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SCOTT: So, what is a private pension, how does it work, and what does it do? Let's talk about that. I'm going to borrow your cashews to use as an example here, okay? So, let's pretend this bowl of cashews here is your private pension. This is where you would invest money. In this case, we're saying 67 percent. We'll figure out the number later. We invest say 67 percent of your assets in this private pension. Now, first question is what kind of returns does a private pension earn? Well, the answer is pretty simple. It earns good returns. It never does great or fantastic, but it never does bad or awful. It consistently gets good returns. As a matter of fact, most private pensions right now are yielding between 5-6 percent minimum guaranteed yield. It could be better than that but that's the minimum guaranteed yield. That's not a bad minimum guaranteed yield, is it?

ROY: No.

SCOTT: But what does a private pension do? It just sits there earning good yields on your money, and it waits, and it waits until you say "Scott, we need income now," and the private pension, we turn on a little spigot got on the side here and, boom, it starts paying you a monthly check. And you know how long it pays you monthly check for, Patty?

PATTY: For life.

SCOTT: The rest of your lives. As long as one of you is alive, that check keeps coming, guaranteed, for the rest of your life. You know, if you have all the income you need coming in every single month on a guaranteed basis, you never have to worry about running out of money, do you?

PATTY: No.

SCOTT: You have all the income you need, don't you? Pretty nice.

PATTY: Uh-huh.

SCOTT: So, a private pension just sits there and earns good, solid returns until you need it, and then it pays you guaranteed income for the rest of your life. Now, let's look a little deeper here. It pays you guaranteed income for both of your lives that can be turned on as needed. Now, what do I mean by that? So, let me use the cashews here. I'm going to borrow your candies for a moment here we'll borrow you your Godiva chocolates for a moment. We're going to set these out. Now, for the sake of this analogy, let's just assume that all of these are private pensions. Now, it looks like there's multiple private pensions of different sizes. It doesn't matter what the size is, okay? At some point in time in the future, you're going to need income, right? When you fully retire you're going to need income to replace that. So, when that day comes you say to me, "Scott, we need income." I'll ask you how much, you tell me, and you know what I do? I flip a switch and we turn one of your private pensions on and it pays you guaranteed income for the rest of your life. Now, why did we turn that one on? Because that's how much money you needed as income. The rest of these, you didn't need the income from them right now. They're just sitting there going "Hey, guys; we're here in case you need us. We're just waiting for you." But you know what's going to happen? At some point in time in the future you're going to need more income. Why is that? Inflation, right? You might need inflation. So, I may ask you if you need any extra money. How is inflation affecting you? You'll say "No, we're fine." The next year I'll say "How are you doing?" "No, inflation's not affecting us at all." But at some point in time you're going to say "You know what, Scott we could use a little extra money." How much do you need? And then you tell me how much you need and guess what I do? I turn on the private pension to give you the income that you need at that point in time. Does that make sense guys?

ROY: Uh-huh.

SCOTT: And when you need more money, you tell me, and what do we do? Turn the next one on. So, the private pension pays you guaranteed income for the rest of your lives so you don't ever have to worry about running out of money. Now, a private pension has some very nice similarities to regular pensions, but it also has some key differences. Patty, you have a pension through the Science Center, right? Now, here's the way that pension works: it's a lump sum of money, and they're paying you a monthly check from it. Let's just say hypothetically that one month you guys needed more money, okay? And, could you call up your pension company and say "Hey, I know you're sending me 1,200 bucks a month. could you send me an extra 10,000 this month?" What are they going to tell you? They're going to say "pound sand," right? They aren't going to send you extra money, right? Now, that pension will pay you as long as one of you is alive. It pays you, it pays you, right? But what happens when the two of you die? What happens to all the money that's left over in the pension?

PATTY: It goes away.

SCOTT: They keep it! It goes away, right? That's a regular pension. A private pension's different. When you put money into a private pension, whose money are you putting in there?

ROY & PATTY: Yours.

SCOTT: It's your own money, right, if you put it in there. So, who owns this money?

PATTY: I do.

SCOTT: You own and you control it, right? So, when you need income, it pays you guaranteed income, right, just like a regular pension does, but here's where the key difference is. With a regular pension, if you needed extra money, they're going to say no, correct?

PATTY: Right.

SCOTT: Well, with a private pension, what are they going to say?

PATTY: Sure, how much?

SCOTT: Sure, it's your money, right? They'll say "Here you go, Patty," and they'll give you money. Now, if you take money out, you'll reduce your principle, won't you? And if you reduce your principle, what do you think that will do to your monthly payment?

ROY: Shrink it.

SCOTT: It'll shrink it, right? It'll reduce it. Now, it's no fun that it will reduce your monthly payment, but isn't it nice to know that if you need the money, you have access to it? Does that make sense, guys?

ROY & PATTY: Uh-huh.

SCOTT: Now, there's another key difference here. With your regular pension, when you're both gone, all the money just goes away, right? Well, with the private pension, when the second of the two of you pass away, what happens to the money in there?

ROY: Goes to the beneficiaries.

SCOTT: That's right, it's your money. It goes to your named beneficiaries. It passes on to your kids. Does that make sense?

ROY & PATTY: Uh-huh.

SCOTT: What it does is it gives you the peace of mind to know that no matter how long you live, you have that check coming in. The check you need do what? To accomplish all your goals. Now, when they're paying you this monthly check, let's say stock market crashes over here. How does that affect your monthly check?

PATTY: This is the private? No.

SCOTT: It doesn't affect it at all. Remember, it's guaranteed.

PATTY: No.

SCOTT: So, no matter what, you get that monthly check. What if there's a bad economy? How does it affect your monthly check?

ROY & PATTY: It doesn't.

SCOTT: So, a bad economy or a stock market crash doesn't affect your ability to accomplish your goals, right? Does that make sense?

ROY & PATTY: Uh-huh.

SCOTT: So, it pays you guarantee income for as long as you both live, you can turn it on as needed, rights?

PATTY: Uh-huh.

SCOTT: Now there's another statement up here: it can also strive to protect you against the spend-down in the event of a long-term care crisis, thus allowing you the option to self-insure against the long-term care crisis. Now, what am I talking about here? A long-term care crisis is you need nursing care, all right? So, if you need nursing care, what is happening in your life? Now, I'm not going to talk about physically, or emotionally or psychologically, all right? I'm not going to look at a long-term care crisis that way. I'm going to look at it strictly from a financial point of view, all right? From a financial point of view, a long-term care crisis is an income crisis, meaning you have this expense you've got to pay now. You need income to pay pay that expense. Does that make sense?

PATTY: Uh-huh.

SCOTT: All right. So, what does that have to do with what I'm talking about here? So, let me draw an analogy for you here. I'm going to use the navy as an example as a naval analogy. On a ship, on a navy ship, they generally have three shifts of sailors. One shift of sailors is working, one shift is recreating and the other shift is sleeping. And they rotate between sleeping, working and recreating all day long, right? That's how they do it. They rotate those shifts all the way out, okay? They do that unless there's a crisis, right, and when there's crisis it's all hands on deck, right? I want you to think of your money as sailors on your ship. If you have a long-term care crisis, it's what? All hands on deck. So, we need all of your money to do what? To pay you a monthly income. Are you with me? We need it to pay you a monthly income to cover the expense of long-term care. So, if there's a long-term care crisis, there's all hands on deck, these are already been turned on, right? What happens with all these over here? We turn them on. It's all hands on deck. We need create the income to pay not just for that long-term care expense, but to pay to make sure that the spouse who's still healthy at least can have dignity in retirement and can at least continue to enjoy, you know, spending time with the grandkids or hanging out with your church group friends. Does that make sense guys?

ROY: There's no interest that grows on this, is there? Does interest grow on these?

SCOTT: Absolutely. Yeah, remember the five to six percent yield internally on there, and there's other ways they credit interest. I'll cover that later. Yeah, there's interest, absolutely. So, what this does is this positions you so that you have all the income you need to accomplish all your goals coming in guaranteed every month no matter how long you live. You turn it on as needed to offset inflation, and then if there's a long-term care crisis, it's all hands on deck, we've created the income. That income gives enough money to pay for the nursing care, whoever needs it, and it has enough income for the remaining spouse to at least live with dignity at that point in time. And you never have to worry about the spend-down, because the income covers it. Does that make sense, guys? That's what a private pension is, a great way to get peace of mind. Does that sound good to you guys so far? A good description? So, a lot times people at this point in time they ask me what exactly is a private pension and how do they work? So, private pensions work like this. They are what is known as a shared-risk pool. Now, you're probably thinking to yourself I don't know what a shared-risk pool is, Scott. Actually, you do. You use them all the time, you just don't realize you use them. I'll give you another analogy for a shared-risk pool. When you drove here today, you took a chance. You took a chance that you could crash into a bus load of nuns, and get sued for $500,000. I don't know why I think that's funny. Nuns are not litigious, but I think it's funny. You hit a bus full of nuns and you get sued for $500,000. But, to help offset that risk, what do you do? Who do you have your car insurance through?

ROY: Safeco.

SCOTT: Safeco. So, here's what you do, okay? You take Safeco as an insurance company and you pay them a $1,000 premium per year. That $1,000 a year premium per year goes right over here into a shared-risk pool. Your neighbor puts in 2,000. The kid down the street puts in 900. Tens of thousands of people all pool their money together in one shared-risk pool, okay? Now, that shared-risk pool is professionally managed, all right? It's also regulated by the state government. Now, whether you love or hate it state government doesn't really matter to me. I can tell you this: the state government does a very good job of regulating this pool, all right? They set the rules and parameters, and the money managers have to follow those rules and parameters. By following those rules and parameters, there is about a zero percent chance of that pool will ever run out of money, okay? It could happen; I'll get to that in a moment, but the chances of it happening are slim. Now, what's the purpose of this pool? The purpose of this pool is to pay claims, right? So, let's go back to the example of you hitting that busload of nuns. You put $1,000 in that pool, you get sued $500,000. They have to pay out 500,000 dollars. Did that pool just lose a half a million dollars on you? Believe it or not, the answer is no, they didn't. You know why? They didn't know that you were going to hit that busload of nuns. They just knew that somebody was going to hit a busload of nuns. And they knew somebody was going to get rear-ended. And they knew that somebody was going get hail damage, and somebody was going to get their car stolen. So, they pay out all the claims to cover those losses. But what happens to the vast, vast majority of people who put their money that pool? Nothing. They don't have any claims at all, right. That's how the pool works. It's a shared-risk pool. Now, the chances of that pool, as I said earlier, of running out of money are about zero percent, but not quite zero. It could run out of money. So, if that pool were to ever run out of money, you know what you need? You need a big, strong, safe insurance company like Safeco that says "Hey, we have billions of dollars in reserves. If that pool ever runs out, don't worry. We can make it whole. We have the money to back that pool." Make sense guys?

PATTY: Uh-huh.

SCOTT: So the pool running out of money, chances of that happening, almost zero, but if the unthinkable happens and did happen, the insurance company can back it. But what if, what if that pool ran out of money and the insurance company said we're out of money, too? What happens then? Well, you want to make sure that if you ever to business with any insurance company, you want to make sure that you only do business with what's known as a legal reserve insurance company. You ever heard of legal reserve before? This is one of the greatest things ever, I think. I'll explain it to you. The first thing I'm going to do is I'm going to use an analogy. You've heard of the FDIC, right?

ROY: Right.

SCOTT: Now, this is not the FDIC. I'm going to use the FDIC as an analogy, okay? FDIC: Federal Deposit Insurance Corporation. Now, interestingly, a lot of people think the FDIC is the Federal Government. It's actually not. The FDIC is one single privately held insurance company . . that's backed by the Federal Government, okay? And here's how it works. Banks -- and these dots represent banks -- have to pass a very stringent set of financial criteria to get admitted to the FDIC. Once they're admitted, they then pay premiums to the FDIC. In exchange for those premiums, the FDIC says if one of you gets in trouble, the FDIC will do what? Bail that one out. So, what you end up with is you have one insurance company backing hundreds and hundreds of banks. That's the way the FDIC works. Now, I said "legal reserve" earlier. What's the legal reserve? The legal reserve is what insurance companies have. Now insurance works like this. Insurance companies -- and these dots represent insurance companies -- in order to get admitted to the legal reserve, have to pass have very stringent set of financial criteria. Now, once they get admitted, here's the difference. Unlike the banks that pay a premium to the FDIC, insurance companies don't pay a premium to the legal reserve, all right? The legal reserves works like this. Think of it as a form of reinsurance if you will, all right? Whereas one of those companies here gets into financial trouble, guess what happens? All the other companies do what? Step up to fix that company. Now, you may think that's crazy, because they're fixing their competitor down here, right? Why would they want to help a competitor? Well, remember the insurance industry, the entire purpose of the insurance industry is built upon trust, right? It's trust that they're going to be there to pay their claims. So, if one of those companies gets into trouble, it gives all of them a black eye, and they don't want that. They want healthy competition. Does that make sense?

PATTY: Uh-huh.

SCOTT: Now, people say, wait a minute; isn't the FDIC backed by the government? The answer is of course it is, it's backed by the Federal Government. What about legal reserve? Who's ultimately backing the legal reserve? The state governments are. So,I mean, you're okay there, all right? As a matter of fact I'll tell you a little secret: If we ever get to a point where the state governments are having to bail all these guys out because hundreds and hundreds of insurance companies are going out of business . .

ROY: We're in trouble.

SCOTT: Guys, we're in trouble. It is a bad situation, you know? I submit to you, nothing against the FDIC, but I submit to you that one insurance company backing hundreds and hundreds of banks is not as good as hundreds and hundreds of insurance companies all backing each other, okay, ultimately backed by the state government. Does that make sense? That's a very watered down version of how that works, but when I talk about guarantees today that's level of guarantee that I'm talking about. So, you may say "Scott, that's wonderful. What does that have to do with a private pension?" A private pension's simple. A private pension is you taking 67 percent, which is about a million dollars, of your portfolio and investing it into a shared-risk pool. And it's the guy down the street putting in 2 million, and this guy putting in 750,000 and this guy putting in 500,000, and this guy putting in 300,000. It's tens of thousands of people all pooling their assets together in one shared-risk pool. And the purpose of that pool is to do what? It's to take the people who put their money in there and pay them a guaranteed monthly . .

PATTY: Income.

SCOTT: A guaranteed monthly income, right? Does that make sense?

PATTY: Uh-huh.

SCOTT: So, it's designed to pay you a guaranteed monthly income. Now, this pool is professionally managed, all right? It's regulated by the state government, and again, whether you like the government or not is not relevant. What's important to know here is that the state government does a great job of regulating this pool. If I people managing the pool follow the rules, which they have to, the chance of that pool ever running out of money is essentially zero. But, it could happen. Now, how does the pool work? Well it's shared-risk pool. Remember in the class where you learned that in most situations, even the people that do the best with their money, there's still about a 29 percent you'll run out of money in your lifetime, okay? So look at this pool for a moment over here. Statistically, 29% of the people that are in this pool will still run out of money, but that means what? 71 percent won't, and the 71 percent now that don't run out of money make such large profits that it offsets the losses of the 29 percent so that everybody; excuse me, nobody loses money and everybody makes good returns. See the shared risk? See, when you spread risk out amongst many people, the risk essentially goes away. But that pool, remember I said it had about a zero percent chance of running out of money? It's not quite zero. So, if that pool were to run out of money, what happens? Well, you want a big, strong, safe company with billions of dollars in reserves that says if that pool runs out, we have the capital to back it. What's the only type of company that has billions of dollars in reserves that backs up risk pools like that? Insurance companies! It's an insurance company You want a big, strong, safe insurance company backing that pool right there that says if that pool ever runs out, we got the money to make everybody whole. But what if, what if the pool runs out and if the insurance company says we don't have the money, either? You want to make sure that insurance company's a member of what? You see it guys? So, this is what I'm talking about, all right? Again, that's very high-level thumbnail sketch of the way it works. When I talk about guarantees, this is kind of guarantee level that I'm talking about, okay? So, that's how a private pension works. Does that make sense? Any questions about that so far?

ROY: No, pretty easy.