Briefly Noted

Donald Sterling's Lesson: Read the Estate Documents

The seemingly boilerplate clauses in estate planning documents can lead to unintended consequences. Donald Sterling's loss of control over his trust, and thereby the Los Angeles Clippers basketball team, provided a good example of just how important it is to understand everything written into an estate plan.

Donald Sterling forfeited control of the trust holding the Los Angeles Clippers basketball team after experts determined he was mentally incompetent. The trust agreement called for Donald's estranged wife, Shelly, to take over as trustee in such circumstances. Shelly subsequently sold the Clippers over Donald's objections after a Los Angeles court upheld the legality of the trust documents.

In commentary published on an American Institute of CPAs newsletter, estate planning expert Patricia Annino says there are several lessons to be learned from the Sterling court case. They include:

- The importance of reviewing all "boilerplate' clauses. Instructions that may seem benign when a person is healthy and competent may be of big significance in the future. It is very important to plan for disability and incapacity.
- Think through who will serve as the successor trustee. In the case of the Sterlings, Shelly was never removed as the successor trustee even after the couple became estranged. It may also make sense to consider having two successor trustees instead of just one.
- Ensure checks and balances exist. The trustee may want to have his or her doctor be one of the medical professionals designated to make the determination of incapacitation. It is also a good idea to think about who the successor trustees should be accountable to—the spouse, children, etc. Naming a guardian of person and property in the durable power of attorney document gives legal authority to the guardian to defend a trustee accused of being incapacitated.
- Regularly review estate planning documents. Since disability and incapacity often happen gradually, a regular review can allow for adjustments to be made.

Source: "The Importance of Boilerplate Trust Clauses: Sterling, the Clippers, and Incapacity," Patricia Annino, CPA Insider, July 28, 2014

Tougher for Brokers to Remove Complaints From BrokerCheck

Brokers can no longer expunge customer complaint data from the Central Registration Depository (CRD) System without a court order, thanks to a FINRA rule change approved by the Securities and Exchange Commission (SEC) in July 2014. The CRD System provides regulatory and background data to the publicly accessible BrokerCheck database.

BrokerCheck lists a broker's registrations or licenses, industry exams he or she has passed, previous employment, customer disputes, and regulatory or disciplinary events. The database provides information on a firm's history (including any mergers, acquisitions or name changes), active licenses and registrations as well as arbitration awards against it and regulatory or disciplinary events. It is a website the Securities and Exchange Commission (SEC) suggests individual investors visit to research a broker or a firm. BrokerCheck is free and is located at www.finra.org/brokercheck.

Once information is expunged from the CRD System, it is permanently deleted and no longer displayed on BrokerCheck. Knowing this, brokers have an incentive to ensure their BrokerCheck records are as clean as possible. This led to a practice of brokers refusing to settle claims against them unless a client either outright agreed to allow their complaints to be removed from the CRD System or at least didn't oppose requests by the broker to do so. Clients agreed to such requests in order to speed up the settlement process.

The new rules ban this practice. Brokers can no longer use settlement agreements to have complaints removed. Our understanding is that it will not apply retroactively to complaints that have previously been expunged, however.

Though there are still concerns about the type of information being omitted from BrokerCheck—in March 2014, The Wall Street Journal found 1,600 brokers with criminal or bankruptcy records not listed in the database (and FINRA has agreed to resolve this issue)—we think it is a useful resource for conducting a background check. The SEC also recommends visiting its IAPD website (www.adviserinfo.sec.gov) and state regulator websites (www.nasaa.org). We further suggest typing the adviser's name into an Internet search engine, such as Google, to see what comes up.

Source: "Expungement of Customer Dispute Information," FINRA Regulatory Notice 14-31, July 2014.

Required Retirement Savings Rate Depends on Age and Income

Saving 15% of income for retirement is a common rule of a thumb. The actual number depends on the amount of replacement income needed, when the worker starts saving for retirement and when he or she plans to retire, according to the Center for Retirement Research at Boston College.

The Federal Reserve's National Retirement Risk Index (NRRI) assumes that an average replacement rate of 73% of annual income for all households is needed in retirement. The rate ranges from 80% for low-income households to 67% for high-income households. The middle-class replacement rate of 71% factors in a 41% contribution from Social Security.

The Center for Retirement Research says low-income households should save 11%, while high-income households should save 16%. The rates include an employer match to retirement savings. Built into these savings rates is a 4% real (inflation-adjusted) return and the assumption of an inflation-indexed annuity being purchased at retirement.

Age and retirement dates also play big roles. Workers who start saving in their mid-30s can get away with setting aside about 6% of their income if they plan to work until age 70. The targeted savings rate jumps to 24% if retirement at age 62 is desired instead. In contrast, a 45-year old person would need to save 10% to retire at age 70 and 44% to retire at age 62.

In terms of absolute dollars, $538,000 in retirement savings is needed for an individual planning to retire at age 65 in 2040. This calculation assumes Social Security will replace 36% of the person's final inflation-adjusted earnings. Using a 70% income replacement rate, retirement savings will need to compensate for the additional 34% of cash flow needs.

The Center for Retirement Research advises people in their 50s with savings shortfalls to postpone retirement. A 29% to 30% increase in annual savings rates is required for middle- and high-income workers who hope to retire at age 65 but face shortfalls in savings. The study's authors say a more realistic and better strategy is to work longer and reduce current and future consumption.

Source: "How Much Should People Save?," Alicia Munnell, Anthony Webb and Wenliang Hou, Center for Retirement Research Brief, July 2014, Number 14-11.

Stress Hormone Alters Tolerances for Financial Risk

A sustained increase in the stress hormone cortisol leads to both a reduced tolerance for risk and an increased preference for perceived safer, but lower-return outcomes. This physiological response to stress may be a contributing cause to financial market instability, particularly during times of increased uncertainty.

A team of British and Australian researchers reached these conclusions after conducting a study on participants using a combination of cortisol dosing and computerized lottery games. The study was designed to measure risk preferences under placebo-treated, acutely elevated cortisol and chronically elevated cortisol conditions. Though the researchers had previously tested cortisol levels on London traders, this experiment allow them to test responses under controlled conditions.

The researchers focused on cortisol because long-term exposure to raised levels can impair behavioral flexibility and promote anxiety, depression and learned helplessness. The researchers said the effects associated with long-term exposure to elevated cortisol "could be expected to discourage risk taking."

First, they looked at the average utility curve. The flatter the utility curve is, the less marginal benefit is derived from each incremental increase in the amount of benefit. In other words, a flatter utility curve implies that a person is less willing to incur greater risk in order to reap bigger potential rewards. Participants receiving acute doses of cortisol showed no significant difference in risk aversion than the control (placebo) group did. Participants with chronically elevated cortisol had a "large" increase in risk aversion, however.

Second, the researchers found that the group with higher cortisol levels placed a greater emphasis on small probabilities (a sign of more risk aversion).

Commenting on previous economic research treating risk tolerances as static, the study's authors wrote, "We find, on the contrary, that financial risk preferences shift, and do so substantially. We further find that these shifts occur under the influence of a physiological mechanism, specifically the stress response...Our findings suggest that when people are stressed by chronic uncertainty or uncontrollable threat their endocrine systems discourage them from taking risk."

Source: "Cortisol Shifts Financial Risk Preferences," Narayanan Kandasamy, Ben Hardy, Lionel Page, Markus Schaffner, Johann Graggaber, Andrew S. Powlson, Paul C. Fletcher, Mark Gurnell and John Coates, Proceedings of the National Academy of Sciences of the United States of America, March 4, 2014.