INSIGHTS | PERSPECTIVES ON WEALTH MANAGEMENT

Maintaining Income in Retirement:

Simple Ways to Help Ensure Assets Last

CUNA Brokerage Services, Inc.

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Summary/Introduction

Ask a soon-to-be retiree his or her biggest fear and a likely response is "outliving my assets." It's a legitimate concern at a time when people are living longer and largely responsible for funding their own retirement. Three factors tend to drive a retiree's ability to remain financially stable: expenses, income and taxes. Many retirees have questions and concerns in all three areas and might not be taking the right steps to address them.

While financial advisors must be careful not to position themselves as experts in areas outside their scope, they can help clients navigate their retirement income concerns with education and financial planning tools.

Maintaining Income in Retirement

"WILL I OUTLIVE MY ASSETS?"

Longevity is the driver of all other risk according to Cindi Hill, CFP®, CRPC®, a retirement solutions consultant with CUNA Brokerage Services.

"It's the most common concern I hear from near-retirees. Once they've actually retired, people add declining health and concerns about Social Security benefits to the list, but this over-arching fear is definitely the biggest one."

It's no surprise people worry they'll run out of money. After all, the average lifespan has inched up over the years and now stands at 81.2 for women and 76.4 for men.[1] And research by the Transmerica Center for Retirement Studies found that retirees and near-retirees anticipate living to 90 (median response) and that the vast majority (70% of retirees and 84% of workers 50+) consider themselves to be in good or excellent health.[2]

How Long Retirees Think They'll Live	How Long Retirees Will Actually Live	How Many Retirees Think They're in Good Health	How Many Workers 50+ Think They're in Good Health
90 YEARS	WOMEN 81 YEARS MEN 76 YEARS	70%	84%

SOURCES | CENTERS FOR DISEASE CONTROL AND PREVENTION, TRANSAMERICA

Compounding this challenge is the fact that, with the exception of a lucky few, most people no longer have a pension to rely on and are responsible for managing their own retirement assets.

[1] CENTERS FOR DISEASE CONTROL AND PREVENTION, HTTP://WWW.CDC.GOV/NCHS/PRODUCTS/DATABRIEFS/DB244.HTM
[2] "THE CURRENT STATE OF RETIREMENT: PRE-RETIREE EXPECTATIONS AND RETIREE REALITIES," TRANSAMERICA CENTER FOR RETIREMENT STUDIES, DECEMBER 2015, WWW.TRANSAMERICACENTER.ORG/RETIREMENT-RESEARCH/RETIREE-SURVEY

Three contributors to portfolio stability

Let's take a closer look at the three key components of a retiree's asset pool: expenses, income and taxes.

"Unfortunately, too many people don't have a good understanding of these," Hill says. "They're in danger of making decisions that put their financial futures in jeopardy."

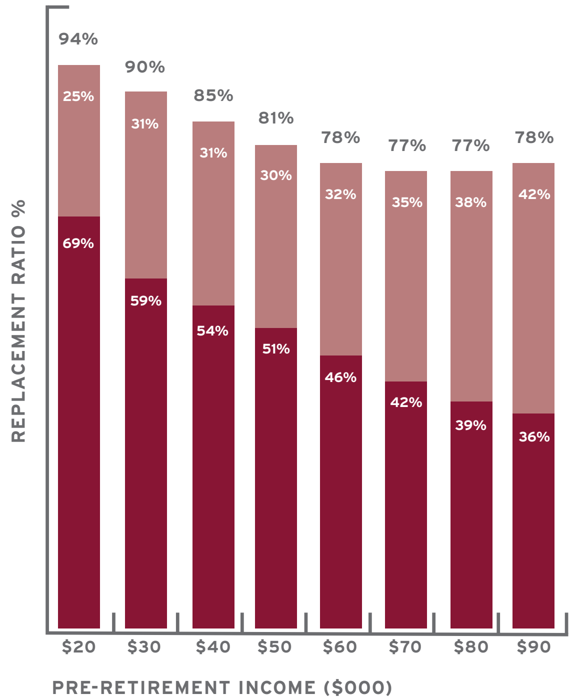
Expenses

Many consumers don't take the time to create an itemized budget of what they can expect their expenses to be in retirement. An important calculation is the "replacement ratio," or how much income you'll need in retirement to maintain your standard of living.

Replacement ratios vary by income, but are usually between 78% and 85%. A study by Aon Consulting showed a growing trend toward retirees needing to replace a larger percentage of their pre-retirement income over time. This is especially true for those at lower income levels. Because their take-home pay represents more of their gross income — as compared to someone in a higher income bracket who might have other sources, such as investment income — they will need to generate nearly as much income in retirement as they did pre-retirement in order to preserve their standard of living.[3]

The chart at right shows different replacement ratios for different pre-retirement income levels, as well as the gap between what Social Security covers and what income will need to come from other sources.

REQUIRED REPLACEMENT RATIOS BROKEN DOWN BY SOCIAL SECURITY AND OTHER SOURCES



SOURCE | AON, "THE REAL DEAL: 2012 RETIREMENT INCOME ADEQUACY AT LARGE COMPANIES"

"Advisors should sit down with their clients and help them think through their budget," Hill says. "They'll have a much more realistic understanding of their finances and required assets. Be sure to discuss 'must-haves' vs. 'nice-to-haves.'"

One expense that's difficult for most to estimate is health care costs.

"Many expenses, such as transportation and food, go down in retirement, but that's often not the case with health care," Hill stresses. "It tends to go up and this catches a lot of people off guard."

[3] "THE REAL DEAL: 2012 RETIREMENT INCOME ADEQUACY AT LARGE COMPANIES," WWW.AON.COM/HUMAN-CAPITAL-CONSULTING/THOUGHT-LEADERSHIP/RETIREMENT/SURVEY_2012_THE-REAL-DEAL.JSP

Research has uncovered some startling facts related to retirees and health care:

- Over half of Baby Boomers expect to pay less for health care or have no idea of Medicare costs.
- Almost half of Medicare enrollees paid more for health care than expected.
- Over half of Baby Boomers say they have a poor understanding or know almost nothing about Medicare.[4]
- Only 15% of pre-retirees have estimated their health care and long-term care costs in retirement[5]
- On average, Medicare Part D beneficiaries spent $458 more than they needed to in 2015
- Only 5.2% of Medicare Part D beneficiaries have the cheapest plans[6]

One study estimates that a couple, both age 65, who retire today with Medicare parts B and D and a supplemental policy, will need close to $395,000 set aside to pay for premiums, prescriptions, copays and deductibles over their lifetimes.[7]

"Your clients need help here," Hill says. "Don't assume they're basing their asset needs on realistic expectations, because most don't have the information they need to do so."

Income

TIMING RETIREMENT

Income is another area where clients have a lot of questions and uncertainty.

"One of the biggest question marks I see is around their expectation of how long they'll continue to work," Hill says.

A recent study showed that although the majority (67%) of workers 50+ think they'll work past age 65, with a median anticipated retirement age of 67, the reality is a bit different: 60% retire sooner than expected with a median retirement age of 62.[2]

"EVERYTHING FROM A GREAT BUYOUT DEAL TO HEALTH ISSUES CAN MEAN AN UNEXPECTED CHANGE TO THE ANTICIPATED RETIREMENT DATE," HILL SAYS.

[2]"THE CURRENT STATE OF RETIREMENT: PRE-RETIREE EXPECTATIONS AND RETIREE REALITIES," TRANSAMERICA CENTER FOR RETIREMENT STUDIES, DECEMBER 2015, WWW.TRANSAMERICACENTER.ORG/RETIREMENT-RESEARCH/RETIREE-SURVEY
[4]BANKERS LIFE AND CASUALTY COMPANY CENTER FOR A SECURE RETIREMENT, "RETIREMENT HEALTH CARE FOR MIDDLE-INCOME AMERICANS," 2012, WWW.CENTERFORASECURERETIREMENT.COM/MEDIA/166389/RETIREMENT-HEALTHCARE-REPORT.PDF
[5]HEALTH AND RETIREMENT: PLANNING FOR THE GREAT UNKNOWN," MERRILL LYNCH AND AGE WAVE, 2014, WWW.ML.COM/PUBLISH/CONTENT/APPLICATION/PDF/GWMOL/MLWM_HEALTH-AND-RETIREMENT-2014.PDF
[6]EHEALTH "CHOICE & IMPACT" STUDY, OCTOBER 2015, AND HEALTH AFFAIRS, OCTOBER 2012
[7]HEALTH VIEW SERVICES, 2015 RETIREMENT HEALTH CARE COSTS DATA REPORT, WWW.HVSFINANCIAL.COM/PUBLICFILES/DATA_RELEASE.PDF

TIMING SOCIAL SECURITY FILING

Social Security is another huge income question mark, especially when it comes to timing.

"There have been legislative changes in recent years that have eliminated some of the income-optimizing strategies available in the past," Hill says. "This has many wondering if it still makes sense to plan for the best timing on Social Security. The answer is, 'absolutely.'"

The example below illustrates the importance of Social Security planning. It shows that if a primary earner waits until he or she reaches full retirement age (FRA) — or even past it — to apply for Social Security Benefits, that can add up to a big difference in lifetime benefits for both the retiree and spouse.

Here, if the primary earner, Bob, waits until 70 to claim benefits, and he lives to 85, and his wife, Betty, lives to 90, they'll receive over $55,000 more in benefits than they would have at FRA.

IF BOTH CLAIM AT 66	**IF BOB WAITS UNTIL 70**
Bob claims his full retirement age PIA of $2,000 at 66.	Because Bob waited until 70 to claim his benefit, he's earned delayed retirement credits that increase his PIA to $2,640
Betty has her own PIA of $800, but begins the higher $1,000 spousal benefit at age 66 based on Bob's benefit.	With Bob waiting until 70, Betty begins receiving her own benefit of $800 at age 66. At 70, Betty will receive the higher spousal benefit of $1,000.
At 66, Bob and Betty have a combined payment of $3,000—at end of retirement*, they will have received a total of $840,000.**	At 70, their combined payment is now $3,640–at end of retirement*, they will have received a total of $895,680.**

* ASSUMES BOB LIVES TO 85 AND BETTY LIVES TO 90.
** ASSUMES NO COST-OF-LIVING ADJUSTMENTS (COLAS)

Please note: Advisors should be aware that if a couple opts to use this strategy, the secondary earner will need to contact Social Security when the primary earner files in order to get the spousal adjustment.

"I often get questions from advisors who question the value of a client spending four years of their portfolio while they wait to claim Social Security," Hill says. "There's definitely a perception they won't be able to overcome the cost of that expense."

Here's how that would play out in Bob and Betty's situation:

- If Bob delays his benefit until 70, they will need to withdraw $105,600 from their portfolios during this period (ages 66-70) to replace what Social Security would have provided.
- The "return on the investment" for waiting to file will be an extra $640 per month, or $7,680 per year, for Bob.
- Over 20 years, this results in an extra $153,600 of income through Social Security benefits.
- Alternatively, let's assume the necessary returns could be realized to generate $7,680 per year if the $105,600 stayed invested. The extra $153,600 of income would then be withdrawn from the portfolio rather than provided by Social Security.
- By using $105,600 in the beginning to buy time to increase the Social Security benefit, an extra $48,000 remains in the portfolio at the end of retirement. More income was provided by Social Security and less income was needed from the portfolio.

THE IMPACT OF ADJUSTED GROSS INCOME

Adjusted gross income (AGI) affects the client in a number of critical areas, including taxes and Medicare Parts B and D. Advisors need to understand this impact in order to convey its importance to clients. The following chart illustrates how AGI affected Medicare Part B surcharges in 2016.

Medicare Part B Surcharges 2016

SINGLE*	JOINT*	PART B PREMIUM	ADJUSTMENT	TOTAL PART B PREMIUM
≤ $85,000	≤ $170,000	$121.80**	$0.00	$121.80**
$85,001–$107,000	$170,001–$214,000	$121.80	$48.70	$170.50
$107,001–$160,000	$214,001–$320,000	$121.80	$121.80	$243.60
$160,001–$214,000	$320,001–$428,000	$121.80	$194.90	$316.70
> $214,000	> $428,000	$121.80	$268.00	$389.80

SOURCE: WWW.MEDICARE.GOV, 2016

*BASED ON MODIFIED ADJUSTED GROSS INCOME (MAGI) = ADJUSTED GROSS INCOME (AGI) + TAX EXEMPT INTEREST

**$104.90 IF HELD HARMLESS (MEDICARE PREMIUM DEDUCTED FROM SOCIAL SECURITY CHECK IN 2015)

Taxes

The final piece of the asset puzzle is taxes.

"One of the most frustrating things your clients will face in retirement is paying taxes on a portion of their Social Security benefits," Hill says. "They might feel they're being hit twice — once when they paid in and now when they're finally collecting."

THE PERCENTAGE OF RETIREES WHO WILL BE TAXED ON A PORTION OF THEIR SOCIAL SECURITY INCOME IS GROWING.

"In 2005, 39% of beneficiaries paid taxes on their benefits, and in 2014, 56% did," Hill says. "The main reason is because the thresholds haven't been adjusted for inflation — they're still at the levels set in 1984."

The threshold set at that time was $25,000 in annual income for a single person (the equivalent of $57,030 in 2016 dollars) and $32,000 (the equivalent of $72,998) for those filing jointly.

HOW THE TAXABLE PORTION OF SOCIAL SECURITY BENEFITS IS DETERMINED

SINGLE OR HEAD OF HOUSEHOLD

50% taxable if you have $25,000 combined income

85% taxable if you have $34,000 combined income

MARRIED, FILING JOINTLY

50% taxable if you have $32,000 combined income

85% taxable if you have $44,000 combined income

Combined income is defined as your adjusted gross income plus nontaxable interest plus 1/2 of your social security benefits.

SOURCE: SOCIAL SECURITY ADMINISTRATION, WWW.SSA.GOV, 2016

Here’s how advisors can help

Educate themselves

Advisors must stay on top of the latest changes that could impact a retiree’s expenses, income and taxes, and be able to direct clients to helpful resources.

“You’re not expected to be an expert in these areas, but you do need to know what’s going on and where your clients can turn for help,” Hill says.

Work with clients to pinpoint their top concerns and priorities.

Although Hill has found that not having enough assets tends to top the list, some clients want a guaranteed income, to ensure the financial security of a surviving spouse or to be able to leave something behind for their children and grandchildren. The client’s goals should drive all decisions.

Educate clients.

Based on their needs and concerns, advisors should direct clients to helpful resources and encourage them to talk directly with other experts, such as their tax advisor.

Here are some tools and strategies that may be useful for you and your clients:

MEDICARE

“Research has shown that most Medicare Part D recipients are spending more than they need to and that the vast majority don’t have the cheapest plan,” Hill says. “You don’t have to be a Medicare expert to help your clients.”

Hill recommends referring clients to these resources to optimize their coverage:

Medicare Plan Finder This site lets clients compare plan options based on their prescription medications. The advisor should stress the importance of looking beyond premiums as clients weigh their options: Clients should compare the total out-of-pocket costs, including premiums, co-pays, and deductibles.

SHIP National Technical Assistance Center The State Health Insurance Assistance Program (SHIP) is designed for those who aren’t computer-savvy or would simply prefer to speak one-on-one with a Medicare expert. This is a free service program whose counselors are trained and certified to answer questions about Medicare, Medicare Advantage, Part D plans, Medigap and Medicaid. Clients can choose to ask their questions via phone or check to see if there are local resources for a face-to-face consultation.

INCOME AND TAXES

Although advisors cannot offer tax advice, they can make clients aware of planning options that could help manage their adjusted gross income. Since adjusted gross income also impacts the taxable portion of Social Security benefits and Medicare premiums, here are a few things worth learning more about:

Qualified Charitable Distributions. This distribution option has expired and been reinstated in the past, but in 2015 it was made permanent by the Protecting Americans from Tax Hikes or PATH Act. Clients who are 70½ or older can request a distribution up to $100,000 be sent directly from their IRA to a qualified charity. This type of distribution is tax-free and can satisfy the client's required minimum distribution.

"We've found retirees tend to put a lot of value in being able to support their favorite charities," Hill says. "The QCD gives the client the best of both worlds: supporting their charity while also satisfying their RMD without adding to their AGI."

Roth IRAs. "People tend to assume they'll be in a lower tax bracket once they retire" Hill says. "But this isn't necessarily true. The brackets for various tax levels are so wide that it's quite likely people will be in the same tax bracket after retirement as they were before."

This could make it more appealing for a client to use a Roth IRA. With a Roth, taxes are paid the year the money is put into the account, but that investment grows tax-free and can usually be withdrawn tax- and penalty-free after the age of 59½.

Use financial planning tools. These are an excellent way to help clients sort through possible scenarios and develop strategies for addressing them. The best tools allow advisors to show clients how both their own choices — such as asset allocation — and factors beyond their control — like inflation or market fluctuations — can impact their portfolio.

"These are especially helpful when a client is trying to understand the best time to retire," Hill says. "For instance, although a client might tell you, 'I'm going to work until I'm 70,' I'd recommend running two versions of their retirement plan, one for his or her preferred retirement age and one for the median retirement age of 62. This will help uncover gaps and put clients in a position of knowledge as they're making decisions about their future."

Consider annuities

Annuities ensure a steady income stream and can make a big difference to retirement security. Hill describes them as a "personalized pension in an era when less than 20% of employers offer a pension program."

Whether a client considers annuities or not often comes down to two things: their personal experience with annuities and whether or not their advisor introduces them.

"IF ADVISORS INTRODUCE ANNUITIES, THEIR CLIENTS ARE 30% MORE LIKELY TO ADD THEM TO THEIR PORTFOLIO," HILL SAYS.

Conclusion

At a time when consumers are living longer and are typically responsible for their own retirement assets, many are understandably concerned they'll outlive their resources. Financial advisors can best serve their clients by helping them understand and seek out additional information in the three areas that impact portfolio health: income, expenses and taxes. While advisors are legally limited when it comes to providing advice in these areas, they can understand recent regulatory and financial changes that could affect their clients; direct their clients to appropriate resources; and be able to illustrate potential opportunities and pitfalls when it comes to portfolio planning. Financial planning tools are an easy, effective way to help clients gain a clearer picture of how different choices — both theirs and those beyond their control — can affect their retirement assets.

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