LifeHealthPRO

5 COMMON CLIENT PITFALLS IN RETIREMENT PLANNING

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Retirement planning has been a hot topic among pundits, politicians and financial experts for quite a while, but today's level of longevity risk is still a new phenomenon. While the average consumer may realize they need to plan for retirement at some point, people of all ages still hold many of the same misconceptions and make many of the same financial mistakes.

For advisors, these misunderstandings represent a great opportunity to educate clients new and old, middle-aged and pre-retirement. Addressing these issues early on will make it easier for almost any advisor to guide their clients into retirement with as much security and as little risk as possible.

1. LIFE EXPECTANCY ASSUMPTIONS

Anyone can see that average life expectancies are increasing, but averages are misleading. "If you've made it to 65, there's a good chance you're going to be here a while longer," said Dan White, Founder of Dan White and Associates. A Society of Actuaries study found that couples aged 65 today have at least a 50 percent chance of at least one spouse living to 92, and a 25 percent chance of at least one living to 97. For singles, half of all 65-year-old males and females are likely to live to 85 and 88, respectively.

For anyone close to retirement, these figures make the sequence of returns all the more important. Those who play the market in their 50s and 60s in hopes of huge returns can be wiped out during a correction, as huge proportions of their portfolios are lost when they've still got decades to live. "What you're looking for during this stage in your life is not a high rate of return," said White. "You need to position your assets for income that's going to last you a lifetime."

For all but the wealthiest clients, and perhaps even for them, this level or risk requires a pullback from the market and greater investment in safe income sources. "If a client wants to retire worry-free, they need to take longevity risk off the table and have enough guaranteed income to support their lifestyles," said Hagen Pruemm, president of Senior Insurance Solutions. Given the death of pensions, indexed annuities and certain life insurance policies are some of the best ways to provide that income.

Life expectancy underestimations can also lead to unsustainable withdrawal rates, even among savvy clients. In a survey by the American College, 16 percent of respondents thought it would be safe to withdraw between six and eight percent in retirement, while 20 percent believed they'd only be able to sustain two percent. Still, even the majority that guessed in the neighborhood oft-advised four percent may need to rethink their plans. Another American College study found that while four percent was a sustainable rate early in the twentieth century, today's market conditions, costs of living and lengthy retirements made three percent a far safer bet.

2. POOR "GAP" YEAR PLANNING

Quite a few Boomers are still expecting to retire before 65, yet many don't understand their financial needs during the gap between retirement and Medicare. Medicare doesn't kick in until age 65 and anyone retiring before then will need to have a big enough nest egg for health insurance, purchased either privately or through the new healthcare exchange.

More importantly, early retirees often fail to strategically plan their Social Security collections for maximum lifetime income. "One of the biggest problems is that people collect Social Security too early," said Pat Simasko, founder of Simasko Law. "People aren't pulling out of their 401(k)s and IRAs when they retire, but they're collecting Social Security and pulling from their bank accounts."

Collection at age 62 entails a 30 percent reduction in lifetime monthly benefits, while each year of delay from 66 to 70 offers an eight percent increase, according to the Social Security Administration. While it may seem intuitive to clients to take that "free" money before they draw down their limited nest eggs, waiting will provide for far more lifetime guaranteed income. "They could instead be chipping away at their retirement accounts and reinvesting what they don't spend," Simasko added.

3. A LACK OF LONG-TERM CARE PLANNING

Even among clients who expect to live well into their 80s and 90s, long-term care planning is unfortunately scarce. "People are oblivious about the potential for a long-term care event," said Pruemm. "It should be addressed in every plan." Younger retirees and pre-retirees often believe their good health will keep them out of assisted living and nursing homes, but statistics say otherwise. According to LongTermCare.gov, a person turning 65 today has a nearly 70 percent chance of needing some form of long-term care – 3.7 years of it for women and 2.2 years for men. And, while one third of seniors may never need long-term care, a full 20 percent are expected to need it for more than five years.

What will the costs be? "The average now is about $75,000 per year, but 20 years from now, it could be as much as $185,000," said Pruemm. That kind of expense is devastating for retirees who've failed to plan, but there are plenty of long-term policies and life insurance riders that can offer quality coverage and peace of mind. The issue with most clients is getting them to understand the need.

4. NOT SAVING EARLY

Middle-aged clients have perhaps the greatest need to save early and save often – yet they're still falling behind. In fact, a 2014 Bankrate survey found that a third of Americans between 30 and 49 hadn't even started to save." Most people spend more time planning their next vacation than they spend planning their retirement," said Simasko. "Everyone's worried about the next new gadget, but you have to pay yourself first." Given the huge advantages of compound interest, even double-digit monthly contributions could go a long way in securing middle-aged workers' futures.

Means aren't always the problem, though, nor is a lack of education. "A lot of people would rather help their kids go to college, and they push retirement planning to the back burner," said White. "Just about any expert will tell you you've got to be putting away money every year." Far too many parents prioritize private university educations over sound retirement planning, often in the hopes their children will take care of them later on. The opportunity costs of delaying contributions are huge, however, and it's unrealistic to count on kids' future incomes to make up the difference. For most families, the choice of college and field of study needs to be more of a business decision – one that takes Mom and Pop's future prospects into account.

5. NOT CONSIDERING TAXES IN RETIREMENT

Finally, a surprising number of clients aren't aware that they may still bear hefty tax burdens once they stop working. "Some people actually think they're not going to pay taxes on the income they're not earning," said Pruemm. Of course, 401(k) and IRA withdrawals, capital gains and even Social Security will all be subject to taxation. Because it's the bracket and tax liabilities that count, not just total income, Pruemm usually advises younger clients to invest in Roth IRAs. In contrast, middle-aged clients in their highest earning years should usually prioritize traditional 401(k)s and IRAs.

HOW TO HELP

Not all clients will listen to reason, but for those who will, course corrections usually come down to a hard look at the numbers. "Sit down and have a formal retirement analysis done," said Simasko. An inventory of a couple's assets, income sources, expenses and reasonable return rates will show them how much they'll be able to spend in a best-case scenario. Running market corrections, medical emergencies and long-term care scenarios will clearly illustrate the need to save more, save smarter and reduce market-related risk.