

CREATIVE

Wealth Maximization Strategies

Hill Financial & Insurance Services, Inc.
5732 E. 2nd Street, Suite A
Long Beach, CA 90803
And
26421 Crown Valley Pkwy, Suite 100
Mission Viejo, CA 92691

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Will 75 Become The New 65?

In 1949, Casey Stengel became the manager of the New York Yankees. Over the next 12 seasons, the Yankees, under Stengel's leadership, would go to the World Series 10 times, and win seven World Championships – a record of sustained success that has remained unmatched in professional baseball history.

And yet, at the conclusion of the 1960 season (the Yankees lost the World Series to the Pittsburgh Pirates when Bill Mazeroski hit a ninth-inning home run in the decisive seventh game), Stengel was fired. **Why?**

After the 1960 World Series, Dan Topping and Del Webb, the businessmen who owned the Yankees, decided to institute a mandatory retirement age, a common practice among many businesses at the time. The age they selected was 65. As Stengel had just turned 70, his employment could be terminated, regardless of his job performance. A few days later, Topping called a press conference to announce that Stengel's contract with the Yankees would not be renewed. Stengel, who was known for his eccentric, yet witty quotes about baseball,



attended the conference. When asked to comment on his dismissal, Stengel quipped, "I'll never make the mistake of being 70 again."

This incident took place just over 50 years ago. But even today, age 65 holds an almost sacred position in the discussion of retirement. Why? How did 65 become the magic number for retirement?

The 20th-Century History of Age 65

When the U.S. government established the Social Security program in 1935, participants became eligible to receive retirement benefits at 65. Some commentators have described this decision as a copy of the first modern government insurance program established by Otto von Bismarck in Germany in 1889. But the "real story" is a bit more mundane. The German plan initially set 70 as the retirement age and didn't lower it to 65 until 1916. And according to Social Security's official

website :
www.socialsecurity.gov...

"This decision was not based on any philosophical principle or European precedent. It was, in fact, primarily pragmatic, and stemmed from two sources. One was a general observation about prevailing retirement ages in the few private pension systems in existence at the time and, more importantly, the 30 state old-age pension systems then in operation. Roughly half of the state pension systems used age 65 as the retirement age and half used age 70. The new federal Railroad Retirement System passed by Congress earlier in 1934, also used age 65 as its retirement age. Taking all this into account, the CES planners made a rough judgment that age 65 was probably more reasonable than age 70. This judgment was then confirmed by the actuarial studies. The studies showed

Perhaps more than any other single issue, increased life expectancy has changed the financial metrics of retirement. While news-papers and media pundits attempt to divine the tea leaves of today's economic activity, they often overlook the trends put in play by demographics, trends that almost certainly will play a larger role in everyone's long-term economic well-being.

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that using age 65 produced a manageable system that could easily be made self-sustaining with only modest levels of payroll taxation.”

A Self-Sustaining System? Really?

Note that last phrase: **“using age 65 produced a manageable system that could easily be made self-sustaining with only modest levels of payroll taxation.”** Considering that both Social Security and Medicare are under-funded today, what was the logic that believed these programs could be sustained with only “modest levels of payroll taxation?” **It was the belief that most citizens would not live long enough to receive benefits, and those who did would not live long in retirement.**

When Bismarck instituted government-sponsored retirement benefits in 1889, life expectancy in Germany was under 50, and according to J. H. Schulz in his 1988 book, *The Economics of Aging*, “Bismarck knew that the program would cost little because the average German worker never reached 65, and many of those who did lived only a few years beyond that age.” Five decades later, when Social Security was implemented in 1935, “the average life expectancy in America was only 61.7

years.” If these numbers held true, many workers would pay taxes for benefits they wouldn’t live long enough to receive. Projecting a large number of payers and small number of beneficiaries meant the plans could be administered with minimal taxes spread over a large number of people. As age 65 became the benchmark for Social Security, the private sector followed suit, using 65 as the retirement ages for pension plans, often as the end-point for some insurance benefits, and in the establishment of mandatory retirement provisions, like the one that cost Casey Stengel his job.

But Actual Life Statistics Changed.

Since 1935, several factors have changed the rosy projections of low-cost government pensions and the practicality of using age 65 as a benchmark. A great number of people have been living longer – but still collecting benefits at 65 (or earlier in some cases, as most government-sponsored pensions have adopted an early eligibility age – EEA – at which participants can receive slightly lower benefits). This increased longevity results in a two-way stress on government

retirement plans: more people receiving retirement benefits for longer periods of time.

After a great surge following World War II (the baby boom), population growth has leveled out in many Western countries, meaning there are proportionately fewer tax-paying workers to support the retirees. Instead of a large number of payers and small number of beneficiaries, the equation has been reversed; there are too many retirees and not enough workers to support them. In order to restore these retirement programs to financial viability, there are only three options: increase taxes, decrease benefits, or raise the retirement age. Considering the possible reactions of their citizens, the most expedient course of action has been to raise the retirement age.

So the Rules Changed.

In 1983, the Social Security Administration began gradually increasing the age at which participants could be eligible for full retirement benefits, from 65 to 67, based on the year of birth, with those born after 1960 not eligible for full benefits until age 67. In recent months, legislative discussions have proposed raising the age requirement to 70, usually in a similar

graduated fashion.

In Europe, where the demographic double-whammy of aging populations and fewer workers is more severe, changing the normal retirement age (NRA) is a volatile social issue. This past summer, France raised its NRA to 62 from 60 **and riots broke out**. Spanish political leaders have proposed raising its NRA to 67 (from 65), and raising the NRA is on the radar of several other European countries. In the modern world, 65 is no longer the magic number for retirement.

So What?

There is some evidence to suggest that the retirement ages established in government pensions strongly influence individual retirement decisions. A November 2010 report from the Heritage Foundation titled **“Time to Raise Social Security’s Retirement Age”** cites data collected from 1997 to 2009 by economists John Rust and Christopher Phelan, saying the “results suggest that Social Security creates significant disincentives to labor force participation, and is largely responsible for the peaks in retirements at ages 62 and 65....” In general, once you can begin receiving a monthly check from the government, you are more

Life Expectancy and Retirement

Year	Life Expectancy at Age 65		Percent of Life in Retirement, Normal Retirement-Age Retirees		Percent of Life in Retirement, Early Retirees		Equivalent Normal Retirement Age	
	Men	Women	Men	Women	Men	Women	Men	Women
1940	77.7	79.7	16%	18%	n/a*	n/a*	n/a*	n/a*
2007	82.5	84.8	19%	21%	25%	27%	69.0	69.1
2035	84.2	86.4	20%	22%	26%	28%	70.4	70.5
2080	86.5	88.6	23%	24%	28%	30%	72.3	72.2

* In 1940, workers were not able to receive benefits before the age of 65.

Source: Heritage calculations based on Social Security Administration, *The 2008 Annual Report of the Boards of Trustees of the Federal Old-Age and Survivors Insurance and Disability Insurance Trust Funds*, April 10, 2008, Table VA-4, at http://www.ssa.gov/OACT/TR/TROBIV_demographic.html#203457 (November 17, 2010).

Table I • B 2492  heritage.org

likely to retire or decrease earnings from other employment. Conversely, if governments were to raise the age for receiving benefits, it appears many people will find compelling reasons to work longer and retire later.

But modest increases in the normal retirement age for government pensions will not fully address government pension problems. Remember how both Bismarck's retirement age of 70 and Social Security's 1935 NRA of 65 exceeded the average life expectancies of their country's population at that time? According to statistics from the Social Security Administration cited in the same report from the Heritage Foundation, the life expectancy of a man who retired at 65 in 2007 was 82.5 (see chart on previous page).

What's the Answer?

If the goal of government-sponsored pensions is to be self-sustaining with only modest payroll taxes, the normal retirement age has to rise even further, perhaps to 75, or even higher! Otherwise, the only other alternatives are increased taxes or decreased benefits.

Higher taxes and decreased benefits would effectively force many people to work longer and retire later. Higher taxes result in less take-home pay, which means less money available for saving. Decreased benefit levels mean the individual must accumulate more to offset what will not be received from government plans. 50 years ago, Casey Stengel was told to stop working because he was past 65. Today, many signs point in a different direction: **After 65, you must keep working!**

So... If Age 70 (or 75) Is The New 65, What Else Changes?

If longer life expectancies result in higher normal retirement ages for government pensions, these changes will likely have a ripple effect on regulations related to personal saving and accumulation. If, for example, the NRA for Social Security is raised to age 70, then the age regulations pertaining to required minimum distributions and/or penalties for early withdrawals might also go up. If more people are still working (and saving) past age 70½, does it make sense to *require* retirement account withdrawals while they are still working full time?

David C. John, the author of the Heritage Foundation report referenced above, mentions that if economic conditions compel people to work longer, income insurance benefits must also be changed. For example, disability benefits currently administered by Social Security stop at age 65, when retirement benefits take over. It is also common for many individual disability income policies to stop paying benefits at age 65. For disability benefits to continue beyond age 65, higher taxes (or premiums) will most likely follow.

The structure and use of other income protection products, such as life insurance, will be affected as well. Decisions about the amount of life insurance to purchase are frequently derived from an estimate of one's income-earning potential. In the working-until-age-65 paradigm, a 35-year-old might project another 30 years of earnings. But having to *protect 40 years of earnings* will result in proportionately larger life insurance amounts.

Projecting a longer lifetime may also compel individuals to give greater consideration to the cost-effectiveness of permanent life insurance or blends of permanent and term insurance.

Because government-sponsored retirement benefits are funded by taxes collected during one's working years, it is almost impossible to discontinue existing programs, even if they aren't financially viable. You just can't tax someone for 30-40 years, then renege on the promise to deliver retirement benefits; the social and political fallout would be too great. Given these practical realities, the most logical "adjustment" is raising the normal retirement age – and the early eligibility age as well. As these changes would apply to all Americans, many aspects of individual financial planning could be affected.

DO YOUR CURRENT FINANCIAL PROGRAMS ACCOUNT FOR THE EFFECTS OF INCREASED LIFE EXPECTANCY?

OR ARE YOU STILL STUCK AT "65"?

Financial Protocol: How To Compensate Family Caregivers.

Another socio-economic impact of increased longevity is the growing occurrence of children and/or other family members serving as caregivers for aging parents and relatives. The latest statistics from a 2010 report by the

National Alliance for Caregiving (NAC) reported that 43.5 million Americans in 2009 were looking after a friend or relative over the age of 50, which represented a 28% increase compared to 2004. This includes the new category of "sandwich" families, in which households are still raising younger children while also caring for older family members as well.

Two factors, one social and the other financial, have spurred this increase in family members providing care. First, in-home health experts have long recognized that family members often make the best caregivers. Many elderly individuals may not want or feel comfortable receiving help from strangers, especially in very personal care matters such as bathing, dressing, cleaning, and food preparation, etc., yet are much more comfortable receiving assistance from family members whom they know and trust.

In addition, the skyrocketing medical costs of longevity have left many families financially unprepared for the expenses of nursing homes or extended-care facilities. For many elderly individuals, continuing to live at home with family assistance is their



only viable financial option.

The NAC report notes that currently the majority of family-related caregivers are not receiving compensation for their services. However, the report also notes that caregivers usually find their duties require significant financial sacrifices – cutting work hours, moving to live with an aging parent, etc. – and financial remuneration to the family caregivers is not only a reasonable expectation, but likely to increase in practice. The reasoning is sound, but as with many other financial transactions, the devil is in the details. The following is an overview of some issues to consider if you or a member of your family is facing this situation.

Payment Methods

Payment arrangements for providing care can be simple or complex, depending on circumstances. Some caregivers may be compensated by receiving a larger inheritance when the elderly person's estate is distributed. Anne Tergesen reports in a December 11, 2010, *Wall Street Journal* article (“Should You Pay a Relative to Take Care of Mom?”) that “some families prefer to give tax-free gifts in lieu of compensation.” Current tax laws allow individuals to gift up to \$13,000 each year to any individual without incurring either income or gift taxes.

While relatively simple, both options have potential drawbacks. \$13,000 a year may not be enough compensation, and larger gifts may trigger a taxable event. Within certain time frames, gifts may be subject to “clawback provisions” if the elderly person applies for financial assistance from Medicaid, as it may be presumed that the gifting was



part of a strategy to reduce one's financial assets in order to better qualify for Medicaid benefits. Depending on the size of the estate and the duration and cost of care, the assets of an estate could be exhausted and the amount left as inheritance minimal.

These potential issues cause many families to consider straightforward payment arrangements, which in short order makes these payments subject to income tax provisions. When annual compensation exceeds \$1,700, an employer and employee each owe federal payroll taxes Social Security and Medicare. In addition, the employer must generally pay 6.2% on the first \$7,000 in wages in federal and state unemployment tax, according to Melissa Lubant, a CPA quoted by Ms. Tergesen in the *WSJ* article. In some cases, people employing someone for 40 or more hours a week also are required to contribute to state workers' compensation insurance pools.

While the terms of compensation may typically be based on an hourly wage, to minimize the bookkeeping requirements some families may choose to receive payments monthly, or even as a single annual distribution.

With both gifts and payment arrangements, estate-planning issues may also be in play, depending on the size of the estate, ownership of assets, and other family issues.

Get it in Writing!

Whatever method of compensation is chosen, it is vitally important to be sure any compensation agreements are disclosed to the entire family. When revealed after the fact, compensation agreements can exacerbate family tensions, and create unnecessary suspicion. It is not uncommon for “surprise” arrangements to result in uncomfortable and embarrassing litigation that often drives families apart.

Some financial experts are comfortable with using generic documents that can be found online to craft “personal care contracts.” Others may find comfort in using experts to craft the agreement and explain the particulars to all interested parties. Regardless the process, contracts should clearly specify the caregiver's responsibilities, hours, and rate of pay.

Having a written agreement in place not only clarifies the terms for other family members; it can be a vital document if the individual eventually applies for Medicaid benefits. Although care recipients can pay whatever they choose, Medicaid could disallow some payments if they substantially exceed the prevailing wages, seeing this as another effort to minimize assets when applying for Medicaid benefits.

Is There a Long-Term Care Policy in Place?

There are instances in which using family members as caregivers can impair the ability to receive long-term care benefits from private

insurance coverage. While many newer long-term care policies give discretion to the beneficiary as to where and how benefits are disbursed, the terms vary with the insurance companies and the language of their contracts. This is particularly the case with older contracts, which often specify the use of caregivers with specific licenses.

In addition, families should be careful about assuming care responsibilities without first consulting medical professionals. In a January 22, 2011 follow-up article, Ms. Tergesen relates the experience of families who “bridge the gap by relying on friends and relatives” to care for an elderly family member for a 90-day waiting period, only to find out that the waiting period begins only after the individual has first been seen by a licensed caregiver. The family's early intervention actually delayed the receipt of long-term care benefits.

Receiving Payment as a Caregiver from Medicaid

In some circumstances, it may be possible for a family member to serve as a Personal Care Assistant (PCA) for an elderly person receiving benefits from Medicaid. Quoting a brochure produced by the state of Virginia's Department of Medical Assistance Services, “a PCA can be anyone of your choosing who is at least 18 years old, but Medicaid rules do not allow you to hire your spouse. Any family member who meets the criteria above may be your PCA. Oftentimes, sisters, brothers, aunts, uncles, cousins, etc. work as PCAs for their family members.” The fees and guidelines for PCA

services are established by Medicaid and/or a state agency which may administrate the PCA program.

From the variety of options and accompanying details, it should be obvious that plans for caregiving should include input from financial experts. Caregiving is not a do-it-yourself project.

The life expectancies experienced today in the developed countries of the Western World have no precedent in history; never have so many lived for so long. In this “brave new world,” of longevity, the process of caring for elderly family members is still evolving. Eventually, governments and businesses may provide workable institutional strategies for long-term care. But for now, families are most likely the first and best choice for providing care and dignity.

ARE YOU FINANCIALLY PREPARED TO CARE FOR AGING FAMILY MEMBERS?

ARE YOU FINANCIALLY PREPARED TO HELP YOUR FAMILY CARE FOR YOU?

The Behavioral Nudge to Spend, Built Into the 2011 “Payroll Tax Holiday”

One of the tax changes negotiated in Congress’ closing session of 2010 was a one-year reduction in the employee’s portion of Social Security and Medicare taxes

deducted from workers’ paychecks. Previously, each employee paid 6.2% of their first \$106,800 in salary into Social Security. Employers matched that amount, and each party also contributed 1.45% of earnings into Medicare. The one-year tax reduction from the payroll tax credit will reduce the employee’s contribution by two percentage points, meaning employees will pay only 4.2% of their first \$106,800 (employers will still continue to pay 6.2 % as before).

According to an article by Ylan Q. Mui in the January 10, 2011 *Washington Post*,



the White House estimates the “payroll tax holiday” will result in increased take-home pay of around \$1,000 a year for the average American family. Any increase in take-home pay will usually be received positively by the public, but **it is interesting to note the structure of this tax break.**

How to tempt us to spend it?

Many economic advisors believe one of the keys to financial recovery is increased consumer spending. But given other factors in the economy, such as high unemployment and high levels of personal debt, a large percentage of Americans have chosen to

forgo discretionary spending in favor of either *increasing their savings* or *reducing their debt*. Mui states that since the beginning of the most recent recession two-and-a-half years ago, the savings rate for Americans has jumped to 5.3%, a sharp rise from the negative rate of saving prior to the bursting of the real estate bubble.

This is where the behavioral element comes in. Unlike previous one-time tax breaks that were typically single payments distributed after filing one’s annual income tax return, the 2011 payroll tax reduction will be dribbled out, paycheck by

paycheck, over the course of the year. For the average family receiving \$1,000 in additional income, the difference amounts to less than \$20 a week. And since the amount is small, behavioral studies show the “extra” will most likely be spent, not saved.

Think of it this way: If you receive a \$1,000 windfall in the form a single check, what is the likelihood that you will immediately spend all of it? It’s probably quite slim, because the size of the number causes you to consider larger financial questions. You find yourself thinking, “Should I pay off that debt, set it aside for a large purchase, or add to my retirement account?” With an extra \$20 in your pocket, the questions are more likely to involve dinner and a movie.

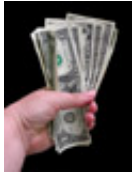
Richard Thaler, a prominent financial behaviorist and author of the best-seller *Nudge*, determined that most Americans have three categories for their finances: income, assets and future income. Money that falls into the first bucket (income) is most likely to be

spent. The second bucket is a mixture of spending and saving, while money allocated to the last bucket (often through automatic withdrawal or payroll deduction) is almost always saved. Thaler found that small increases to Americans’ paychecks were usually considered *income* (and often not even recognized as increases), while larger disbursements become assets. Considering these findings, Mui notes that “some economists think the smaller payments will increase the likelihood that the money will be spent because it seems negligible or perhaps even goes unnoticed.”

Unless...

You decide to override your natural tendency to spend small amounts of “extra” money by automatically diverting it through payroll deduction or automatic withdrawals. Now that you’ve had a few paychecks to see the difference in take-home pay, the simple way to capture those savings is to make an adjustment to any automatic “third-bucket” saving programs you already have in place.

A surprising aside: Mui cites a recent analysis by the National Bureau of Economic Research that examined how consumers responded to the 2008 stimulus checks and the 2009 Making Work Pay credits that appeared in each paycheck. Some data suggested that consumers actually preferred lump-sum payments instead of a stream of payments over the course of the year – even people whose cash flow was tighter. Mui reports: “For years, the government offered low-income workers the ability to receive their tax refund throughout the year instead of



all at once. But that program was discontinued this year because only 3% of eligible workers signed up.” Perhaps receiving a lump-sum encourages more circumspect and deliberate financial decisions, or maybe having jmore money in hand allows for the consideration of more alternatives. If the financial behaviorists are correct about this issue, i.e., that small regular payments will be consumed while larger lump-sum amounts will result in greater saving, and if consumers apparently prefer receiving lump-sum payments instead of extra

drips and drabs, it appears the government is inclined toward having people spend their extra money instead of saving it.

NOW MIGHT BE THE PERFECT TIME TO ADJUST YOUR SAVINGS ALLOCATIONS!

DON'T LET \$1,000 (OR MORE) SLIP THROUGH YOUR FINGERS JUST BECAUSE IT COMES IN SMALL PAYMENTS OVER THE COURSE OF THE YEAR!



By the way...

Casey Stengel returned to professional baseball in 1962 as the first manager of the New York Mets. Stengel managed the Mets until 1965, and died in 1975 at the age of 85.

Paul W. Litchfield, (1875-1959) joined the Goodyear Tire & Rubber Company in 1900, when he was 25, as a plant supervisor in Akron, Ohio. In 1903, Litchfield was granted a patent for the first tubeless tire. By 1926, he was the president of the company, and served as the chairman of the board from 1930-1958. The community of Litchfield Park, Arizona, west of Phoenix, was named after Litchfield, who had established the town in 1917, as a cotton farm enterprise providing fiber for Goodyear tires during World War I.

"One realizes the full importance of time only when there is little left of it. Every man's greatest capital asset is his unexpired years of productive life."

- P.W. Litchfield, Chairman, Goodyear Tire & Rubber, 1930-1958

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