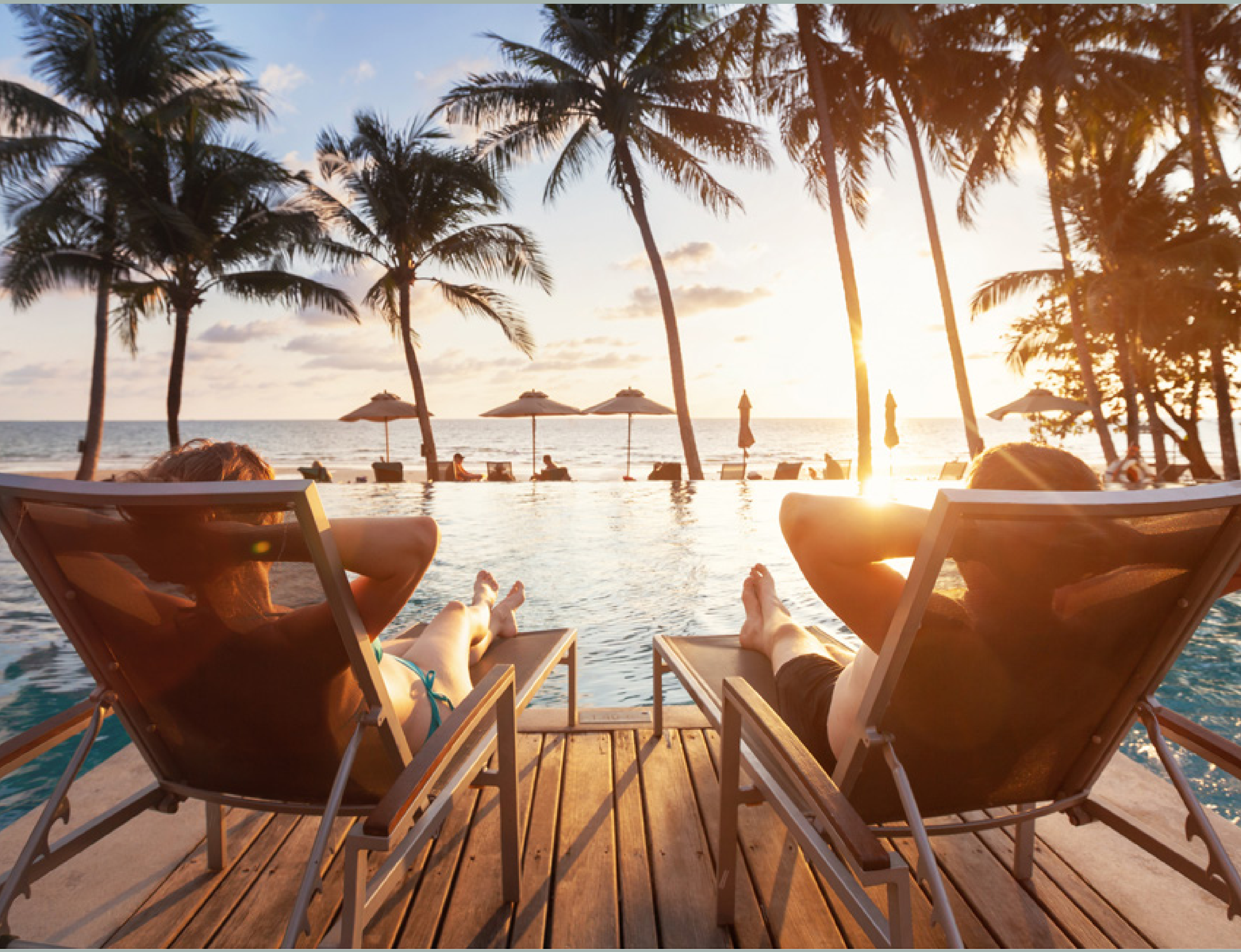
# Why Is Saving for Retirement So Hard?



A short paper explaining why saving enough to maintain your current lifestyle for retirement can be so difficult for most highly compensated individuals, and what you can do about it.

NIW

## Is my Fact Pattern Like Yours?

After a good career in the Corporate world, and in my late thirties, I decided to form a new company. As is common with any new company, it took a while to get going. Throw in a divorce, three kids in private school followed by college, a nice house along with associated costs, and you can start to see a common fact pattern. When I finally started to earn a decent income, I was starting from a position of depleted funds. Since then, my quality of life has greatly improved, and I am earning a six-figure salary. I now enjoy the quality of life for which I have sacrificed and risked so much to achieve. Here's the problem I needed to solve: the risks and sacrifices I took meant that I did not start saving meaningfully until my mid-forties (apparently that is normal according to Fidelity). I wanted to enjoy the life I had earned and I sure as heck didn't want a retirement that prevented me from continuing that lifestyle. In fact, due to the hours I have and continue to work, my bucket list is a mile long! And, it turns out, 90% of successful professionals, doctors, CPAs, lawyers, finance experts and engineers are just like me in this regard.

### *WHY IS IT SO HARD?*

If we are all so successful and intelligent, why is it that 90% of us are chronically under saving vs what we should be saving, to maintain the lifestyle in retirement we promised ourselves? Are we just fools or is it actually hard to do? Being too busy is common, but it should not be an excuse.

**What do I mean by saving?**

Let's be clear, we have all maxed out our 401(k)s and many of us have some additional savings or some form of deferred compensation plan. Let's start with basic facts. If you earn over $250,000 per year, Social Security (if it exists when we retire) and a fully matched 401(k) will cover less than 30% of what is needed to maintain our lifestyle in retirement. Those plans were designed for people with average salaries and average retirements, whereas you and I don't fit that fact pattern. The other 70% must come from additional means of saving (we will cover those later). Remember, statistically, you will live 22 years in retirement and spend as much per year as you do now.

**When do we save?**

Almost every study of highly compensated professionals indicates most start really saving for retirement in our mid-forties. That means we have to save more, and compound it over less time, than the wise 18-to-25-year-old unicorns that actually do save.

**How much are we supposed to save?**

According to research by Fidelity, Mercer and Aon, if you start saving in your mid-forties, to maintain lifestyle in retirement you need to save at least 35% of what you make. The average amount saved amongst those professional groups mentioned above is more like 9-15%. So, you can see the problem: there is simply not enough money at play to solve the issue. Look at the math. If you make $400,000 per year, you are supposed to save $140,000 per year. But then, real life gets in the way; taxes, house payments, kids in college, lifestyle, etc. Yet every supplemental retirement plan discusses how to invest your money and does not attack the root problem of not having enough to invest. According to Principal (one of the largest 401K providers in the country), 74% of your income in retirement is driven by how much you save and only 26% is a result of your investment return and asset allocation. Why is everyone focusing on the 26% and not the 74%? We will cover that later.

**How well do we invest?**

According to Bloomberg, 95% of individual investors under-perform a base market index like the S&P by 4% or more. Statistically speaking, we might as well be investing in bonds to get those returns.

## *We Need to Clarify Our Focus*

*According to Principal, 74% of your income in retirement is driven by how much you save and only 26% is a result of your investment return and asset allocation. Why is everyone focusing on the 26% and not the 74%?*

Why is that? We are busy, work long hours, and get to our investments after work or at the weekends. That is why we use professionals like Fisher, The Motley Fool, etc. Those are some of the better firms, but statistically, 70% of money managers under perform the baseline indexes they benchmark against. Probably better than self invested returns, but still poor odds. Invest too little money and have its returns under-perform, and the situation gets even more difficult.

### Taxes

For most of us, the days of 15% effective tax rates have long since passed. State and federal taxes can take between 40-55% of everything you make. The problem, according to the Congressional Budget Office, is that without immediate and meaningful reform of entitlement programs, marginal tax brackets will have to double in every category. It may happen, but irrespective of your political persuasion, it is a suicidal politician who proactively wants to reform programs that over 50% of all retirees (who vote) depend on, before they are forced to. Realistically, the crisis must first exist before real change will happen. The crisis will be in 2030 according to the federal government: around that time you were expecting to retire. An increase in taxes is a far bigger risk than one thinks. Do you hope taxes will be the same or lower, or do you plan for the higher taxes and enjoy the day if they don't increase?

### Lifestyle

This has been covered, but take what you are spending now, and multiply it by the 22 years you will statistically live in retirement. The number is...a big number. I have the pleasure of living in a million-dollar-plus house, and let's assume that I cut my annual household expenditure to $300,000 (unlikely if you know my family). $300,000 sounds like a lot until you realize that 85% of all my medical costs will be in retirement. My in-laws' alone cost the family over $250,000 to live in a memory care facility, where they have lived for over 5 years. I need a plan that will allow me to comfortably consume $6.6 million. The point here is that, regardless of your views on my lifestyle, $300,000 x 22 is 6.6 times the value of my house, and I would not consider paying for my house out of cash flow. Why, then, does every retirement plan expect me to self-fund something that is significantly more expensive than my house?

### Illness

According to the department of labor, 20% of us will either die or lose our ability to earn pre-retirement. 70% of us will need chronic care in retirement. And if either of those events happen and you dare to survive the event, then your retirement is gone. Covering those risks depletes money we can save for retirement, so most of us underfund, or don't fund at all, one or more of those risks/needs. If you are a male, statistically you will be focusing on the retirement income, because you know it will be someone else that gets hit with the above. If you're female, you know males are delusional, and it is going to happen to us and you want to protect against that risk. The competition for resources continues, as there is not enough for both.

## Lawsuits

You work hard, and do your best. Then one mistake or one accused mistake, and you can lose it all.  If you're an executive or physician, you have a 25% chance **per year** of being sued in the US.  It is not fair, but life isn't fair. Not protecting against it is what far too many of us do.  So many of us are so busy working in our business or practice that we forget to protect it.  So, again, why are most supplemental retirement plans not asset protected? Because the asset is not intrinsically protected most of the time and the extra work and expense is just that: extra work and expense. Ask any former partner of Arthur Anderson what happened to their retirement.

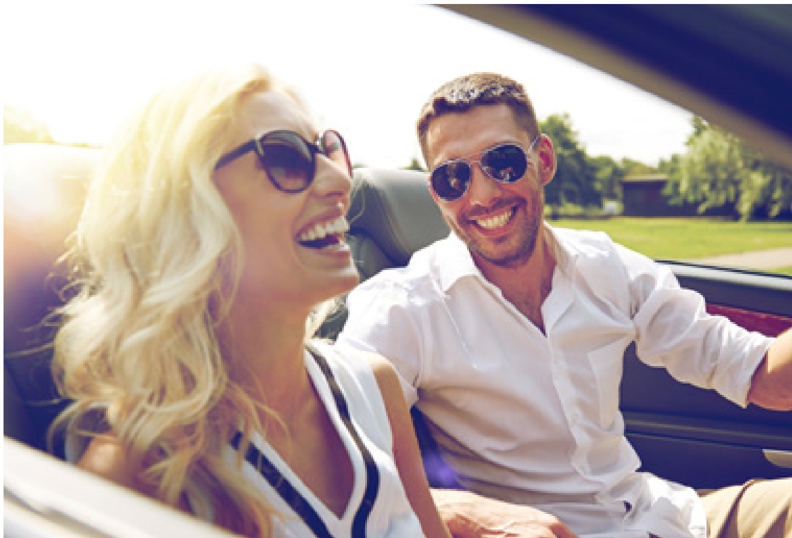
## The Economic Future

Many of us remember the 2008 crisis when 40% of market value was lost.  Back in 2000, I was on an international flight and out of communications for a few days when the dot-com bubble burst and took a painful amount of my investments with it.  Since 2008, we have enjoyed one of the longest bull markets in history, with many quickly forgetting, risk is not always rewarded.  The current interest rate environment is low, making bonds and fixed income investments unattractive, but do not forget that when interest rates go up, the bond value itself goes down. So much for protection and the old 30/70 rule.

I belong to Vistage.  This year at their annual summit, ITR Economics, who I believe are one of the best predictive economist groups in the country, showed the data on the economic outlook.  2019 showed slow growth, as the effects of the tax stimulus wear off. 2020, a recession, and in 2030, a high likelihood of The Great Depression 2.  It does not mean for certain these events will happen, but with their track record, it is worth planning for.  Now let's deal with government debt. The days of balanced budgets are long over, with trillion-dollar deficits being the norm and unlikely to go away any time soon.  As debt increases, an increasing amount of tax revenue is spent paying interest.

Debt to GDP ratios are increasing.  For perspective, average debt to GDP ratios in the US from 1940 to 2017 was 61.7%.  Currently, it is 105% with a projected 152% by 2048 (source Congressional Budget Office (CBO)).

What does all this mean?  It doesn't mean you are stupid; it is just ridiculously hard to save sufficiently for retirement in order to live those golden years you have promised yourself.  Also, there are storm clouds ahead that traditional retirement tools are not prepared for.  So, what should you do?



## *CONVENTIONAL WISDOM... ISN'T!*

When my wife and I started exploring our retirement savings options, what struck us most was how many of the professionals are saying the same thing. How often have you heard something like: "after careful analysis of your situation, we recommend you put 70% of your money into diversified stocks or equivalents and 30% into fixed income or equivalents." Absolutely none had any solutions for the basic problem that there was not enough money on the table to achieve our retirement objectives. All were trying to come up with good ways to invest. Let's look at those quickly, not from an investment logic, but their ability to hit your goals:

**Traditional supplemental retirement**

Cash Balance Plans, Deferred compensation etc. Put money into an investment that you self-manage and get taxed when you take it out at the then tax rate. Invest as best you can, and hope tax rates will fall. Qualified plans have the additional restrictions of limitations on amounts and penalties for early access. Non-qualified plans are not typically asset protected and may still suffer a tax bite when liquidating

Stocks/Bonds- using bonus money which has already been taxed, invest it as best you can and pay capital gains tax, no intrinsic asset protection.

**Property**

The feeling with property owners is that people will always need a place to live and work, which is true. Most property is purchased using leverage and the assumption is that it can't really fall in value. The last property crises showed the fallacy, but in the Great Depression property values even in New York fell by 67% (Source Real Estate Prices During the Roaring Twenties and the Great Depression Tom Nicholas and Anna Scherbina). There is no doubt property has been a good investment over time, but what is interesting is that most of the investment uses leverage where you have full investment risk.

Property loans above $50m are often non-recourse, but the smaller deals are not. I like the non-recourse part, let's make use of that later.

### Funding shortfall

Except for property, the conventional tools simply don't bring enough money to the table. Your advisors are all trying to find a better way to invest the money you have, but none have a plan to get more money to the table. Property is conducive to using leverage and most property developers leverage extensively. So why is that same logic not used on other retirement options? Simply put, stocks, etc. are not very attractive for a lender to lend against. Bonds don't give enough return to make leverage attractive, while stocks and securities have inherent risk that forces lenders to make you personally accountable for all the risk.

## *WHAT ABOUT LEVERAGE?*

For 99% of the population, leverage is used to fund any significant capital purchase except benefits. We use leverage to buy houses and cars, but our retirement, that is 6-9 times more expensive, we conventionally have not (for reasons already explained). When leverage is used for the first time, it is almost always seen as risky, except by the wealthy who have used it so routinely to build wealth, that for them it is just a natural tool used to build value. The point here is not that there is no intrinsic risk, there is, but the perceived risk is higher. Lack of familiarity distorts the risk to be greater than it is.

Why use Leverage? If there is not enough money being saved for you to have the lifestyle you enjoy and aspire to maintain, then we just need to bring more money to the table. Leverage, when done correctly, may just be the cheapest and most sustainable source of the money needed to have sufficient capital in play to achieve our objectives.

What do we like about Leverage? We like it if there is enough access to money to achieve our goals. After all, most of us are living in a house where we put 10-20% down and mortgaged the rest i.e. we enjoy a better house than we could have afforded just using our own available cash. That's the upside.

What do we not like about Leverage?

- Risk of loss. Psychologists have known for years that fear of loss outweighs the pleasure of winning by almost 2:1 when it comes to decision making. If the investment doesn't work, we are on the hook. If our house price does not go up, then we end up paying a lot of extra money for the privilege of using debt. But what if this risk was removed? What then?

- Paying interest drains our cash flow – every month we typically are paying a house and car payment, and in my case, car payments for my kids, too. What if we could get rid of those, too?

- All the paperwork, financial background checks and pain associated with getting a loan is frustrating. Totally agree - let's get rid of that also.

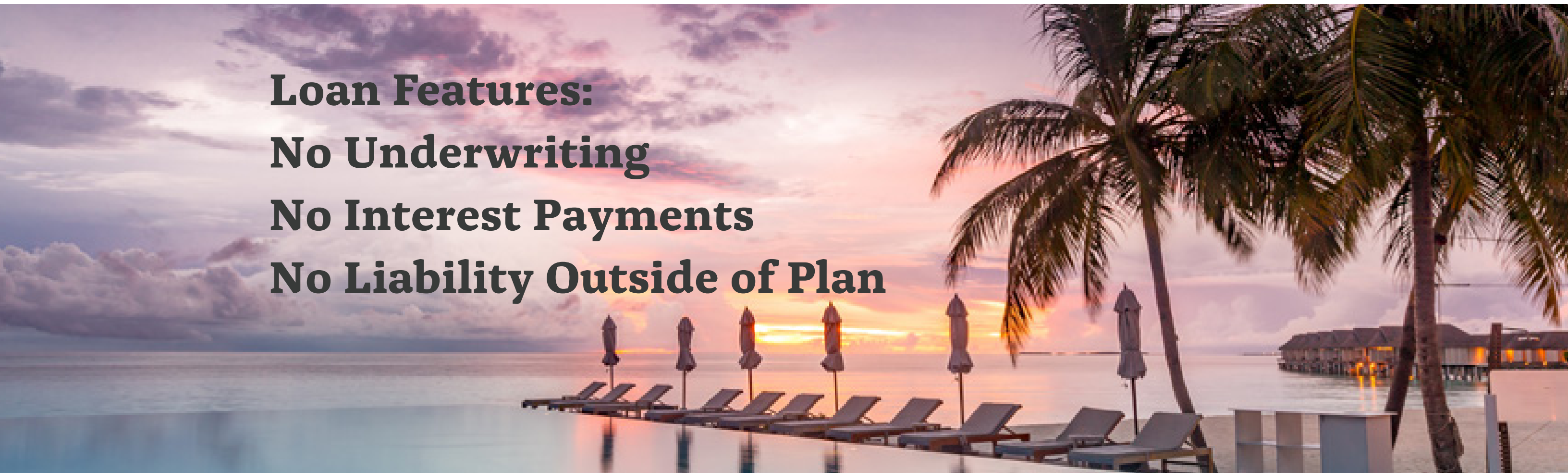
The risk of the lender pulling the loan scares us. Agreed, let's ensure that we have lots of back-up.

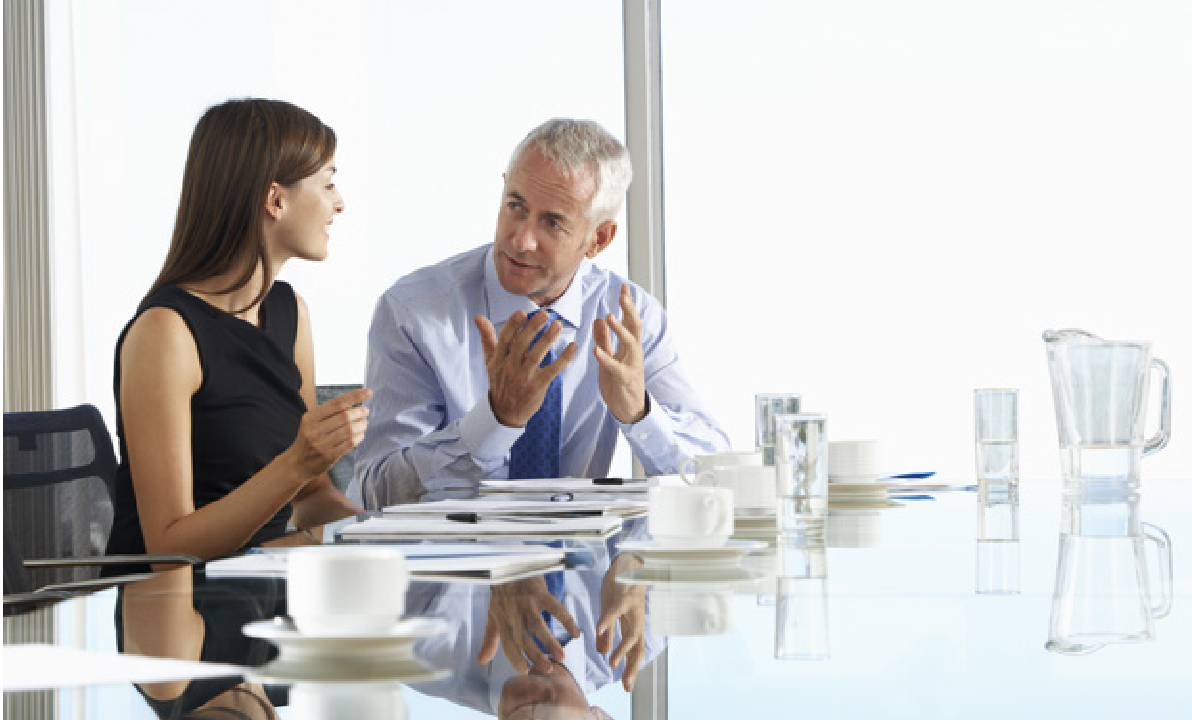
So, while Leverage makes a lot of sense to bridging the funding gap on retirement, unless we can resolve the above concerns, no one would think to recommend it. If we can resolve the concerns, then using it makes a lot more sense.

NIW took the above concerns regarding leverage and built the solution into our Kai-Zen and Tri-Zen products. But let's look at what the conventional wisdom says about it.

Before we talk about Advisor reaction, let's be clear about what the "Zens" are and are not:

a) There are no interest payments, no personal guarantees or loan paperwork – actually, you don't sign any loan documents.
b) They are not considered securities, so do not have the risk profile of a margin loan. Thus, the risk of loss is dramatically reduced and, in my opinion, offers a lower risk profile than alternative choices for the same return.
c) There is no loan liability to the owner outside of the payments into the plan.
d) There are standard tax and asset protection advantages associated with the treatment of cash value in a life insurance contract that we are taking advantage of (code section §7702).
e) The plan has been stress tested to severe black swan events for high loan interest rates and poor product performance.
f) Life insurance, while perceived to be an expensive asset class, does not have to be, and in this case is not. For the average client, total ownership costs are below 1% to age 100.





The plan was used by NIW to create a supplemental retirement tool for themselves. We have ultra-wealthy clients, so we learned from them. I mention this because if you are an expert, we are, and you were designing something for yourself, then you would control risk, minimize cost and optimize the chances of getting the desired outcome, that is what we did.

## *WHAT ADVISORS SAY?*

When introduced to the Kai-Zen strategy by a new advisor, many take the concept to their old advisor for a second opinion. It is new, you're not sure what questions to ask, so go to an expert, right?

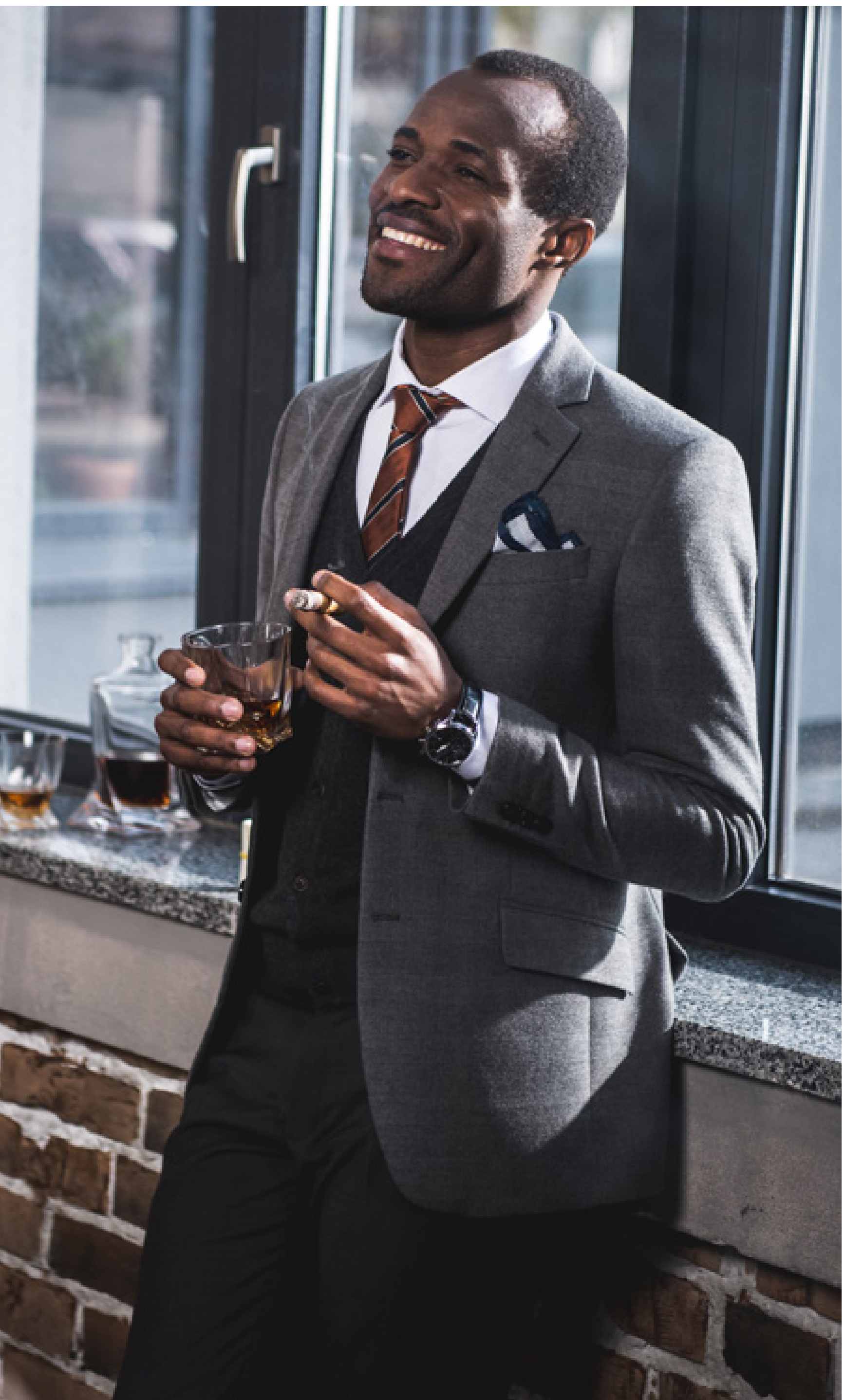
There are advisors who genuinely know about the plan, but most have not seen it. Why? We have limited the distribution of the plan to those we have trained to present it correctly. Those who don't have access to it don't know the plan, but being advisors, don't like to appear like they don't know. They can only sell what they know and have access to. We find many advisors saying it won't work, can't work, etc. When we find this out, we typically ask to be put on the phone with the advisor, and when the clients do this, we almost always find that the reasons for the concern are based on an incorrect understanding, which does not mean they don't have good questions, most do. So, if this situation occurs, put NIW on the phone with them, but remain on the phone and you can hear the questions, but also unfiltered answers. We have the data, so we can separate conjecture from fact quickly.

There are, however, entities that have taken the time to due diligence the plan in depth. Aon (one of the largest benefit consulting firms in the world), did their due diligence on the plan for three and a half years before they approved it. Mercer, the same. Their experts examined our data and found it to be accurate.

Here are the most common responses we see from those counter-selling to Kai-Zen or Tri-Zen.

Alternative Choices. "I can design you an alternative that does the same." Typically, this is just a plan using your money without leverage or a financing plan where you have full liability for the loan.

"Too Good to be True." This is a common response by those unfamiliar with the plan. The question is what is too good to be true?



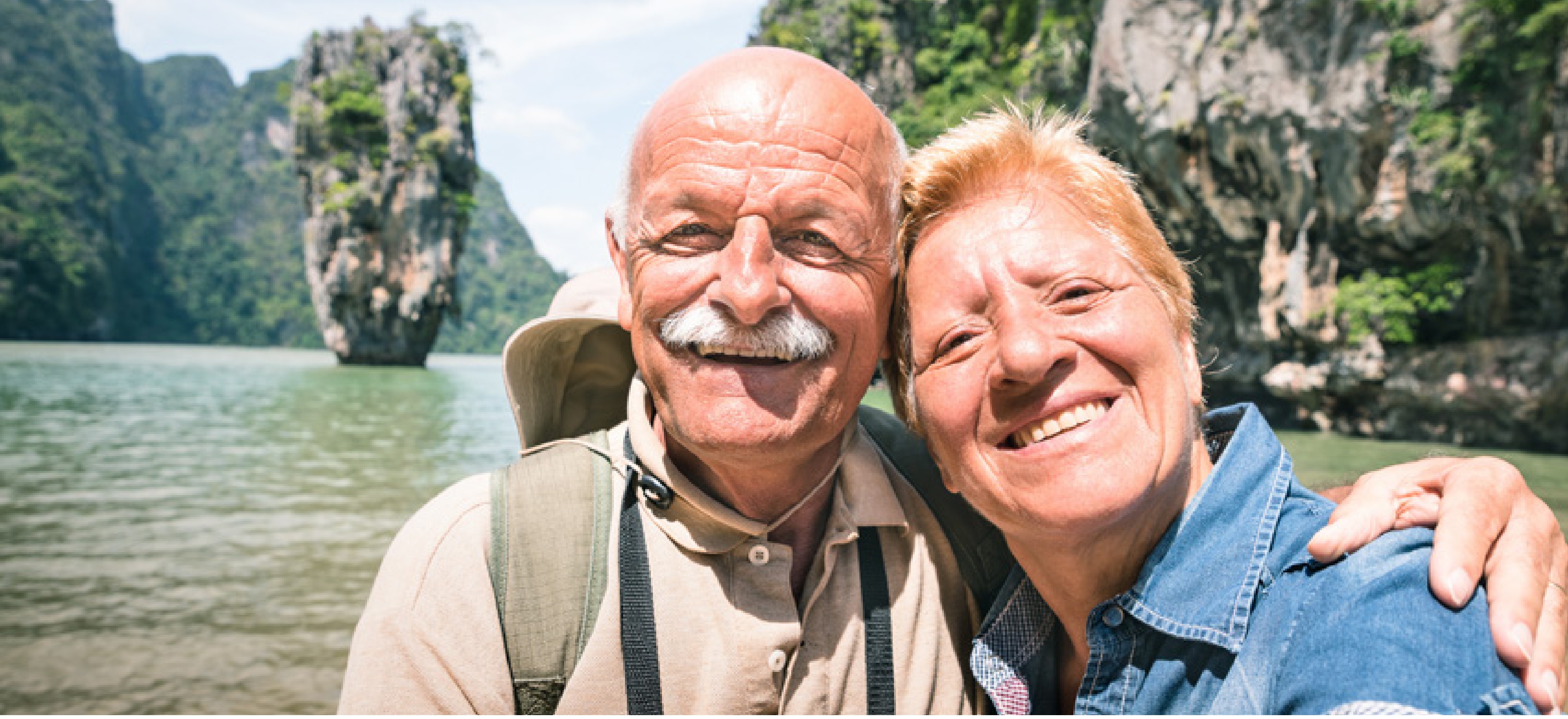
The tax advantages? That is standard §7702 tax code.

The return profile? Just look at S&P returns, less dividends, remove negative years and look at the return. The product has caps so you won't get all the up-side, but you can see the different risk profile just by removing negative years in the market. The return and the risks are greatly reduced. A good site to get the information from would be Political Calculations. This is the most common misunderstanding with advisors not familiar with these types of returns.

Bank Leverage. Why would banks do this? Lending against cash value in life insurance is safer than lending secured by a bond. If you pay enough to cover the bank's loan, even in a stressed condition, why wouldn't a bank do this?

Insurance is Expensive. This is "buy term and invest the difference" logic. Let's break this down as it is a common statement and is misleading.

Term insurance is just covering costs for the death benefit and nothing else. As you get older those costs go up. If you just cover costs either by buying term or under-funding a life insurance contract, of course costs will eat up all the cash you put into the plan. What if you purchased an insurance contract and, instead of under-funding it, you over funded the contract to the maximum allowed by law? Not good for insurance commissions, but good for investment return, because now there is surplus cash in the contract. If you do that every year, the costs are



diluted by a larger and larger amount of cash. In the case of my own policy, I did just that, at a starting age of 50. Calculating all costs to age 100, my average cost as a percentage of cash in the policy is now only 0.45% vs the 6-10% average cost when funding the minimum premium. At less than 1% average cost, it is extremely efficient. Most are not familiar with this fact because, most of the time, when you purchase insurance, you ask, "what is the cheapest I can get for this amount of coverage?" Most clients don't wake up and think to cram as much cash as they can into a life insurance contract. And how would you know if your advisor didn't tell you?

What happens to all that surplus cash, "investing the difference"? First, you can invest the difference outside of the contract and be taxed or invest inside the contract and essentially eliminate tax when done correctly. In traditional policies such as Universal life and Whole life, for all intents and purposes, the surplus is invested in bonds (just look at the net rate of return on the contracts and you can see that, especially if you ignore death benefit and just base your returns on cash value).

Variable universal life contracts invest the difference in mutual funds, ETF's, etc. It acts just like a security would with all the ups and downs associated with that investment.
Indexed Universal Life (IUL) contracts are different: see next part.

## *RETURNS CAN'T HAPPEN*

IUL's invest sufficient cash value into bonds to get you back to where you were (Principal is maintained) and the rest is invested in long options. Options are complicated and misunderstood, but essentially, they are bets on the market index growing. The bet is as if all your cash value was in the market, but only actually risking the money you used to buy the option (in this case, the growth you would have received on the bond). This changes the return profile when

compared to an index fund which is fully invested in the market.

Test this yourself. Start with basic data (source: Political Calculations and Wall Street Journal)

S&P return without dividends 1930 to 2018 average return is 7.55%

Now calculate S&P return as above, but 0% growth instead of all the negative years, average return is 12.19%

Changing the down-side risk, as per the IUL, changes the entire risk profile. But IUL's have caps.

So how much of the upside do you receive with an IUL? There was no public domain data, so NIW researched it (with the help of life carrier's actuaries). Adjusting for the actual caps in the actual years we had data, it was just over 80%. Most advisors don't realize caps go up and down each year based on the bond return at the carrier. Illustrations don't adjust either. But if you had an IUL in 1930 and kept it through today, and we add all the usual disclosures about assumptions, the average return would have been in the range of 9.7%. This is not a good or bad number until you realize that the average cost of a loan with the 1.75% over LIBOR margin being charged by the lender would have been below 6.7%. In fact, we could not find a single 15 year period using rolling averages where the spread between the average policy return and loan cost was less than 2%. Why is this important? Because if the spread between loan cost and average return of the policy is over 2% or more and you only need 0.9% for leverage to add value in the Kai-Zen design, then using leverage to add more money to your plan makes a lot of sense.

So, not only can the returns happen, but the returns vs the loan cost map out as well. This is not some weird mumbo jumbo of the insurance industry; this is basic risk return economics that drives the overall economy and has not changed in any measurable way since 1930 (Fisher money management volatility (risk) assessment).

## *WILL IUL CAPS ONLY GO DOWN?*

Remember that it is overwhelmingly the bond return that determines the cap on the IUL. So now let's understand why they will go up or down almost annually.

First, the carriers guarantee the surrender value of your policy, and that won't change due to interest rates in any given policy year. That is true for Whole Life, Universal Life and Indexed Universal Life products, this is nothing new. What that means is if the carrier had to sell the bonds your cash value is invested in to pay for surrenders, they would pocket the profit if interest rates had fallen, but they would eat the loss if interest rates had risen. Securities advisors call this the mark-to-market adjustment to bond values. It is totally linked to interest rates.

Most of the time, carriers don't have to sell bonds as they have a float. But if a lot of clients surrendered their contracts, all in one year, this would become a huge issue for the carrier. The biggest risk to a carrier is if a large number of clients surrender their policies due to caps being too low. Interest rates are now slowly rising, making this mark-to-market loss risk very significant to the carrier. Actuaries know this, but design products with 50-year-plus time horizons. They don't know what will happen to interest rates, so to protect themselves, they make the bond return and caps neutral to them. This also reduces risk to the client. To make it neutral, carriers take their charges and fees (just like a money manager does) and pay out the rest as a dividend, or declared rate, or policy credit depending on the product you have. So why will caps rise? Should interest rates go up, if the carrier does not raise their caps as soon as they can (they will lag naturally - that's just math) then they run the risk of a mass surrender. They know if they don't, an agent will persuade you to move to carrier A from carrier B, carrier A will eat the losses on those bond sales. So, for the first time in 40 years, the carrier's self-interest and yours are totally aligned.

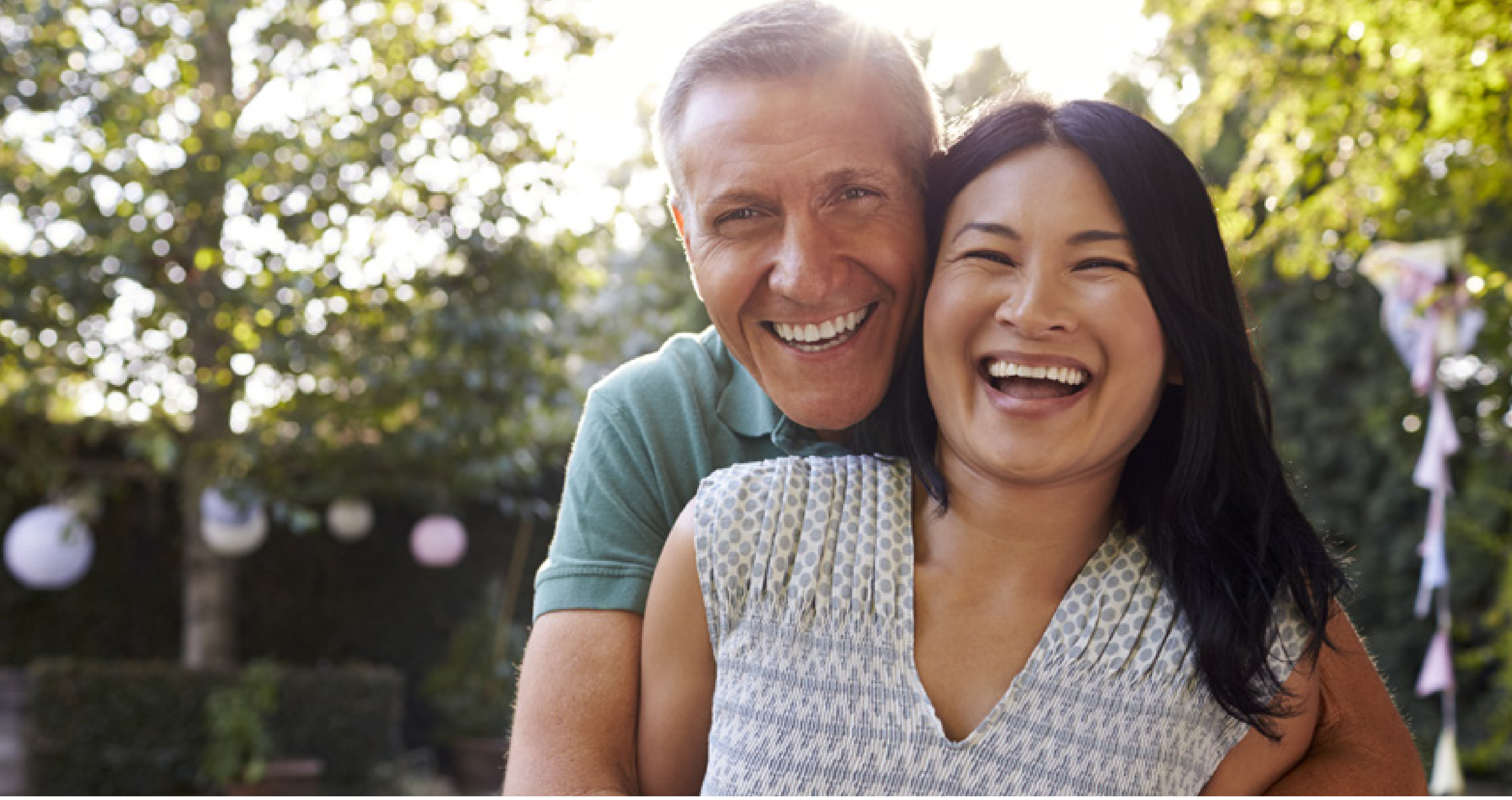
## *WHAT DO THE EXPERTS SAY?*

Because we were designing the plans for ourselves and because we are, if nothing else, experts in leveraged life insurance field, we asked the life carriers we were working with to spot the flaws in our plan. As mentioned, Aon did due diligence on the "Zens" for three years before approving it; Mercer the same. The final meeting being 6 actuaries, 2 attorney's, 2 CPA's and a bunch of insurance experts playing "sick'em" for 6 hours. They agreed with the math and economics.

One of our partner carriers (name removed for compliance reasons) ran specific failure analysis on Kai-Zen and concluded "no plausible economic sce-

*"No plausible economic scenario broke the [Kai-Zen] plan - it would have to be something totally out of the ordinary."*

*-Actuary, with one of the top insurance carriers*



nario broke the plan - it would have to be something totally out of the ordinary.

Another life carrier now has it as their most profitable block of business because clients keep the plan in place. Actually, many clients, at the end of the fifth payment, just buy another plan to layer up.

But in the final analysis, it represented a significant part of the leadership team here at NIW's, retirement plan and we, like you, needed it to work. My personal plan at the time of writing this is 6 years old. My average return is 9% and my loan cost is 3%. I don't expect that to remain forever. Economics says it should be +2.25% vs the loan, but then I only need 0.9% for the leveraging to work so you can understand my enthusiasm for the plan.

**Summary**

The reason it is incredibly hard to cover retirement goals even when you are highly compensated is because it is really hard to save 35% of everything you make.

NIW is genuinely concerned on the economics in this country over the next twenty years because we plan to retire like you some day. And conventional plans simply don't protect us from those potential downside risks. The Kai-Zen and Tri-Zen plans mitigate these risks better than our alternative options, while still giving us 60% plus more supplemental income vs alternatives.

We are also concerned about the direction of taxes on highly compensated persons like you and ourselves. If the Congressional Budget Office indicates taxes must rise substantially within 10 years, then this is a risk. Conventional plans are very exposed to tax increases, especially tax deferred plans like 401(k)'s, Cash Balance plans and deferred compensation. This is resolved using a life product as the underlying investment structure.

Conventional supplemental retirement plans try to invest your money wisely but are limited by the insufficient cash available and statistically are not going to get you there. The "Zens" add the extra cash needed.

Using leverage makes sense if the underlying investment is a prudent one to leverage. Retirement and benefit consultants were largely not interested in insurance outside or term or Corporate owned products. Because leveraged financing was a specialist field they have no expertise in, understandably, they did not know this was an option. You don't, after all, ask a sword smith to invent the Gatling gun. It takes a completely different perspective and expertise. Consequently, the outside advisor has little exposure to this new and disruptive approach to supplemental income in your golden years.

We are interested in IUL contracts not because they are life insurance products but because they offer the ideal medium to allow leverage to take place and taxes to be minimized. We are not focusing on the protection aspects in this paper, although they are substantial in protecting you if you have a severe medical issue that would ordinarily wipe out most of your assets. No, we are interested because the paradigm of how plans are constructed has to change so that more of us can achieve the retirement, we have sacrificed so much to enjoy but statistically won't get unless this change takes place. In the movie Jaws, remember that phrase "we need a bigger boat!"? That is true for our retirement plans, also we just need more cash. This plan is a way to achieve that.

We sincerely hope that you found this paper useful.

If you have any questions or would like to discuss this subject further, please do not hesitate to contact NIW.

www.niwcorp.com

Daen Wombwell is the CEO of NIW a company dedicated to solving retirement funding shortfalls in ways others can't. He is considered a national expert on the financing of life insurance.

David Green is a Vice President of the NIW who has been advising in executive benefits for over thirty years and regularly trains financial advisors on this and other supplemental income strategies.

NIW Companies, Inc.
4975 Preston Park Blvd. Suite 425
Plano, Texas 75093
972-755-1582 or 800-294-9940
niwcorp.com
kaizenplan.com