I WANT TO RETIRE SOON

by Bob French, CFA

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Introduction

As you approach retirement age, you're increasingly eager to benefit from the freedom retirement offers. But are you really ready? From financial preparation to estate planning and advance directives, those nearing retirement have a range of matters to consider. This resource offers a big-picture look at the tasks involved in preparing intelligently for the opportunities and challenges of retirement, plus a few important questions to help you get on track.

What Do You Want to Do in Retirement?

Figuring out your priorities for retirement is a great place to start your planning process. Plus, it's fun to dream about the possibilities. For some people, retirement means they just keep working until they're dragged from the office. For others, it means the chance to start that new business or project they've been dreaming of. Many prioritize spending time with family and friends or diving into travel or volunteer work.

Planning your activities for the next 30 years, while exciting, can also feel a bit overwhelming. For most of our lives, we've had a clear task before us, but in retirement that's not necessarily going to be the case. Many retirees can expect to have a long retirement, which means preparing for change. Just as you aren't the same person you were when you were 30, you won't be the same person at 95 as you are today. This article *What Does Retirement Mean?* has more to say on this.

Budgeting for Retirement

Given all these variables, setting up a budget can be pretty difficult. We encourage clients to think about the standard of living they want to maintain and make an educated estimate from there. There are two very effective approaches for working out the financial details: a replacement ratio approach, and a traditional "budgeting" approach.

Replacement Ratio

The replacement ratio approach is a useful tool for those getting started. With this method, you plan on spending a certain percent of your annual pre-retirement income every year in retirement. The basic idea here is that if you want to maintain your current standard of living, you don't actually need as much income as you did previously. As you spend more time with your retirement plan, you'll probably end up moving towards a more detailed "budgeting" approach.

Traditional "Budgeting" Approach

We put "budgeting" in quotes because this isn't your traditional budgeting. This approach allows for more precision. We don't really care about your grocery bill when you're 72. What we're more concerned about is the big ticket items, and how both the amount and type of those will change through time. The goal here is to come up with a round income number for each year, or set of years, you are in retirement.

Both methods work. Financial planning is not an exact science by any means, so not having the exact answer is not necessarily a bad thing. However, like with many things, the more precise we can be with the planning that we put in, the more confident we can be with the results we get out.

For more in-depth explanations of these methods and how they work, check out "*How Will You Pay for Retirement?*" Now let's take a look at your insurance needs in retirement.

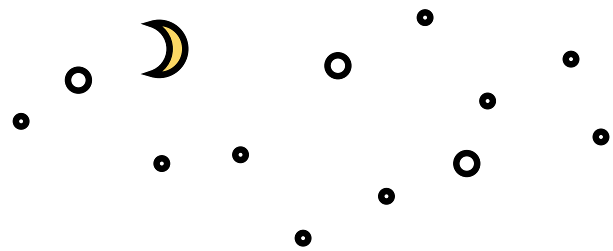
What Insurance Do You Need?

Health Insurance

If you've thought at all about insurance, it's likely been about health insurance. You need it. That much is pretty straightforward. If you are 65 or older, the basics are taken care of through Medicare. If you are planning on retiring before 65, you'll need to look into other health insurance solutions. Early retirees have two main options when looking for health insurance policies. The primary option is to use your state's health care exchanges and purchase individual coverage. The other option is to rely on COBRA. Whatever you do, make sure you have health insurance. Without insurance, your retirement projections can change quickly - and not in a good way.

Long-Term Care Insurance

It's a good idea to consider long-term care insurance, which helps cover long-term medical care. This type of insurance tends to be pretty expensive, so people will often choose not to purchase it, unless you have some reason to believe you are more likely to need long-term care than most people. That being said, paying for long-term care without insurance can be extremely expensive, so it is worth considering whether it is appropriate.



What Insurance Don't You Need?

Life Insurance

Life insurance generally becomes less important in retirement. During your working years, when you were living off your income and saving for the future, life insurance made perfect sense. But now, the future you prepared for has arrived. You don't need to worry about replacing lost income, as you likely will not have a large amount of income from work. While there are specific planning situations where carrying life insurance in retirement makes sense, for most people it is just an unnecessary additional expense.

Once you've determined how you want to use your time and what your insurance needs may be, you're ready to tackle the big question of paying for retirement.

How Are You Going to Pay for Everything?

Income comes from two main sources in retirement – money coming in and money going out.

Money Coming In

Just because you are retired doesn't mean you won't have any income. Besides Social Security and any pensions that you might have, many retirees continue working either as consultants or in a second career.

Social Security

Depending on your exact situation, a number of strategies could help you make the most of Social Security. As a general rule, the longer you defer claiming, the more money you will receive.

Pension

If you're lucky enough to have a pension coming, you'll mostly likely have two options for how to take it: in a lump sum, which you can then manage however you want, or as an annuity that will pay out over a designated timeframe.

Deciding between an annuity and a lump sum may be complicated, depending on your particular pension, but often the choice boils down to two factors: the stability of receiving an annuity check in the mail, and what you can do with the lump sum your pension offers. *We offer a detailed breakdown of choosing an annuity versus a lump sum here.*

Working in Retirement

Working in retirement can offer social connection, it can be a way to feel useful, or it could just be doing something you enjoy. Aside from the intangible benefits, working in retirement can significantly help you pay for retirement. Any money you earn is money that is not coming out of your portfolio. This means the money in your portfolio has even longer to grow.

Investments in Retirement

While your basic investment approach should stay the same after retirement, significant differences exist. You still want to make sure *your portfolio is well diversified*, is *focused on harvesting market returns*, and *is built for the long term.*

Given the new challenges your portfolio faces, as well as the fact that most people are more risk averse in retirement, many investors make their portfolios more conservative. There's no right or wrong answer here, but now is a good time to reassess your risk tolerance and adjust your portfolio accordingly.

Money Going Out

Taking Money Out of Your Portfolio

Withdrawing from your investment portfolio in retirement involves careful thought. This means you need a distribution strategy. Without a strategic plan, you risk taking a huge tax hit that could significantly impact how long your money lasts and how much you can spend. You can avoid major pitfalls by sticking to a couple guidelines about standard distribution order and withdrawal sequencing. For a detailed explanation of how investment accounts are taxed and what that means for withdrawing money from your investment accounts, including estate considerations and Roth conversions, *click here*.

Pay Attention to Your Required Minimum Distributions

You need to take required minimum distributions (RMDs) from some (but not all) of your retirement accounts starting the year you will turn 70 ½. You'll need to take RMDs from your traditional IRAs, 401(k) plans (both traditional and Roth), and any other employer-sponsored retirement plans. It's important to know how much you need to take out as there are significant penalties if you get it wrong. What you do with your RMDs is up to you, as long as you take them out and give the IRS their cut.

Estate Planning:

How Will You Protect Your Assets and Make Your Wishes Known?

Estate planning can be massively complex, or it can be incredibly simple. For most people, it's pretty straightforward and includes:

Your Will	*Beneficiary Designations*	*Health Care Directives*	*Financial Power of Attorney*

Creating Your Will

Your will is the central document of your estate plan, and it does a lot of the heavy lifting in making sure your wishes are known. Your will generally tells where you want your assets to go, who will be in charge of making that happen, and, if you still have minor children, who you would like to be their guardian. Thankfully, creating your will is very simple. There are sample wills available online, but many people choose to work through the process with an estate attorney. Different states have different rules, so check your local laws to confirm everything will be handled correctly.

Your Beneficiary Designations Matter

Even with a will in place, you want to make sure your investment account and insurance beneficiaries are set correctly. Listing beneficiaries correctly – meaning they match what is in your will – makes things go much more smoothly. If your beneficiaries don't match what is in your will, complications can arise or your assets could even go to the wrong person. The 2013 Supreme Court case Hillman v. Maretta is a perfect example of this. Warren Hillman listed his first wife, Judy Maretta, as the beneficiary of his life insurance policy. They divorced and Hillman later remarried. When he died, his will stated that everything should go to his current (second) wife, but Hillman never updated his life insurance policy's beneficiary. In the end, the money ended up going to his ex-wife and not his widow.

Setting Up Your Health Care Directives and Medical Power of Attorney

In addition to making a will, we recommend you consider making a living will, or advanced directive, to inform your family and doctors of your wishes in regard to your medical care in case you can't communicate them yourself.

You should also designate a medical power of attorney for health care decisions. This simply means you choose the person you trust to make medical decisions for you if you're incapable of doing so. It's generally a good idea to have some frank conversations with this person about what your wishes actually are. You may also want to sign HIPAA releases to allow this person, or potentially multiple people, the right to access your medical information when you are incapacitated.

Setting Up Financial Power of Attorney

Just like your medical power of attorney, designating someone your financial power of attorney will allow them to make financial decisions for you when you can't. If you do decide to name different people as your medical and financial powers of attorney, make sure they work well together. Oftentimes when these documents are activated, big decisions need to be made quickly, so you want to make sure everyone knows each other, and, most importantly, they know what you would have wanted.

Conclusion

Our aim is to provide clear and accessible guidance for those approaching retirement. We hope this overview is useful to your planning process and invite you to find *more in-depth information here*. Please *contact us* with your questions and let us know how we can be of assistance as you prepare for the best possible retirement.

WHAT'S NEXT?

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As McLean's Director of Investment Analysis, Bob helps keep the team at McLean on the forefront of market developments.

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ABOUT McLEAN

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