Do We Need More Incentives to Save? - Transcript

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Tom Mullooly: Welcome back to the podcast. This is Episode Number 317 of the Mullooly Asset Management podcast. I'm Tom Mullooly, and with me today is Tim Mullooly and Brendan. Glad to be back, guys.

Tim Mullooly: There was an article from The Wall Street Journal. We usually like to talk about articles that have come out in the last week or so, but this one was actually written in the middle of February. It was February 17th, by Shlomo Benartzi. It was about how people don't save enough for emergencies, but he said there are ways to fix that.

And I thought it was interesting reading that article, having been written in the middle of February before the pandemic started really, here in the United States, and before the shutdown, and before there was a huge emergency. I feel like people revisiting that article today would read it with different lenses on their glasses having gone through an emergency when, before the pandemic, there wasn't really a huge national emergency for a handful of years.

Brendan: Yeah. I mean, I would say if people are looking at it differently now, then there are lessons to be learned from it, and we should make changes if we've learned something. If somebody was unprepared, obviously that sucks in the moment, but it doesn't mean that you can't become prepared for future emergencies. I mean, I don't know how often I'd prepare for a national emergency, but people have personal emergencies all the time and they're even less predictable than something of this magnitude.

Tim Mullooly: Yeah. You got to be prepared for the unknown.

Tom Mullooly: I think, Brendan, there's like an underlying current the last couple of years as interest rates have gone to zero. I mean, we've heard this on the phone, where people are like, "I don't want to be stupid. I want to maximize my money that's sitting there for a rainy day fund," and so they're using air quotes. Rainy day fund is actually sitting in tech stocks or something else, where they really are taking on a lot more risk. It's a problem. And I think that people feel a little stupid saying, "Well, I can't just leave three to six months expenses doing nothing."

Brendan: So the feeling generally, it does give off the vibe of like, "I don't want to be stupid. I want to maximize," but it can only be stupid in hindsight. So in hindsight, after the fact when there was no emergency for the last six or 12 months, then yeah, of course, it looks stupid, just like it looks stupid to pay for homeowner's insurance or car insurance when you don't have an accident at your house or out on the road for six or 12 months. Sure, I'd love to have that money back in my pocket, but we don't live in a world where we get the benefit of hindsight. We only can act with the future in front of us, which is unpredictable.

And so, yeah, there's certainly an opportunity cost to leaving some money in a bank account. So you want to make sure that what you are leaving there for emergencies is fine-tuned to make sure it's appropriate, make sure it's enough to be there for you when you need it, but not too much should be, air quotes, irresponsible, but there has to be something there. And the fact that it's not going to earn much doesn't change that.

Tim Mullooly: One thing in the article that I kind of chuckled at, because I think a lot of people give lip service to the fact that they would save money if something were presented to them, like a vehicle to save money. So there's a survey in the article and it said 71% of workers would contribute to an emergency savings fund if employers offered it, and that went up to 87% if the employer would provide matching contributions. That sounds great.

Brendan: It does.

Tim Mullooly: I don't believe people. When it's hypothetical like that and it doesn't exist, it's like, "Yeah, I would do that. Sure. I would do the right thing." If you ask someone a hypothetical question, they're always going to say, "Yeah, I would do the right thing."

Tom Mullooly: That's a good point. That's a good point. Yeah.

Tim Mullooly: But then they went on to say, in reality, in 2019, there's the Federal Reserve survey that said four out of 10 Americans can't cover a $400 emergency.
So I don't know. I just don't believe a lot of people with these survey results saying 87% of people would contribute to an emergency savings fund.

Brendan: And why should this be on the employer's plate to cover it any way?

Tom Mullooly: Yeah. Thank you.

Brendan: It shouldn't be, and if it was, people would resent that fact, just like they would resent it if the government made some program where they could also take people's money from a check and put it into some emergency reserve account for them. They'd say, "Ah, Big Brother, get out of my life."

Tom Mullooly: Right.

Brendan: There are a certain percentage of people out there that just can't be helped. They don't want the help. And no matter how easy you make it for them, they're going to complain about it and they're not going to do it. So yeah, I agree. I think the survey results are kind of bunk.

Tom Mullooly: I recall sitting around doing a podcast where we talked about, wouldn't it be great if these employers offered some kind of emergency savings bucket and actually make that a requirement before they contribute to a retirement plan? Because, let's face it, you're going to need that emergency money before you're tapping into your retirement fund. And unfortunately, we're finding, or have found, especially recently, that people who don't have emergency sources of cash, not a line of credit, if they don't have an emergency stockpile of cash, they are raiding their 401k or their retirement plan at work.

Brendan: If they even have one, which is an important point to consider here. Most employers can't even bear the cost of offering a 401k plan to their employees. It's expensive.

Tom Mullooly: Yes it is.

Brendan: I'm not saying that as a knock against the employers. It costs a lot of money. Why do they have to do that anyway? And then to layer on another cost, which they would obviously have to bear, of setting up these bank accounts or whatever the heck we would call them to do the emergency funding. Like why is this being thrust upon the employer? I get that that's the existing framework because that's how 401ks work. It's just, that's another thing employers have to bear the cost for here?

Like I don't think it's their responsibility to save for people, even though that makes it easier if you can do it through payroll. So maybe if we could just make it easier to do things through payroll, as opposed to making the employer set up accounts for people when they may or may not want them.

Tim Mullooly: Yeah. I mean, on paper, like the hierarchy of funding an emergency fund plan through your employer and then the 401k, it sounds good. And they talked about in the article about how they've been setting up auto-enrollment for 401ks and it increased the participation rate from 70% to 90%, which, on the surface, sounds good, and in a lot of cases, it is helping a lot of people save for retirement, but going back to what we were just talking about, how four out of 10 people can't cover a $400 expense, maybe the auto-enrollment into a 401k isn't a good thing for people.

Because now we're finding, with the CARES Act, so many people are going in and just raiding their 401ks because they don't have enough cash on hand to pay for their life right now. So why are you putting money away for retirement when you need money in the near-term?

Brendan: I agree. But then the flip side of that is, if we don't do these things to encourage people to save, then ultimately, where is the burden going to be when these people don't have anything saved at all for retirement and then they can't work anymore? It means that they're on programs that are being funded by-

Tom Mullooly: Taxpayers.

Brendan: Taxpayer dollars anyway. So I don't know, I fall on both sides of the fence here. I don't disagree with you.

Tom Mullooly: Yeah. Yeah.

Brendan: It's like, in that world where we strip all of the responsibility and just lay it on the individual, like, "Do what's best for your situation," then we're basically saying that, later on, if they don't have money, that we're just going to tell them, "Too bad, you should've done something about it," which is not what we do as a society. We support them. So maybe it's in the best interest of society to do these things where you auto-enroll people in stuff. I don't know.

Tom Mullooly: Part of this that I think we should discuss for a moment or two, and that is the fact that talk is cheap. We all talk about having emergency funds or savings accounts and things like that this. So I am a member of the Finance Council for my parish and have been for many years. And we've had money that has been earmarked for longterm investments. We have some money that's for longterm investments. We have some money that's for capital projects, but we didn't have an emergency fund. We didn't.

And so we just happened to be, in March, when things shut down, we happened to be in the middle of rebalancing the portfolio. And so we had cash that we could pull out and put into our operating fund as a short term patch in case we needed it.

We were very, very, very, very, did I say we were very? We were very blessed that a parishioner who had passed away left money to the parish and we were able to take this lump sum of money and put it away into a special reserve account. I called it the other night, at our Finance Council meeting, the doomsday account. Families need to start talking about this, especially in light of what's happened in the last few months, having some kind of doomsday account. Our doomsday account at the parish now covers 13 weeks, or three full months, a quarter of the year, in all of our expenses. And I think it's a good idea to have it. And I'm going to write up a list of parameters that have to be met before that money, before that principal gets invaded.

So the question then was, "Well, what do we do with the money? How do we invest this?" And the consensus was it needs to be liquid. It needs to be available in something short term. Yes, it's not going to earn a lot of money. The other part of that discussion was, "Hey, if this is a doomsday account and we may not be touching this for a long period of time, why don't we put it into something that's going to grow?" My response was when we needed the money in March and April to tap into, we were really lucky that we were in the middle of doing some transactions in February, and so we had cash sitting there. It had to sit there until the next board meeting. But when we needed money, if we had to tap it into our investments, they were all down 35%.

Brendan: Right.

Tom Mullooly: What do you want to do? That's terrible.

Brendan: So if you're going to put the money into something risky, then just answer the question. "Okay, if this is only 70% of what we have here now, would that be okay?" If the answer is yes, then all right-

Tim Mullooly: Take your chances.

Brendan: And if the answer is no, then you have your answer and it needs to go in something that doesn't have that amount of risk.

I think it's important too, to note that this is an easy conversation to have after this is so fresh in our minds. A year from now, two years from now, when you haven't touched this money at all, it'll become easier and easier for people to say, "Hey, we could have made X by investing that for the last two years for the longterm. I think this is a mistake. We should take more risk." People do this with their portfolios too.

Tom Mullooly: They do it all the time.

Brendan: In the rear view mirror right now, it sounds easy to say, "Hey, we should take the right amount of risk with our investments. That was kind of scary." But the further and further you get away from the market being down 30% in a six week stretch, the more and more willing people become to take risks. And it should actually work in the exact opposite direction of that.

Tom Mullooly: The other point behind this is that we talk about doing these things, but how many people actually take the steps to say, "I'm going to open up an emergency fund."

Tim Mullooly: Yeah. I mean, if people don't, especially now, I think if people don't learn their lesson after something like this, they're never going to. But like I said, I mean, people back in February probably read this article and were like, "Yeah, I would do that. It sounds good," and then they wouldn't actually do it. So I hope more people, having gone through something like this over the last couple of months, will have learned a lesson and maybe actually fund an emergency fund.

Tom Mullooly: I thought it was very coincidental that we tripped over this article this week and it was originally published five months ago. There was another article in The Wall Street Journal this week about small businesses bracing for a prolonged crisis. And the subtitle was that these small businesses are starting to run short on cash and they're also running short on customers.

This is a real concern. The stock market came back immediately when the Fed showed up and brought out trillions of dollars in support for the economy. But the real test of the economy I think is going to be when people feel comfortable going back to their usual lives.

So it's a real risk to small business owners that may not be well capitalized. The PPP money's been spent. That was money that was supposed to cover payroll in May and June. Now what? We're getting near the end of July, what's going to happen next? Some real questions out there.

Tim Mullooly: Yeah. I think things are just lasting longer than people anticipated. I think the PPP and other forms of aid that are running out now, when they were initiated, they were under the idea that things would be better in terms of the virus and states being open and stuff. And in a lot of cases, we're backtracking there. So yeah, we don't know really. I think it was just an underestimation of how long things are going to last and we still don't really know.

Brendan: Yeah. Well, the part that you didn't describe there is that the Fed came out and supported publicly traded companies and their common stock and bonds by doing what they did there, but that has little to no impact on small businesses in your local economy. That was supported by the fiscal policy, which we have an opportunity to do something about in the next couple of weeks, but we'll see if we do or not. Right. That could really help.

Tom Mullooly: It's a real concern.

Brendan: Yeah. It really is.

Tom Mullooly: Brendan, before we turned the microphone on, we were talking about that article that was in Bloomberg about 401k plans, that they may no longer make sense for people. And we wanted to save the discussion for when we had the mic on, but there were a couple of points in the article, and we'll link to it in the show notes, that I saw the headline and I said, "Okay, I'm going to read this." I was like, "That's not true. Of course 401ks makes sense." But the initial four points that the author made actually are true. So I'll just share them and then we can discuss.

The marginal federal tax rate for a median income married couple in 1980, the reason why they're using 1980, that was the first year that 401k plans were available, so the marginal federal tax rate in 1980 was 43%. The capital gains tax rate was 28%. Today, your capital gains rate might be zero. The likely retirement income tax bracket, if you were retiring in the early '80s, was 15%. Now it's 12. And interest rates were 15% when plans were written. Now, interest rates are zero. A lot has changed.

Brendan: Right. The numbers aren't wrong. I just think the example is kind of ridiculous because the rates that they're quoting in today's terms are, again, the median for a two spouse family with two children, but the median is across the country. So that's taking people from North Dakota in the same boat as New Jersey. Because I can tell you right now, that those numbers that they quoted for today's people are not what we see in our practice here in New Jersey.

Tom Mullooly: No.

Brendan: They're not the median in this state.

Tom Mullooly: They're not.

Brendan: So to be in the 12% tax bracket that they quoted here, you have to make, as a married couple, less than $80,000 a year. To have a 0% capital gains rate, you need to have less than $78,000 worth of income in a year. And again, the retired tax bracket would be the same.

So again, we're talking about a very specific sect of people here who this might not make sense for. And I don't think that that's reality. I think most people that are saving into 401k is make more money than this. If they don't, then they probably don't have money to put into a 401k.

Tom Mullooly: That's very true and all good points. I think the kind of couple that we may see in here that's bringing in $75,000 in retirement, they may have assets in retirement plans that they plan on tapping into in the future.

Brendan: Yeah, which would increase the income that they have.

Tom Mullooly: The income as they go further.

Brendan: Yeah. I mean, the article had some good ideas in terms of like incentives to make these plans better again in the future. They said that maybe if you're below the median, again, I think that's kind of dangerous because the median is very, very different and goes a lot further or shorter depending on where you are in this country, so I'm not sure that that's the threshold that I would use here, but if you're below the median income when you're withdrawing this money, maybe it's tax-free in the future. Like it's tax deductible on the way in, and then tax-free too. I'm not sure.

Tom Mullooly: You basically kind of Rothify-

Brendan: I mean, it's the best of all worlds.

Tim Mullooly: You never end up paying tax on that money.

Brendan: I really doubt the government is going to let that happen and I don't think that they really could, in terms of tax revenues either.

Tom Mullooly: I think that they're going to need to do something in the future. Don't pin me to a date, but at some point in the future, they're going to have to say, look, you've got social security, and for a long time people, that's it, that's what they're going to have in retirement. Some people, a shrinking number of people have a pension. People have retirement assets, but not nearly enough. And so they're going to have to do something to make a break for retired income folks. And maybe they do take a look at making distributions from retirement accounts zero taxable, or at some reduced tax bracket.

Tim Mullooly: Yeah. I think this kind of goes back to the beginning when we were talking about the burden and where that falls. Maybe those people should just save more money for retirement and then the taxes wouldn't necessarily matter, or they withdraw less and their money lasts longer. I think that just shifts the burden too. Like the government, they have to do something. It's like, well, why is it on them? Why can't it be on the individual?

Brendan: I just think there are already more than enough incentives to use plans like this. And I don't think that more incentives are going to make people do a better job of saving. I just think ultimately, if people aren't saving, it's probably because they can't afford to. And I'm not sure that making the money tax-free in retirement or excluding it from FICA tax too, which was another thing that they threw out there, again, maybe, but is that really going to move the needle?

Like if somebody isn't saving for retirement today and you tell them, "Well, guess what, now you don't have to pay FICA tax either. So what percentage should we put you down for?" I don't think they're going to do it.

Tom Mullooly: Yeah.

Brendan: I don't think that that's going to be like, "Oh, that's it? Now I'm in."

Tom Mullooly: That moves the needle for me.

Brendan: "Oh, but it'll be tax-free in retirement? Now I'm going to do it." If they're not doing it now with all the auto-enrollment features and things that are making it easier and easier to be in these plans, then what is going to make them do it? I think if they had an income that allowed them to save more money, then they would.

So again, I think that the point that they made here mathematically is all true, it's just that I don't think that the hypothetical person that they're quoting in terms of today's tax rates, capital gains rates, interest rates, I don't think that this is a conversation for them. I don't think that they're concerned about the incentives for 401k plans. And the fact that we do all of this stuff to get them in there and make it easier to save, I think that's the best thing we can do is make it as easy as possible. There are incentives on the table and-

Tim Mullooly: If they take advantage of it, great. And if they don't, it was available to them and they chose not to.

Brendan: Right. And it's not because 401ks are no longer a good deal like they were 40 years ago. I don't think that's why people aren't using it. I think it's completely beside the point.

Tom Mullooly: The other thing, two other things I'll just mention. The maximum contribution in 1980 I believe was $6,000. It might've been $7,000. So it didn't really add up to all that much. Buying power has changed a lot since then in 40 years. But the other thing, at the other end of the race, is required minimum distributions, RMDs, are suspended for this year, but most times, when we notify a client that they have to take their RMD, the first thing they say is, "Do I have to?" So they don't need the money. They don't want to take the money out.

Brendan: The government does.

Tom Mullooly: Yes, they want their piece.

Brendan: And there was an incentive on the front end. So I think it's only fair that people need to take it out eventually because otherwise, it's just a free pass on taxes forever. And then the people who are bearing the burden of that if we're letting retirees never pay taxes are just the people who are working because we don't have a choice.

Tom Mullooly: Good point.

Brendan: So I don't necessarily have a problem with that.

Tom Mullooly: That's going to wrap up Episode 317. Thanks again for tuning in and we will catch up with you on the next episode.