6 risks to consider in retirement planning

Don't let your clients be derailed by these common pitfalls

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How do I turn my buckets of money into a paycheck I won't outlive? Should my investments look different as I near or move into the distribution phase of life? Do I still need life insurance now that my children are out of the nest? How do I address the impact incapacity may have on my retirement? These and many other questions raise anxiety in the hearts and minds of those hoping to obtain financial independence in retirement.

Whether one envisions achieving financial independence, living the "American Dream," or has a more modest picture of what retirement should look like, there are six risks waiting to derail the person in pursuit of this goal. Clients and advisers alike must plan carefully in order to effectively address each of these pitfalls to enable the client to live confidently throughout retirement.

Health care risk

Rising medical and prescription drug costs, fewer employer-sponsored retiree benefits and limitations of Medicare are all affecting income and retirement savings. According to Medicare.gov, estimated health care costs for a 65-year-old range from $3,000 per year for someone in excellent health to $10,000 per year for someone in poor health, including premiums, deductibles and co-pays, but not including long-term care, vision or dental expenses.

- **Suggestion:** Include the appropriate health care expense amount in the retirement lifestyle budget and account for health care's inflation rate, which has historically outpaced normal inflation.

Market risk

Participating in the stock market can give an individual's retirement savings and income the potential to keep pace with inflation. However, volatility in investment markets can significantly affect retirement income and savings. This risk, combined with the unpredictable timing of retirement during a market downturn, such as in 2008-09, can force a retiree to seek employment at a disadvantageous time of life.

- **Suggestion:** Keep a cash reserve account in an effort to avoid a forced liquidation of assets in a down market. The typical reserve benchmark is two years of annual lifestyle spending that is not already provided by other income sources such as Social Security, pension and annuity payouts.

Inflation and taxes

With inflation reducing purchasing power and taxes affecting liquidation strategies, fewer resources may be available to spend or to remain invested for the future during retirement.

- **Suggestion:** To increase the probability of success, use a financial modeling tool that incorporates multiple financial trial scenarios anticipating these risks.

Longevity risk

Americans are living longer, increasing the possibility of outliving their resources. There is a 10-percent chance that a 65-year-old male will live to age 97, and a 1-percent chance the same male will live to 105. Yet, the "average" life expectancy is only 85 years[1]. This means that half of the population will die before that age while the other half is expected to live longer.

- **Suggestion:** Consider using a portion of accumulated retirement assets to create income that will last a lifetime, rather than having all of the individual's assets subject to market risk.

Long-term care risk

Many mistakenly believe that provisions in the Affordable Care Act or perhaps Medicare (available at age 65) will provide for extended long-term care expenses. Some assume they will rely on Medicaid, which only provides benefits once a person reaches the level of impoverishment. The cost of care for an unexpected event or long-term illness not covered by private insurance or Medicare is requiring more Americans to prematurely deplete their assets. A 2009 Life Insurance Marketing and Research Association (LIMRA) survey of pre-retirees and retirees ages 55 to 75 found that health care and long-term care expenses together account for 12-15 percent of retirement expenses, depending on the household income[2].

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[1] https://www.medicare.gov/find-a-plan/questions/home.aspx, accessed August 22, 2011

[2] "Retirement Income Trade-offs, Implications for Product Development," LIMRA, 2009

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- **Suggestion:** Incorporate into the retirement plan an inflation-adjusted projection of the cost of an extended health care event. Then consider options and take action to minimize this exposure.

Legacy risk

Many Americans want to leave a legacy, making an impact beyond their lifetime by leaving a financial gift to a loved one or a charity. It is necessary to balance this desire with the need to fund an individual's retirement. Additionally, income and estate taxes can reduce what is left for these purposes.

- **Suggestion:** Give consideration to the minimum amount you want to leave as an inheritance and set this legacy apart from your retirement assets. Include provisions for this in your estate plan. Permanent life insurance is an example of an asset that can easily be designated for this purpose.

Two more critical factors in retirement planning

Planning for Social Security benefits and ensuring that income will continue to the survivor of a couple are integral to the financial independence discussion.

Social Security is an often overlooked opportunity to enhance income during the distribution phase. This type of planning is beyond the scope of this article. Entire books have been written on the subject, and it would be beneficial to study the options under the guidance of a skilled professional retirement adviser.

Even more often than missing out on Social Security options, retirees incorrectly conclude that having the **income and resources to retire** means that a survivor will have the necessary income if one spouse dies. However, there can be a significant reduction of income due to changes in the Social Security benefit at the first death. Income reduction can also result from the chosen survivor income provisions of a client's defined benefit pension.

- **Suggestion:** Rework the plan under the assumption that one spouse predeceases the other in order to provide a foundation from which to make prudent decisions in planning for the survivor's income.

How to prepare?

Here are four steps for helping clients plan for retirement with confidence.

- **1:** Encourage clients to take time to dream a little. After many years of working, help them imagine planning for the longest vacation of the rest of their lives.
- **2:** Develop the "gotta have" and "wanna have" hypothetical retirement budget.
- **3:** Pull together all income and asset resources that may contribute toward the goal.
- **4:** Plan — take careful stock of essential needs and discretionary wants, organize resources, and take action to navigate the six risks in retirement. Don't procrastinate. A recent Northwestern Mutual study suggests that 34 percent of Americans older than 60 feel financially unprepared to live to age 85. Whether retirement is months or years away, it is clear that clients and advisers are well-advised to avoid delay.

The most successful approach is a comprehensive plan to optimize income and protect against the risks that can destroy the plan. It is important to recognize that the income distribution phase of life varies dramatically from the accumulation phase, in both mathematical and psychological impact. While many people are successful in developing and creating their own plan, it is advisable to seek out a trusted adviser with knowledge and experience specific to the area of income planning who can be an additional resource.

Having developed a relationship with a trusted professional, retirees find additional confidence knowing the plan will continue at a point when they become less active in the financial management, suffer an incapacitating event, or pass away. ■

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