your bank account? ❖

Dear IRS: I Have a Pre-Approved Excuse

The US income tax system relies on voluntary reporting by individuals, with just enough cross-checking (through W-2s, 1099s and other third-party documentation), and the possibility of individual audits to encourage compliance. But what happens when the cross-checking shows too many taxpayers are in need of individual attention? In an interesting bureaucratic twist, the Internal Revenue Service has opted for more voluntary reporting – while making individual attention very expensive for the taxpayer. Here's the rest of the story:

The Problem of Too Many Rollovers

As the Baby Boomers reach age 70, there has been a surge in *required minimum distributions* from qualified retirement plans. To meet these requirements, many retirees are reconfiguring their holdings, often by transferring and/or consolidating funds via rollovers.

IRA rollover provisions give account holders a 60-day window in which to take a tax-free distribution from an existing IRA and deposit it into a new one. As long as the distribution is re-deposited to a new IRA within 60 days, there are no income taxes or early-withdrawal penalties which might be associated with a normal distribution. (Note: A *rollover* should not be confused with an IRA *transfer*, which is a transaction in which IRA funds are moved between financial institutions without a distribution to the account holder.)

The Boomer-fueled increase in rollovers has resulted in a corresponding rise in transactions that haven't been completed on time. Each failed rollover requires reporting to the IRS, either to assess taxes and penalties, or to determine if the failure is the result of a correctable error or circumstance.

In the past, taxpayers looking for tax and penalty relief from failed rollovers had to petition the Internal Revenue Service for a review in the form of a Private Letter Ruling (PLR) to determine if their case qualified for an extension or exemption. But with so many taxpayers asking for individual waivers, the IRS just can't keep up. Instead, they are attempting to resolve the majority of failed rollovers without PLRs.

If the taxpayer can attribute the rollover failure to one of 11 IRS-approved conditions, the taxpayer can "self-certify" that their situation deserves an exemption. Here are reasons the IRS lists as acceptable conditions for an exemption from the 60-day rollover deadline:

1. An error was committed by the financial institution receiving the rollover contribution or making the distribution to which the rollover relates;
2. The distribution, having been made in the form of a check, was misplaced and never cashed;
3. The distribution was deposited into and remained in an account that the taxpayer mistakenly thought was an eligible retirement plan;
4. The taxpayer's principal residence was severely damaged;
5. A member of the taxpayer's family died;
6. The taxpayer or a member of the taxpayer's family was seriously ill;
7. The taxpayer was incarcerated;
8. Restrictions were imposed by a foreign country;
9. A postal error occurred;
10. The distribution was made as a levy to collect prior taxes owed, but the proceeds of the levy have been returned to the taxpayer; or
11. The party making the distribution to which the rollover relates delayed providing information that the receiving plan or IRA required to complete the rollover despite the taxpayer's reasonable efforts to obtain the information.

To assist with this self-reporting, the IRS even provides a model letter (found in the Appendix to IRS Revenue Procedure 2016-47) that taxpayers can print, write in the amount, and check off the appropriate reason for missing the deadline. This letter is not sent to the IRS, but submitted to the institution serving as custodian for the new IRA (which then reports it to the IRS).

If the taxpayer cannot attribute their rollover problem to one of the 11 pre-approved conditions, they may still request a PLR, but at a much higher cost. Previously, the IRS assessed "user fees" for PLRs based on the amount involved. Prior to the new guidelines, a rollover of less than $50,000 incurred a PLR fee of $500. From $50,000 to $100,000, it rose to $1,500. For any amount over $100,000, the cost was $3,000. Now, the PLR fee for a rollover waiver is $10,000 – no matter how large or small the amount in question.

How This Impacts You

It is important to note that not all reasons for missing a rollover deadline are valid. Some taxpayers see the 60-day rollover window as a short-term loan opportunity, in which the funds can be used tax-free for 60 days before being redeposited to a new IRA. The increased cost of a PLR is a way to discourage abuse. For example, if $30,000 of rollover funds are used as a down payment on a new house, but the old house doesn't sell in time to replace the down payment, the account holder faces a two-part dilemma: wondering whether the IRS would grant an exemption, and whether it's worth paying $10,000 to find out.

Additionally, IRS rules prohibit sequential IRA rollovers (where a distribution from one IRA is used as the deposit for a previous rollover now due), and taxpayers are allowed just one IRA rollover in a 12-month period. Because direct *transfers* are the prevailing method for repositioning qualified retirement account assets today, the time limitation on rollovers is usually not an impediment to reconfiguring IRA assets. But since there are still circumstances where a rollover may be either required or preferred, individuals should be careful; taking a rollover today means not being able to take another one for 12 months.

As an example, suppose a soon-to-be retiree wants to consolidate three IRAs in one annuity contract to provide regular distributions to meet RMD requirements. Only one of the accounts could be a rollover; the other two would have to use direct transfers to reposition the funds.

> If something goes awry in the rollover process, this new procedure makes it easier for most taxpayers to avoid negative tax consequences. But the procedural change also makes fixing "non-approved" mistakes more expensive. Seeking professional guidance to ensure your IRA rollovers and transfers are completed in a timely manner is the best strategy. ❖

As the executor of her recently departed father's estate, a daughter begins to inventory Dad's assets. She knows he executed many of his transactions electronically, and archived account statements online. In rummaging through her father's desk, she finds a list of accounts with user IDs and passwords. Grateful to have this shortcut to locating Dad's assets, she logs on and begins the process of identifying, sorting, and dispersing the estate. And in doing so, the daughter may be a hacker, in violation of the Criminal Fraud and Abuse Act (CFAA), which imposes fines and even imprisonment for "accessing a computer without authorized access or exceeding authorized access."

Welcome to the labyrinth of digital assets, where new technologies, privacy, identity theft, Terms of Service

Agreements, and still-emerging law create a maze for beneficiaries, surviving family members and executors to muddle through. As attorney Victoria Blachly put it in the July/August issue of the American Bar's *Probate & Property*, "The Internet is outrunning the law."

What are Digital Assets?

In a July 2016 AICPA article, retirement strategist Jeffry Levine gives this definition:

> "In short, digital assets represent anything created, communicated, sent, received or stored by electronic means. These assets may have their own financial value, such as a desirable domain name, may be the way to access assets with financial value, such as an online bank account that stores statements, or they may just have personal and/or sentimental value, such as a personal email or social media account."

By that definition almost everyone has digital assets. Kristen Beckman reports in an August 24, 2016, *LifeHealthPro* article that "Some studies show the average person has 90 online accounts, ranging from social media to banking." And many of these assets are "orphaned." Blachly says approximately 30 million Facebook accounts belong to deceased individuals.

So while everyone may have them, most of us have a very poor handle on our digital assets. We have forgotten passwords, stopped using applications, moved files to disks and thrown them in a drawer. Another problem: almost no one reads the Terms of Service Agreements (TOSAs) for online applications before clicking "I agree."

A July 2016 working paper from Michigan State University and the University of Connecticut gave 543 students a TOSA for a fake social media site that required them to give up their first born child (by no later than 2050), and said their data would be shared with the NSA and future employers. Almost no one read the TOSA – and those who did, signed anyway.

The TOSA above may be a joke, but companies that provide digital services have real liability concerns about the data they collect, store and share. Consequently, many TOSAs are very restrictive. For users of one of the larger e-mail platforms, here is a portion of the TOSA addressing the death of a user:

> *Terms of Service: No Right of Survivorship and Non-Transferability. You agree that your account is non-transferable and any rights to your ID or contents within your account terminate upon your death. Upon receipt of a copy of a death certificate, your account may be terminated and all contents therein permanently deleted.*

When you are dead, your account and *everything* in it are no more. Emails with attachments, pictures, music playlists or other content you'd want passed along to children? Gone. Bank, credit card, or statements needed by your representatives at your death? Gone. And you can't – at least not legally – even pass along your login and password info for someone else to use.

So what happens to digital assets, especially the ones that exist online, when their owners pass? How can fiduciaries, like the executors of an estate, do their jobs? Right now, there are no standard answers, but there are some emerging guidelines.

"The Most Important Law You Don't Know About"

In 2015, the Uniform Law Commission developed the *Revised Uniform Fiduciary Access to Digital Assets Act* (RUFADAA), to clarify and standardize the procedures for accessing digital assets. RUFADAA is not a federal law, but a template for state governments to create standardized regulations. As of June 2016, 19 states had enacted RUFADAA, and another 12 had introduced it. Because of its potential to bring uniformity to the handling of digital assets, Levine has called it "the most important law you don't know about." As summarized by Laura Goldsmith in a March 2016 *Privacy Law* blog post, here are the essential principles:

- Fiduciaries can access and manage certain digital property such as computer files stored in the cloud, web domains, and virtual currency.
- Fiduciaries ***cannot*** access certain digital communications such as email, text messages, and social media accounts, unless the original account holder expressly consented to the disclosure (e.g., in a will, trust, power of attorney, or other record).
- Account holders can also create legally enforceable instructions for the disposition of their digital assets after death, either naming a person to be granted access or directing the service to delete the digital assets at that time.
- If the original account holder has not given express directions regarding disclosure to a fiduciary after death, the service provider's terms of use will control whether a fiduciary can access the account. Or, if the terms of use are silent, the default provisions of the RUFADAA will control.
- Fiduciaries do not have the same rights to access joint accounts.
- Companies will have the right to assess a reasonable administrative charge to comply with requests for access to digital assets and to reject requests that are unduly burdensome.

A Protocol for Preserving Digital Assets

As if pretending to read TOSAs and remembering passwords wasn't enough, owners of digital assets must also embrace a new mindset. Your ownership privileges are intertwined with the companies maintaining these assets as combinations of ones and zeros in cyberspace; what you own is access. And the relevant question is: ***Who do you want to have access to this stuff after you're gone?***

- Regardless of whether your state has passed RUFADAA, many legal experts recommend **adding a provision to your will** which contains a specific authorization for an executor to retrieve, preserve or destroy digital assets.
- As a matter of education, if an owner leaves a list of passwords for executors or trusted family members they should also be **instructed to only use this information after informing the service provider**. Accessing an account without authorization is still a risky legal issue.
- Where possible, some owners **may want to consider authorizing additional users**, typically a spouse or adult child, to pre-empt any access issues later. This might be especially appropriate for on-line financial "vaults" that allow clients to aggregate household financial information and store electronic copies of legal documents.

With so much of our lives migrating to the digital world, it is absolutely necessary to establish legacy protocols to ensure your digital assets are intact and accessible to future generations. ❖

When someone says interest rates are at an all-time low, they really mean *all-time*, as in the past 5,000 years, or essentially, recorded history. In fact, when the central banks of Japan and several European countries decided in 2015 to push interest rates into negative territory, it was so far outside the norm that some wondered if this phenomenon had ever occurred before. The initial answer: not that we can tell.

In 1963, Sidney Homer and Richard Sylla co-wrote "A History of Interest Rates," and have since issued four revisions. True to its title, the work documents interest rates in dominant economies going back to the Sumerians in 3,000 BCE. Using their data, Elena Holodny of *Business Insider* produced this **condensed history of interest rates** in a September 18, 2016, column.

While some experts think pre-World-War-II interest rates in the US may have been closer to zero, there doesn't appear to be any other instances in which private or government lenders instituted negative rates. And this "never-in-5,000-years" event has all sorts of people weighing in on whether it's an anomaly or a lasting trend.

An Anomaly That Can't Last

An August 31, 2016, *Wall Street Journal* op-ed by James Freeman titled "The 5,000-year Government Debt Bubble" begins:

> Politicians playing by their own rules is an old story. But it should count as news that politicians have lately been rewriting a rule in place since 3,000 B.C.
>
> This rule of history is that savers deserve to be compensated when they loan money. Not anymore. In much of the developed world lenders are the ones paying for the privilege of letting governments borrow their cash…Amazingly, governments have managed this feat even as they have become more indebted and even as slow economic growth undermines their ability to repay.

Freeman sees negative rates as a kind of financial sleight-of-hand that allows governments to borrow more money, even as they have a decreased ability to repay. It's like overeating, then recalibrating the scale to prove you haven't gained weight; the numbers don't lie, but they aren't true. Comparing negative rates to "no-doc" mortgages that obscured both values and risks for borrowers and lenders, and led to the housing crisis that triggered the Great Recession, Freeman sees the same end for negative interest rates: an economic bubble that has to burst, with a bunch of countries unable to pay their debts and investors left with diminished savings.

The New Normal

Responding to Freeman in a letter to the editor published in the *WSJ* on September 8, 2016, Michael Barry says there's a logical economic reason for today's negative rates: declining populations in the developed world.

A CONDENSED HISTORY OF INTEREST RATES

Time Period	Int. Rate	Region/Source
3,000 BCE	**20%**	Mesopotamia
1,772 BCE	**20%**	Babylon - The Code of Hammurabi codifies earlier customs
539 BCE	**40+%**	Persian conquest (King Cyrus takes Babylon)
500 BCE	**10%**	Greece, Temple at Delos
443 BCE	**8.33%**	Rome, from the Twelve Tables
300-200 BCE	**8%**	Athens/Rome, during the first two Punic Wars
1 CE	**4%**	Rome
300	**15% (est.)**	Rome, under Diocletian
325	**limit 12.5%**	Byzantine Empire, under Constantine
528	**limit 8%**	Byzantine Empire, Code of Justinian
1150	**20%**	Italian cities
1430s	**20%**	Venice
1490s	**6.25%**	Venice, (Leonardo da Vinci paints "The Last Supper in Milan)
1570s	**8.13%**	Holland, beginning of the Eighty Years' War
1700s	**9.92%**	England
1810s	**7.64%**	U.S., West Florida annexed by the US
1940s	**1.85%**	U.S., Circa World War II
1980s	**15.84%**	U.S., Reagan administration
2015	**0-0.25%**	U.S., Fed does not hike rates in September, 2015

All conventional economics has been premised on the assumption with which Mr. Freeman begins his piece: “savers deserve to be compensated when they loan money.” For 40 years, I believed exactly that.

For 5,000 years, current consumption has been worth more than future consumption, and that is why for 5,000 years interest rates have been positive. But things have now changed.

I now believe that the theoretically correct way to think about interest rates is that, in these markets, market participants are trading time preferences. You can (especially if you are a financially dependable first world economy) command a premium for a promise to pay money in the future.

Think about it in real terms. When there are fewer young people than old people, who is going to take care of you? The few young people who are around are going to – through the “magic” of the market – demand a premium from you for their promise to labor for you in the future. One version of that premium is negative interest rates.

Barry is referencing another never-before-seen event: In developed economies, old people (i.e., over 65) now outnumber the young (those 5 and under). And these demographics are like a large battleship: they can’t turn quickly. With little expectation that there will be enough new workers and increased productivity to support the promises governments have made to retirees, anyone who wants their savings guaranteed has to pay “storage fees” in the form of negative rates. Never-in-5,000-years negative rates are a logical result of never-in-5,000-years demographics.

Macro Awareness, Micro Responses

The discussion of the reasons for all-time low rates is, in a word, interesting (and yes, that is a pun). But there are practical considerations as well. Interest rates set by central banks have macroeconomic ripple effects through all sorts of saving instruments, from bank accounts and CDs to life insurance dividends and bond yields.

But all-time low interest rates don’t mean the end of saving. Safe and liquid cash reserves are still a necessary component in a comprehensive financial program. What may change are the details, like “How much saving?” and “Where do I put it?”

These are great questions to ask the professionals helping you with your personal finances. So why not make interest rates the first topic at your next review? You can’t change macro-economic events, but you can craft microeconomic responses that match your unique circumstances. ❖