



Regions Wealth Podcast

Episode 7: How Important is a Financial Safety Net?

Many of us have a goal we'd love to pursue, whether it's a midlife career change, entrepreneurship, or an early retirement. Of course, making these goals into realities comes with risk. How can you decide if achieving your goal is financially sound? Chief Investment Officer Alan McKnight joins us to discuss how to make a financial plan that will allow you to achieve your goals while protecting your financial future.

Episode Transcript

Anne Johnsos:

Welcome to a Regions Wealth Podcast, the podcast that tackles life's challenges with financial experience. I'm your host Anne Johnsos. Most Americans spend at least four decades of their lives in the workforce. That's a lot of work. And as the finish line looms, it can be tempting to call it early, especially when you've got some savings. But changing your income — whether through retirement, a career change or selling a business — comes with risk. How can you decide if following your dreams is financially sound? Joining me in the studio is Alan McKnight. He's the Chief Investment Officer at Regions Bank. Alan thanks for being here.

Alan McKnight, Chief Investment Officer, Regions Bank

Thanks for having me today.

Anne:

In this episode we are talking about how important is a safety net. We have taken frequently asked questions from a bunch of people and developed a fictional character who needs your help. Let's listen.

Gil:

Hiya. My name is Gil. I'm 56. I guess you could say I'm a bit of a serial entrepreneur. I started my first business at age 18... a small coffee shop in an old storefront in my neighborhood. Did so well, it expanded to five more locations. I sold it off at age 26 and used the money to fund a new business. I've started four businesses; the most recent one launched late last year. My inability to sit still has my wife Lucia pulling her hair out. She's always joked that if she ever had to work for one of my businesses, it would ruin our marriage. She's probably right! Lucia's had a successful, busy career as an ad exec, but is starting to think about retirement. The late hours and nonstop travel have been getting to her for years, and it's taking a toll on her. I'd love for her to retire early, but at age 53, she's seven years ahead of her target date. Overall, I'd say we're in a good place financially, but there's so much to consider... that 401(k) early withdrawal penalty is a big one.



Anne:

So, let's start with the 401(k) early withdrawal penalty.

Alan:

The withdraw penalty is particularly onerous and you should really attempt to limit that if at all possible. The reality is that the 401(k) program was created with the very idea in mind of making it until those retirement dates, and by getting hit with that penalty, so much of what you've saved pre-tax and so many benefits that you've had are then wiped away. So other than for a specific reason and/or an emergency, it really isn't prudent to make that type of decision. And similar in this conversation about what you may want, understanding what the trade-offs might be by continuing forward without that early withdrawal is really the better plan.

Anne:

How important is it for the average person to have a safety net in place?

Alan:

We think it's critical to have a safety net and we think understanding what that safety net entails vis-à-vis savings and expenses, so how much do we actually spend every year? How do you understand — if we were to look forward over the next one year, two years, three years — what do we actually spend and do we have the income to actually ensure that we will be able to cover it? And that's where the safety net comes into play. If we put money aside, is it enough? And let's take a worst-case scenario: if something were to happen, would we be able to handle and manage that?

Anne:

Is there some sort of algorithm or a formula you use when looking at someone and determining how much of a safety net is needed?

Alan:

There is. As a rule of thumb, we like to think of it as one to two years' worth of full spending. We know that we would get through that even with hardship, so even applying something, an exogenous expense that you hadn't prepared for. Someone has a fall, someone gets sick, something else happens, the house needs a new roof — all those types of things that people don't typically put in their savings plan, in their expense plan because they don't have it, but one of those will come up over the course of a couple of years. If you get that in place, then you can have an accurate portrayal of what that safety net is and feel like the suspenders and the belt are actually doing their job so you don't worry when one comes up and you don't think, "oh my gosh, I've got a reverse course and go do something else."

Anne:

So two full years with an additional sort of emergency expense anticipated?



Alan:

That's right.

Anne:

OK. So, what factors should Gil and Lucia consider before she just quits her job or retires or however you want to couch it?

Alan:

Well, we've always said if you can't measure it, you can't manage it. So measuring what is needed at this time, understanding what are our full expenses, what are the penalties for withdrawal of the 401(k), what are the real expenses associated with these businesses and the capital that is needed. And he alludes to the idea of eventually selling a business, but is that realistic and what is the timeline for that, how much does the economy play into it and whether that's actually feasible or not. In addition, it's looking at just the very basic data about life expectancy and retirement needs. Right now for her she should expect to live until she's 85 years old according to the Social Security Administration calculators. He should expect to live to be 82 based on that. That is a long runway. For her that's 32 years. Does she believe over that 32 years that it's worth taking a penalty, maybe not having a safety net? We would argue that it's probably not prudent, so all those factors bake in to then say, what really is the plan? Is this the best idea? Is this the most focused idea, or again, is this the shiny object that sounds great, sounds fun, but isn't the most prudent.

Anne:

At age 53, Lucia is too young to tap into her 401(k) without penalty. What would you advise them to do?

Alan:

I think it starts with the term "may" versus the term "will", and any plan should not begin with "it may cover it". It should begin with "It will. We have the highest confidence." That doesn't mean it's 100%, but if it's not 95 to 100% it's probably not a realistic plan. And you shouldn't expect a different outcome if you haven't done that sort of planning. So as we think about that and we think about how to move forward, it's really around what does a safety net look like, doing the background work to understand what those expenses are going to be, understanding what she may have had through her work, what he has for his current businesses, understanding how realistic a sale of one of those businesses might be, or even what kind of income they will generate. There are four different businesses — understanding what the different dynamics are there from an economic perspective to say if it's similar to his first business as a coffee shop, maybe it's pretty consistent. Maybe it's one that's very much tied to a certain dynamic or industry and if you don't understand that, you will be surprised when things don't go well. And the two of them together having that dialogue versus one, in



this case Gil thinking about it and recommending something without the full conversation with her and what those trade-offs may be.

Anne:

So it sounds like he needs a spreadsheet.

Alan:

He does. He needs a playbook.

Anne:

And a financial planner.

Alan:

That's right. And even to the end of — it wasn't captured before — but who is going to pay for healthcare? Could that change with the change of a job? Do these private companies that he owns, will he have the same level of it? All those types of things that are glossed over in an exciting change in life that really don't build the foundation for the future.

Anne:

Great. Let's hear the last bit from Gil.

Gil:

Living solely on my income, well, I fear we might hit some rough patches. I just launched that new business, and as every entrepreneur knows, things don't always pan out. That's the nature of the game. And none of the four businesses are ripe for acquisition just yet. We always had Lucia's income to fall back on. Without that, the stakes are higher. Plus, most of our assets are tied up in four separate companies, well, our safety net isn't in the greatest spot. We're covered for maybe a year or so. Two if we really pinch our pennies. Our mortgage is paid off and we don't carry any debt, so, you know, we're not going to find ourselves out on the street or anything. But I don't like the thought of not having at least one steady source of income. Lucia, well... she's been so supportive of my crazy endeavors all these years, both emotionally and financially. Now, I want it to be her turn — I want to support her. But at the same time, I'm worrying that we're not really thinking this through.

Anne:

From that last bit we hear some red flags. He says most of his assets are tied up in four businesses, none of which is ready to sell. Let's start there. How does that impact their decision?

Alan:

It's a big part of it because it's not owning a stock that's traded on the New York Stock Exchange, every morning you can find out what you can sell it for. If you want to sell it, you



can. There are really no restrictions for most public securities. Private companies are very different. The timing of that sale, the value of that sale all needs to be considered, and most business owners don't have an accurate perception of what it's actually worth. They look at it every day. They see the income streams, but they are not talking to independent valuation experts and appraisers to understand what can I actually get for this, as well as many times they run a lot of expenses through those businesses. Well if you haven't captured that in your expenses and understand what those trade-offs are, it's very difficult to have a good picture. So if you start with let's find out what they are really worth. Let's find out how many expenses we actually run through them, and let's look at a scenario around both good and bad in terms of the revenue from those companies and what they will really kick off and what they might need from a capital perspective. That will give you a much better portrait of where you're going to be and how much you can actually assume about your retirement savings.

Anne:

For sure. And also, you have to find someone who wants to buy it. My father had a business that he had to sell and just because it is a good business doesn't mean anyone is interested in buying it and running it.

Alan:

No one wants to call your baby ugly. That is the job of the valuation expert, of the appraiser to say, maybe it's not quite what you thought it was. Maybe it could be a little better. And these are the things you could do even if saying it's not worth as much as you think today, and this gets into the timing of retirement, but over the next three years if you will do these things, if you invest in new capital, if you add new people. If you all these types of things you actually may be more successful and it will be worth 2X, 3X. But without that you can spin your wheels around what it's really worth, and particularly when you have multiple businesses. So how much time do you allocate to each of those? Just because it's the one that's best to sell maybe that's the one you have the most passion for. Are you willing to sell it right now? And that gets into this emotion and the sentiment around folks who they have built these companies, are they truly ready for that next step?

Anne:

Nobody wants to call your baby ugly... I really like it. I want that to be the title of this episode. Should the size of an individual's safety net increase as he or she ages? For example, should Gil and Lucia have a larger safety net than say a 30-year-old woman?

Alan:

You should definitely hold a larger safety net as you get older and specifically because there's a higher probability of something happening, whether that's health related. You have larger asset bases, so something happens to your home or to your car, and the reality is it takes much longer to recoup those expenses over time. If you are younger you have a whole lifetime to save and to be able to plan against it. It doesn't mean that when you're 30 you shouldn't



have a safety net, it's just that you likely have the ability to earn into whatever expenses you may have incurred at that time. As you age, you really need to understand what kind of surprise expenses should we have. How can we think about that? How are we prepared for that? As well as inevitable which is over that time typically you are spending more and you may want to spend on things that you previously hadn't really captured, versus when you are younger you typically don't have those, or to the same level or absolute level of it.

Anne:

So the runway gets shorter as you get older.

Alan:

That's right, and the planning is more critical because you do typically have more — one, you have more means at your disposal, but then you also have considerably more expenses than you had when you were younger on average.

Anne:

Let's assume Lucia is willing and able to delay her retirement for another two years. What should they do during that time to help them achieve a better outcome? We are talking about their personal savings, the 401(k), their businesses, or anything else?

Alan:

The first thing they should do, first and foremost would be to maximize the amount of savings in a retirement account and the ability to save on a tax-deferred basis. Even in a short period of time they can maximize savings by doing that, and over those two years focus on how they might be able to achieve that. That may mean that Gil could actually create a new retirement account or to fund some of it via some of his ventures or even in that time period understanding what that might look like for him in terms of retirement assets.

Number two, it's cataloguing and characterizing all their expenses. What do we have today? What do we envision going forward? Specifically around healthcare expenses where insurance may be what costs were covered before by her job, all of those type of things.

If you catalog those, understand what they may be, not just now but in the future you have a better plan going forward. And then the final one is around long-term savings and their investments. So he talks about these assets and the ability to use those as their retirement accounts. How feasible in that? Has he had valuations on those companies? Does he have a sense of if he actually could sell them or is that a dream rather than a reality? So starting to combine those three things of how do I maximize retirement savings, what are true expenses and what should be expect going forward, and our asset base and what it looks like today versus in the future and how realistic are some of the assumptions that we've made over that time period. Two years should give them that runway to deliver.



Anne:

At the end of these podcasts we like to ask for some takeaways, something that maybe one of our listeners will share with a friend, an a-ha moment. You know, so, if you had Gil and Lucia in your office and they were sitting here and they presented this what would you tell them?

Alan:

It starts with a planning process. Again, what they need to do is understand, what are the trade-offs? What are the trade-offs in 1) having your own business, what it's worth and what it may generate in income? For her having the confidence in her career and in the company that she works for and having a healthy retirement plan. And then from there, understanding what are the things we need to do to be prepared?

It seems as though, as we hear of a lot of clients like this where folks are excited about a change. They recognize they worked very hard for what they've achieved but maybe it's not the time yet. And that doesn't mean it's not going to occur; it just may not be the right time for it and understanding what that trade-off is. So would you rather retire now but maybe not have quite the level or enjoyment during retirement because you really have to watch every penny and you are concerned about each year are we going to make it, versus waiting five more years or taking a different role that allows you to save more and having a really healthy and fruitful retirement that is more the one of your dreams.

Anne:

Thank you so much Alan McKnight, Chief Investment Officer at Regions Bank. You have taught us a lot.

Alan:

Thanks so much for having me.

Anne:

That's it for today, and thanks for listening to Regions Wealth Podcast. We hope you'll check back and share this podcast with a friend. Every episode covers a new financial topic with fresh insights from a Regions advisor. We put a lot into it, and we hope you get a lot out of it.

Anne:

Copyright 2019 Regions Bank, member FDIC, Equal Housing Lender. This information is general education or marketing in nature and is not intended to be accounting, legal, tax, investment or financial advice. Statements of individuals are their own—not Regions'. Consult an appropriate professional concerning your specific situation. This podcast is intended for educational and marketing purposes only. The people and events are fictional but represent real issues. No identification with actual persons is intended or should be inferred.



Copyright 2019 Regions Bank, member FDIC, Equal Housing Lender.

All non-Regions' owned apps, websites, company names, and product names are trademarks or registered trademarks of their respective owners. Their mention does not imply any affiliation with or endorsement by Regions of them or their products and services. They are merely used as examples of the many available apps, companies and websites that offer similar services. Before using any app or website you should carefully review the terms of use, data collection and privacy policies. Apps may have an initial cost or in-app purchase features.

This information is general in nature and is not intended to be legal, tax, or financial advice. Although Regions believes this information to be accurate, it cannot ensure that it will remain up to date. Statements or opinions of individuals referenced herein are their own—not Regions'. Consult an appropriate professional concerning your specific situation and [irs.gov](https://www.irs.gov) for current tax rules. Regions, the Regions logo, and the LifeGreen bike are registered trademarks of Regions Bank. The LifeGreen color is a trademark of Regions Bank.