Understanding Retirement Planning

According to a 2012 Pew Research survey, more than 50 percent of individuals between the age of 36 and 40 worry that they will not have enough money saved up for retirement. With uncertainty surrounding Social Security's sustainability, fewer companies offering pension plans, and an increase in health care costs, there is plenty to worry about. But with proper planning, sound investments, and savings, individuals can sustain their quality of life throughout their retirement years.

Income replacement rate

According to Mary Brunson, vice president and wealth adviser for Investing for Catholics, the most important aspect of retirement planning is understanding what your income replacement rate needs to be during retirement in order to maintain your pre-retirement lifestyle.

MARY BRUNSON

"Most people want to live the way they did pre-retirement without having to make cutbacks," she says, "but most people don't understand what their income replacement rate looks like."

A few things need to be analyzed in order to determine your income replacement rate.

Most experts agree retirees need about 60 to 80 percent of their pre-retirement income to sustain quality of life.

"There are many reasons why you do not need 100 percent of your income after retirement," Brunson explains. "You are no longer saving for retirement. You're no longer paying into Social Security. And you're no longer paying for work-related expenses."

On top of that, the consumption rate of an individual typically goes down after retirement. So individuals need to look at their pre-retirement income, their expenses, and any special considerations to ultimately calculate their income replacement rate. Once they discover the amount they need for retirement, that amount will come from a variety of sources, according to Brunson:

- **Social Security** Depending on one's pre-retirement income and the age one starts collecting, the Social Security amount may be a low or high number.

- **Pensions** There are still some people who are covered under a defined benefit or pension plan from their previous employer, although these plans are becoming rare.
- **Defined Contribution Plan** These plans, like a 401(k) or a 403(b), are offered by employers where either both the employer and employee or just the employee make regular contributions.
- **Savings** Any other type of accounts used to accumulate savings to contribute to retirement income.

After individuals calculate their replacement rate income and the amount they will receive from all their retirement sources of income, they can determine if they will have a shortfall.

What if there is a shortfall?

Brunson says there are ways to make up a shortfall for those individuals who have not been saving for retirement until their 40s or 50s or beyond. First of all, a person faced with that situation should immediately begin saving as much as possible, for as long as possible. Another option for an individual facing a shortfall is to delay retirement. A person can also postpone the date he or she begins collecting Social Security, which will increase the monthly amount they eventually receive. Lastly, there is a catch-up provision for those over the age of 50 that allows them to contribute an additional amount, which varies depending on the retirement plan. According to the IRS, an individual over 50 can contribute an additional $6,000 into a 401(k) or 403(b), up to $3,000 in a SIMPLE IRA, or $1,000 in a Roth or Traditional IRA.

What about investments?

When considering your retirement planning, Brunson says, "It's really important to save and to defer into your retirement plan, but the investment piece is also important. Depending on your investments, you can either help fuel your retirement nest egg, or erode your retirement nest egg depending on what kind of investment vehicle you're in."

Brunson says the most important decision for an individual is to invest in a diversified blend of index funds. Index funds give individuals access to capital markets in an extremely low-cost way. There are a few ways Brunson recommends to do this: through a Vanguard fund, through Dimensional Fund Advisors, or through iShares.

Catholic investments

For those concerned about their investments reflecting Catholic values, Irvine, California-based Investing for Catholics builds and manages portfolios screened for Catholic values. Brunson, who co-founded Investing for Catholics, set out to address a need she saw in Catholic investing.

She worked with Dimensional Fund Advisors "to build out their suite of Catholic-values, passively managed, low-cost, diversified investments so that Catholic organizations and individuals could have access to great, low-cost investments that are great from an expected return perspective, great from a diversification

PHOTO: (LEFT) MARY BRUNSON

perspective, great from a cost perspective, but also commensurate with the teachings of the Catholic Church and the guidelines set forth by the United States Conference of Catholic Bishops."

Death benefit protection

If you have saved appropriately for retirement, you may no longer need death benefit coverage, depending on your retirement objectives, according to Scott Witt, a fee-only insurance adviser and founder of Witt Actuarial Services in New Berlin, Wisconsin. Witt says there are many considerations when deciding to keep or let go of a life insurance policy once you reach retirement age.

Are you trying to leave an estate for your loved ones?

You have saved adequately for retirement. Life insurance is often purchased in order to adequately provide for lost income to a family after the death of an income earner. If you have saved adequately and are now enjoying retirement, the need for life insurance, especially term life insurance, is mostly nonexistent. In addition, since you are no longer earning income, the cost of monthly premiums may be money better allocated to your daily expenses or investment opportunities. However, if you feel like there is a shortfall in your retirement savings, you may want to hold on to your life insurance.

The policy might have a huge taxable gain. Some permanent life insurance policies have a considerable tax on the money once cashed. For people facing this situation, Witt says it might make sense to hang on to the policy until death. If there is not a taxable gain on the policy, it might make sense to walk away. Unfortunately it's not a simple decision. Many things need to be taken into consideration before you surrender your policy, especially the health of the insured, your cash flow situation, or if you will need to take cash out of the policy.

Inheritance objectives. The last thing to consider when deciding whether you want to keep or surrender a life insurance policy is if you have any inheritance objectives. Are you trying to leave an estate for your loved ones? If you have no children, are you attempting to spend all of your money so you will have nothing left? The answers to these questions will help determine your best course of action concerning life insurance decision.

Long-term care insurance

Long-term care insurance (LTCI) is a product an individual can purchase in order to cover the costs of care needed if they should ever be unable to conduct activities of daily living, such as eating, dressing, or bathing. Policies come with an elimination period (typically a 30-, 90-, or 180-day period) that must be exhausted before benefits kick in. Benefit periods usually last only 3 or 5 years. A rider can be added to include inflation protection. While the coverage varies widely, there is one thing that is consistent: The premiums are excessive. And with more companies leaving the market

and even more premium increases looming, many are deciding against purchasing LTCI.

Witt says those who do insist on purchasing LTCI often end up stripping out so many of the benefits in an attempt to afford the monthly premiums that, as a result, the coverages end up being minimal. Hybrid products combining LTCI and life insurance attempt to entice purchasers by offering a single lump sum premium with the chance to get your money back and a death benefit, but unfortunately the coverages have been scaled back to even shorter benefit periods and less coverage amounts than the stand-alone policies.

So how should you cover the risk of a catastrophic long-term care need? Witt says, "If you have significant wealth, many roll the dice and self-insure."

A person who has significant savings and assets can forego the cost of premiums and just allocate a certain amount of money toward a possible future long-term care episode. For those unable to self-insure, Witt recommends viewing LTCI with caution and offers this advice:

- Go into it with your eyes wide open and understand that these are non-guaranteed premiums. Premiums can and have dramatically increased.

- If you do purchase LTCI, realize that you may not have completely covered the risk. With short coverage amounts of 3 or 5 years, even individuals with LTCI end up having to pay for their care out of pocket because they have exhausted their policy coverage when faced with a longer nursing home stay, especially in cases of Alzheimer's care.

- In an effort to encourage individuals to purchase LTCI and cut down on Medicaid costs, the federal government partnered with states to offer LTCI through private companies with certain standards — for example, inflation protection. Individuals who purchase the insurance through this partnership program are offered asset protection on a dollar-per-dollar basis. So even if you go through your policy coverage, you only have to pay down your assets to the amount that you purchased in LTCI in order to qualify for Medicaid.

- If you want the peace of mind of LTCI and you can afford the coverage, "Cadillac" policies are your best bet. You can choose low elimination periods, long benefit periods, and add inflation protection. Just be aware that your premiums will be extremely high and can continually rise, depending on the industry.

Immediate/income annuities

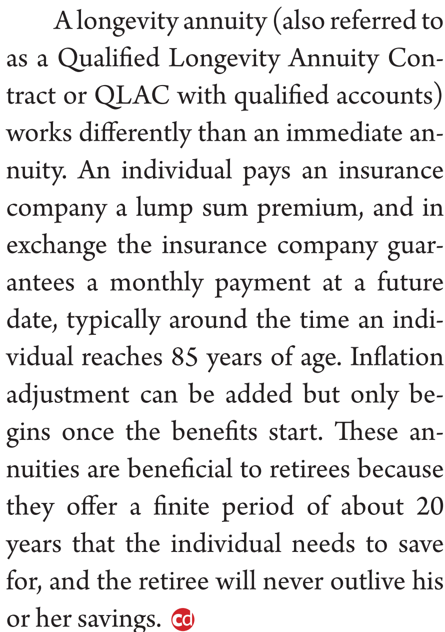
As part of your retirement planning, Witt recommends considering immediate or income annuities.

"Like Social Security, this is a very powerful weapon to have in your arsenal as a retiree," he says. "You know that you have a guaranteed monthly income stream that you cannot outlive."

The way a straight life immediate annuity works is that an individual pays one lump sum to the insurance company and from that day forward receives a monthly payment for the rest of their life. You can

tailor an immediate annuity to last for a certain period (10 or 20 years), have inflation protection, and add a refund option so an heir would receive payments after the individual dies prematurely.

All of these features cut down on the monthly benefit amount. Witt says researching the cost of an immediate annuity is a simple exercise to begin an intelligent conversation on weighing the different retirement plan options. Retirees that do decide to purchase an immediate annuity have the security of a lifetime income. That security gives them the opportunity to consider taking on other investment risks. Any profit from those investments can be used to build toward an inheritance for their children, travel, or other daily comforts.



Longevity annuity

A longevity annuity (also referred to as a Qualified Longevity Annuity Contract or QLAC with qualified accounts) works differently than an immediate annuity. An individual pays an insurance company a lump sum premium, and in exchange the insurance company guarantees a monthly payment at a future date, typically around the time an individual reaches 85 years of age. Inflation adjustment can be added but only begins once the benefits start. These annuities are beneficial to retirees because they offer a finite period of about 20 years that the individual needs to save for, and the retiree will never outlive his or her savings.

SEEKING *Advice*

Everyone can benefit from a financial planner or adviser to help guide them through the complicated ins and outs of investments, saving, insurance, and retirement planning. But not all advisers are equal, and it's important to know the difference.

Fee-only financial planner:
A fee-only financial planner is an adviser that has a fiduciary responsibility to act in the best interest of his or her client. They should disclose any potential conflict of interests. They do not receive a commission for any of the products the client decides to purchase or invest in. They get paid directly by the client either by a percentage of assets under management, a flat retainer, an hourly rate, or an individual task.

Commission-based financial planner:
A commission-based financial planner works strictly off commissions received by companies for referrals or business sold. These financial planners will more likely steer you toward products you don't need based on their natural desire to get paid.

Fee-based financial planner:
A fee-based financial planner charges a fee for consultation and also receives a commission from the products clients decide to purchase or invest in.

Life insurance agent:
Life insurance agents either work for a specific life insurance company or may act as an independent agent for a variety companies, but both receive a commission based on the products a client buys. They typically handle life insurance, long-term care insurance, and annuity-based products. These agents might up-sell unnecessary benefits or riders based on company incentives.

Fee-only insurance adviser:
A fee-only insurance adviser is an expert who works independently of any insurance company to offer his or her clients advice. Instead of commission, they charge an hourly rate. A fee-only insurance adviser may help you compare the benefits of insurance-based products that a financial planner might not consider. Other times a fee-only financial planner will have a fee-only insurance adviser on retainer so they can offer their clients the best expertise and a holistic approach to their financial or retirement planning.