The Two Biggest Mistakes in Retirement Planning

#1) Failing to plan for a long-term chronic condition.

It happened to Superman and the President of the United States…and you're special, why?

That's my classic answer to the person who tells me he or she doesn't expect to ever need long-term care, which is defined as:

- being expected to need help with at least two of six daily living activities (bathing, dressing, etc.) for at least 90 days; OR
- having a cognitive impairment severe enough that you can no longer stay alone.

If devastatingly handsome Christopher Reeve (those blue eyes – don't get me started) can become a quadriplegic at 44 and someone as highly intelligent as Ronald Reagan can wind up in that shape, who among us can bow out?

It's true that most people are never in a nursing home, but the need for care at home or in an assisted living facility is exploding, along with the cost. Families are paying $200,000 a year today for 24/7 home care, and the **monthly** cost of a really nice assisted living facility is expected to grow from $6,000 to $25,000 in 30 years. The Society of Actuaries most recent claims survey shows that the average duration is 2.5 years but is almost 4.5 years for people who need care longer than a year.[i] On average, a person with Alzheimer's lives four to eight years after diagnosis but can live as long as 20 years.[ii]

The "sequence of returns" can derail the best plan to self-insure for this kind of expense. If you haven't heard that term, you will. It means the market is down the first few years after you retire. Someone with a $1,000,000 counting on withdrawals from assets can run out of money in less than 15 years with a few really bad years at the start, and this prognosis exists **without** a long-term care need.

Don't let anyone tell you there aren't any good options left to insure for long-term care. Traditional products have stabilized by pricing for the worst-case economy. Life insurance and annuities with LTC riders offer guaranteed premium and pay a handsome death benefit if care is not needed. There's even LTC annuities for people who are uninsurable.

#2) Failing to plan for a guaranteed lifetime income.

What do people miss the most when they retire? Friends, mental stimulation, making a contribution? Maybe, but the most common answer is they miss a **paycheck.**

In the last century, many people received a gold watch when they retired after many years of faithful employment. The watch was nice, but what they relied upon most was a pension funded by their employer that provided them with a guaranteed income for the rest of their life. Because it was a guaranteed amount, it was called a "defined benefit". Between pensions and Social Security, the focus for a successful retirement was on guaranteed lifetime income.

As stock prices and interest rates dropped after the "dot-com" stock market crash in 2000, many companies could no longer afford to offer pensions. Some froze their pension plan so that it wouldn't grow with the number of years worked, and some eliminated the pension program entirely.

Employers began setting up retirement accounts like 401(k)s or 403(b)s that employees could use to fund their own retirement with pre-tax dollars automatically deducted from their paycheck, many with an employer match.

Any financial planner will advise you to contribute enough to your retirement account to get your employer's full match; otherwise, you are throwing away free money. If you are self-employed, you already know that you must fund your own retirement with a Solo 401(k), a SEP, Keogh, SIMPLE IRA, or a traditional IRA. For those who want tax-free distributions, an index universal life insurance policy can fit the bill and also a Roth IRA for those who meet the IRS qualifying income requirements.

So today, retirement for most people is based on a "defined contribution", not a "defined benefit" system, which simply means how much are we contributing to our retirement savings accounts? In other words, retirement planning has changed its focus from guaranteed income to return on investment. How much and how fast are our retirement accounts growing? Retirements are based on assets today, not income, and there is a lot of talk about a "safe withdrawal rate" so we don't spend our retirement savings too much or too fast, once we need to rely on them for income. Nobody wants to outlive the retirement nest egg!

However we define retirement, the primary concern of the saver is still . . .

> *Will I have enough income in retirement to live comfortably?*

Remembering this concern changes the retirement outlook dramatically. For example, Nobel prize winner Robert Merton points out that the U.S. Treasury bill (T-bill), while usually thought of as the consummate risk-free investment, is nearly as volatile as the stock market when evaluated in terms of how much the saver would receive if the investment were converted into an income stream. [iii1] Bonds, the other classic guardian of retirement wealth, have been struck down with yields near historical lows and the prospect of capital losses in lieu of capital gains, as the Federal Reserve reduces monetary policy support by inching up interest rates. Building on this dramatic change to the fixed income portion of retirement planning, Roger Ibbotson of Ibbotson-Morningstar fame and Professor Emeritus of Finance, Yale School of Management, released a bombshell report this year that uncapped Fixed Index Annuities (FIAs) would have outperformed bonds on an annualized basis *for the past 90 years*. Based on his research and back testing to 1927, he further said that uncapped Fixed Index Annuities are a viable option in accumulation portfolios leading up to retirement as well as at retirement . The best allocation for today's economy, he concluded, is 60% stock/40% Fixed Index Annuity *and no bonds*.[iv2]

What is a Fixed Index Annuity (FIA)?

An FIA is a contract between the policyholder and the insurance company to allow money to grow with some of the upside of the market and none of the downside. It gets better. There's no fee if the account is just used for accumulation. A fee of generally 1% a year is assessed when a lifetime income rider is added. The money is not in the market. Instead, the insurance company tracks at least one stock index and credits interest based on the performance of that index. My favorite type of FIA is one that is uncapped and credits at least 150% of the index performance and retains no more than the first 1.5% of annual earnings. The longer the surrender period, the greater the growth. A reasonable surrender period in my opinion is 10- 12 years. At the end of the surrender period, you can move the money if there is a better deal available. The policyholder has access to 7-10% each year penalty-free, with the exception of an annuity funded with pre-tax dollars established by a policyholder who is < 59 ½, as that would generally trigger a 10% early withdrawal penalty.

Let's look at how long-term care insurance and a fixed index annuity can work hand in glove to prevent my client Mary from making these two big mistakes.

Mary is 60, a single female in Minnesota planning to work to 70, at which time her Social Security will be $2700 a month. She has a pension of $500 a month which starts in four years. She switched jobs a couple of years ago and is still saving for retirement. She has an eight-month emergency fund and contributes regularly to a fund she calls “periodic expenses” like auto repair, new water heater, etc. She knows she needs LTC insurance now but discretionary income is low. However, she has a $230,000 403(b) with Fidelity from her old job. She can roll that into an FIA without a taxable event and allow it to pay the LTC premium of about $4800 annually years 2-4 until her $500 a month pension kicks in. She can turn on the lifetime income at age 70 of around $2500 a month, therefore giving her a lifetime income of $5,700 a month with which she is thrilled. She will have to pay the LTCi premium herself the first year, but she can manage by using some of her other savings. The only fee is .95 a year for the lifetime income. What did this plan accomplish? Mary has peace of mind knowing:

- She is able to purchase a long-term care Partnership policy which will allow her to keep her assets equal to the benefits paid out if she needs care longer than the three-year benefit period which is all she can afford.
- her old 401(k) money is protected from market downturns and will be there growing at 4-8% until she is ready to turn on the income at age 70.
- a long-term care no longer threatens her entire nest egg.
- she can never outlive her monthly income from the FIA.

Also, Mary isn’t as worried about having her new 401(k) in the market because she knows her basic expenses will be met with her FIA. Last but certainly not least, she is happy that I don’t get paid out of her money, unlike the money management fee she has been paying every year, whether her money gains or loses.

Making one or both of these common mistakes can mean you wind up with a “what if” retirement. You will be afraid to spend your retirement savings as you ask yourself:

- What if one of us has an extended chronic health care need?
- What if our retirement savings suffer losses and we aren’t able to pull out enough income to continue our lifestyle?
- What if we outlive our money completely?

Don’t be a “what if” person. Ask your advisor about a fixed income annuity that tracks the market instead of being in the market and can enable you *to keep a paycheck as long as you live*.

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[i] “2000-2011 Long-Term Care Intercompany Experience Study”, Society of Actuaries, 2015

[ii] “Stages of Alzheimer’s”, Alz.org

[iii] Merton, Robert C. “The Big Idea: The Crisis in Retirement Planning”, *Harvard Business Review,* July-August 2014, p. 46

[iv] “Renowned Economist Roger Ibbotson Unveils New Research Indicating Fixed Indexed Annuities May Outperform Bonds Over the Next Decade”, Zebra Capital Management, March 7, 2018, Press Release