

Part XI

Threats to Retirement Planning

There are a number of threats to a successful retirement plan. Sometimes it is possible to plan ahead to minimize the damage from these troubling developments. Let us look at some of the more serious threats as well as some steps to take either in defense against or in response to them.

Types of Threats

Threat of Major Health Problems

A prolonged stay in a hospital or nursing home can absorb a lifetime's worth of retirement savings very quickly. Major medical problems can put one's retirement savings at risk whether they occur prior to or during retirement.

Medicare does not provide complete health coverage for those over 65. It provides very little coverage for such crucial medical services as custodial care and long-term nursing home care, although the specific coverage provided by Medicare varies based on the Medicare option that one selects. For those who do need an extended stay in a hospital or nursing home, the costs can be devastating. Even the most responsible savers would have trouble paying for such care for long out of pocket. If one's savings run out, Medicaid will prevent him from being thrown out of the nursing home, but not until his personal savings are almost completely gone.

Long Term Care

Better medical care means more Americans will be living into their eighties, nineties and beyond. Even though life expectancy has increased, many older individuals have serious health problems that keep them from living on their own or completely caring for themselves. There are over 31 million people over the age of 65, accounting for 11 percent of the population. Of that number, about 50 percent will suffer from a cognitive impairment or have limitations requiring long-term care services.

The costs of nursing or convalescent facilities run high. Insurance industry experts have estimated that the cost of long-term care will financially ruin 70 percent of all single people admitted to a nursing home within three months and 50 percent of all couples within six months after one spouse is admitted.

Given population trends, by 2040 as many as 5.9 million people may reside in nursing homes. In the mid-90s statistics showed over 3.5 million senior citizens receiving LTC services in their homes, and more than 1.5 million live in licensed nursing homes. Medicaid pays for over 70 percent of nursing home costs.

By 2011, those over 65 will number 38 million and represent 14 percent of the population. The number of people potentially requiring LTC will increase as will the “dependency ratio” or the relationship between retired and nonworking people to FICA-taxpaying workers. By 2011, over 6 million elders will need LTC services.

Long Term Care Insurance covers a wide range of care possibilities. It is usually necessary when a person cannot take care of themselves by performing the Activities of Daily Living.

Long Term Care refers to a broad range of medical, personal and social services provided to people who are unable to care for themselves for a period of time, sometimes a very long period of time. Most people tend to think of nursing homes when they think of long term care, but this type of care can be provided in almost any setting, including care in the home, a community based living center, or in an adult day care center.

Typically, it is the effects of aging, and in some cases the effects of an accident, that prevent an individual from performing the basic, routine tasks of everyday life. A person with a broken hip might need some rehabilitative care. A person recovering from a stroke might need help bathing or dressing. And someone with a cognitive impairment, such as Alzheimer's Disease, might need constant supervision.

The purpose of long-term care is to keep the individual as independent and functional as possible by helping this person meet everyday needs. Nationally, the annual cost of a nursing home exceeded \$40,000 in 1998. And the cost of care at home is just as expensive.

Threat of Conflicting Financial Need

According to a recent survey, 35 percent of people aged 30 to 59 with living parents either expect it to become necessary for them to provide financial support to their parents or are providing support already.

This is one major expense that often takes retirement savers by surprise. One should find out as soon as possible if his parents will need his financial assistance. The problem will be far worse if he doesn't have time to prepare. If one's parents depend heavily on a pension for their income, he should find out if it is a life-only pension. If so, the surviving spouse might be left nearly destitute if the pension-holding spouse dies first.

Before spending money meant for one's own retirement savings, he should see if there is any other way to help his parents.

- Have a parent or parents move in with him.
- Consider taking out a term life insurance policy on the spouse.
- Avoid gift taxes, by planning financial assistance carefully.
- Consider claiming a parent (or parents) as a dependent.

Threat of Loss of a Job

An extended bout of unemployment can force even the most dedicated retirement saver not only to stop saving, but to dip into the savings that already have been accumulated. It is important to plan ahead to help lessen the blow if one is laid off.

- Set aside an emergency fund large enough to cover one's expenses for three to six months.
- Do not wait until late in one's career to start saving for retirement
- Keep a resume updated and in touch with job opportunities

If one does find himself out of a job, or in a lower-paying job with retirement on the horizon, there are some options available:

- Consider retiring early – if one's company offers an attractive severance package
- Consider delaying one's retirement to make up for the lower rate of savings or lower pension benefits provided by one's new job
- Re-evaluate one's budget – both the current one and the projected retirement budget.
- Check with the state's unemployment office about the unemployment insurance that might be available.
- Confirm necessary insurance coverage in new job

Threat of Tax Deferral

All retirement accounts, including IRAs, ask one to name a beneficiary. Most people quickly sign a piece of paper and then forget about it. The difference in using the correct beneficiary for one's retirement plan accounts or making a mistake, can be costly. For one's heirs it can mean decades of additional tax deferral for significantly more money. Also, if one forgets to remove "old" beneficiaries one's ex-spouse could end up with all that money.

The IRS has different rules for beneficiaries of inherited retirement accounts based on when the account holder dies. If one dies before age 70 ½, the beneficiaries lose tax deferral 5 years after the death of the account holder. If he dies after 70 ½, they lose tax deferral 1

year after the death. With a little planning the beneficiary can extend the tax deferral for decades.

The IRS makes it difficult with the Required Minimum Distribution (RMD) rules for IRA's and other retirement accounts when one reaches age 70 1/2. They think it is time now to start getting tax revenues after all these years of tax deferral. The minimum distribution is so important to the IRS that they require it every year and will assess a 50% penalty tax if one takes out less than the required amount.

The decisions a person must make to begin RMD's at 70 1/2 may appear to be simple at first glance but are complex and irrevocable. The result, for many people, is that decisions are commonly made unknowingly that effect their heirs, that can't be changed.

The recalculation method for RMD's is typically selected by the account holder because it gives them the smallest taxable distribution. Unfortunately for the beneficiary, it may make the inherited IRA immediately taxable. The IRS and some IRA custodians also make it difficult to make the right RMD decision. Unless one requests in writing the non-recalculation method the IRS says one has selected recalculation by default. Also, some IRA custodians limit one's RMD choices so he may have to transfer his IRA account before making his RMD decision.

Threat of Divorce

Divorce also is likely to effect one's retirement savings. Some spouses lose a large portion of their accumulated assets in divorce settlements, and the legal bills involved in the process can cut into savings as well. His ability to save will be diminished due to:

- The increased cost of living separately prior to retirement
- Alimony payments
- Fact that one must save on his own without the help of his former spouse

While divorce is almost certain to have a negative effect on one's retirement savings, there are two potential sources of income for a divorced spouse to keep in mind:

- If the marriage lasted 10 years or longer, then one might be eligible for Social Security benefits based on his former spouse's earnings.
- Depending on the divorce settlement, one might be entitled to a portion of one's former spouse's pension or IRA.

Divorces can get to be very complicated from a financial standpoint, and most people should consult with an attorney specializing in divorce or a financial advisor during the process.

The death of a spouse has a different financial effect from a divorce. While both might mean living alone and taking financial responsibility for one's own retirement, widows and widowers do have one crucial financial advantage over divorcees: all the retirement savings accumulated by the couple during their lives likely belong to the surviving spouse.

If one's spouse dies after retirement, one will not be eligible to receive pension income if the pension payout selected was "life only." If a pension will be an important source of postretirement income, one should not agree to a life-only payout. Under current law, a spouse cannot choose this option for his or her pension without his spouse's approval.

Life Insurance

After the age of 40, protecting what one has is extremely important because one does not have extra years to make up for devastating setbacks, such as those caused by unforeseen emergencies, loss of money from illness, or loss of value of investments if the stock market takes a drop. As retirement approaches or if a relatively short period of time exists before retirement, then riskier, higher-yielding investments may be necessary in order to achieve those goals.

The most important asset in one's retirement plan obviously is oneself. Life insurance is insurance that provides income to one's survivors in the event of one's death. If the payoff from life insurance is invested at a reasonable rate, one's family should have enough to carry on without him, after accounting for amounts available from Social Security and other assets one manages to accumulate.

There are many life insurance companies, but only two types of policies:

Term Life Insurance

Term life insurance is the simplest and cheapest form of life insurance; it offers the most coverage for the lowest cost. One selects the level of coverage he wants--\$50,000, \$500,000, or any other amount—and pays an annual premium. If he dies while he owns the policy, his beneficiaries receive the money. The premium is based on the amount of insurance coverage, one's general health, and his age when he first buys the policy.

With some policies, the premium rises each year; with others, the premium is fixed for five-year periods. Most plans are guaranteed renewable as long as one keeps paying the premiums. That renewal feature is important.

Cash Value Insurance

For most retirement plans, term life is great. But cash value insurance coverage can be sound addition if the following conditions are true:

- One needs lots of insurance, such as more than \$750,000.
- One is already contributing the maximum to IRAs for himself and his spouse, to a 401(k) plan if he qualifies, or any other tax-sheltered retirement savings plan available to him
- One can afford it—which is to say that one probably is earning more than \$150,000 per year.

Part of what one pays in premiums each year goes to pay for the life insurance coverage, but the bulk of the money is devoted to the savings and investment features that are intended to build cash value for one's retirement.

This type of policy has a value that increases over time and that one can tap for retirement income. It is very similar to a tax-favored savings plan with life insurance attached. Part of one's premium pays for insurance, part goes to one's savings, and investment earnings are allowed to accumulate tax-free.

Because commissions and fees take such a large bite out of one's cash value during the first few years, he needs to keep funding a policy for at least 10 years for his investment to pay off.

Summary

Accumulating significant savings for retirement is only half the battle; one also must protect his savings and his ability to continue to save from potential major set-backs. Otherwise, all of his saving might turn out to have been in vain.

The most common major setbacks—the loss of a job, a divorce, the need to care for parents, and major medical problems—are the sorts of things that many people are inclined to believe will not happen to them. A wise investor and planner will be aware that such setbacks are possible, and do his best to plan accordingly, through insurance, accelerated savings, and discussions with one's parents about their financial health.