ROBERT C. CARLSON

The NEW RULES of RETIREMENT

SECOND EDITION

Strategies for a Secure Future

WILEY

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Second Edition

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The New Rules of Retirement

To Elaine, my wife and best friend

PREFACE

Retirement Has Changed ... Again

"Retirement and retirement planning are changing ... In the future, there will be more changes to retirement, and the changes will occur much more rapidly."

That was the opening of the first edition of *The New Rules of Retirement*. That opening couldn't have been more accurate, and it still applies today.

Though the first baby boomers hadn't yet reached age 65 when the first edition published (that didn't happen until 2011), they already had an impact on retirement and would continue to transform the post-career years. Other forces and trends joined with the boomers' reaching the silver years to break the old retirement rules. In only 10 years we had to adjust to these and other changes:

- Life expectancy, and therefore the length of retirement, steadily increases.
- Employers and governments continue to reduce benefits to older Americans, leaving retirees more and more on their own.
- Higher-income older Americans are receiving even less support as the government programs become more means-tested.
- Income and estate tax laws changed significantly, requiring updates to plans.
- The nontax factors in estate planning became more prominent and were revised and updated.
- The Affordable Care Act of 2010 introduced many changes to medical insurance and benefit plans, including changes to Medicare.
- Long-term care insurance underwent a couple of revolutions, with both good and bad consequences for retirees.

Of course, few people expected the turmoil in the economy and investment markets and how they would affect retirement plans. The financial crisis of 2008 affected the economy more adversely than any event since the Great Depression of the 1930s. The downturn in the investment markets marked the second decline in the major stock market indexes of more than 50 percent in less than a decade. The Federal Reserve brought interest rates to near 0 percent in response to the crisis, changing the investment plans of many people who were in or near retirement.

The most important lesson from more than a decade of change is: Retirement has changed and will change again.

You need to expect change. Your plans need flexibility, and you need to be ready to adapt and adjust.

Yes, you need a plan for retirement. You also need to realize that it is only a plan. It isn't set in stone, and it isn't a blueprint for the future from which you shouldn't deviate. A plan is based on assumptions about the future. You'll estimate inflation, interest rates, investment markets, the tax law, medical insurance, and more. Reality rarely will match all the assumptions or even come close. Some assumptions will be on target. Others will be a little off the mark, while still others won't even be close.

Plans need to be reviewed and adjusted. When you are in or near retirement, plans need to be reviewed annually. You don't want to review and change plans too frequently, because then you'll be responding to each little change in the investment markets. Regular reviews, however, mean only minor changes in your retirement plan can keep you on track. When too much time passes between plan updates and reviews, then you're likely to need major upheavals to put a plan back on track.

New Help for Retirement

Perhaps the most important change in retirement planning in the last decade is the fresh focus of professionals and academics. When I prepared the first edition of this book, few financial professionals or academics addressed the issues of Americans in or nearing retirement. They were still concerned with helping younger people maximize the accumulation of wealth. They largely neglected the needs of those who were past the accumulation phase of life and were in that post-career spending, or decumulation, stage of life.

Most of those who did offer advice for retirees relied too often on rules of thumb, intuition, and shortcuts to make recommendations. Only a few of us spent the time to create and analyze data to make recommendations. When we did, as readers of the first edition learned, the best actions often were counterintuitive. The rules of thumb and short cuts often led to recommendations that either made sense only in the past or that didn't stand up to analysis.

All that has changed. Now, there is a fairly robust collection of academics and financial professionals vigorously addressing the needs and concerns of older Americans. They use detailed research, data, and analysis to demonstrate the results that would occur from taking different actions under different circumstances. That means retirees and their advisors can spend more time analyzing individual situations and less time constructing models and data. It also means that the problems of retirees benefit from the attention, experience, and intellectual capital of a large number of professionals instead of only a few.

A related change is a new focus on strategies for generating reliable streams of income and cash flow in retirement. Until a few years ago, almost all investment research was geared toward maximizing long-term total returns. With the aging of the baby boomers, there's a realization that a large number of people no longer are interested in total returns. They're interested in making their wealth last, keeping it safe, and generating reliable income to ensure they can pay their expenses for an indefinite period. "Keep my money safe and pay me income" is the new Holy Grail of investing. It is receiving attention from major financial firms, academics, and a range of financial professionals.

In short, those in or near retirement have a lot more intellectual support than they used to, and it will improve retirement advice and outcomes. This intellectual support wasn't available until only a few years ago. Your retirement will be better because of the ideas and research generated.

The Retirement Process

For the first generation or two of American retirees, retirement was an event. A person reached a certain age, usually 65, and then stopped working. Retirement usually was filled with leisure pursuits: travel, recreation, spoiling the grandchildren, and similar activities.

While that model of retirement still exists, more and more Americans are shifting to different retirement models. The old model simply isn't appropriate for many of us.

Extending Careers

One emerging retirement model is to work past the age of 65. There are a number of reasons people do this.

German Chancellor Otto van Bismarck is said to have originated the practice of retiring at age 65 when he created the first old-age social insurance program in 1889. The U.S. Social Security Administration on its website disputes that this was the primary influence on the adoption of 65 as the first full retirement age in Social Security. The SSA points instead to an existing practice of designating age 65 in the U.S. private sector and state retirement systems, as well as actuarial data generated by the government, as the reasons age 65 was adopted.

Whatever the reasons for establishing 65 as the typical retirement age, they don't apply today. People live longer than they did in 1889 or 1935. Age 65 no longer is particularly old and people can live long beyond that, as we discuss later in this book. Many Americans at age 65 are relatively healthy and active. They don't want to stop working.

Research indicates there are many benefits to continuing employment. Mental and physical health often are maintained better with the regular social contact and structure that are part of steady employment. Work also gives a sense of purpose, which is essential at every age.

Of course, many people plan to continue working beyond 65 for financial reasons. The financial crisis of 2008 was a setback to many retirement plans, causing some retirees to seek to return to work while many preretirees began making plans to extend their careers. Since 2008, numerous surveys of Americans ages 40 and over found that many of them plan to continue working longer than they initially planned in order to increase their nest eggs.

Of course, work in retirement doesn't have to be compensated. Volunteer work provides many of the nonfinancial benefits of paid work. Volunteering also can provide psychic income and a sense of purpose because you are contributing to a cause that is important to you.

Keep in mind that retirement age isn't always a matter of choice. About half of retirees report in surveys that they didn't retire when they initially intended. A small percentage of them worked longer than planned, either because they liked what they were doing or needed the money. But most report that they retired earlier than they planned. Only a few retired early voluntarily and because they reached their financial goals. Most retired early involuntarily. Health reasons are a major reason for early retirement. People experience illnesses, injuries, or chronic conditions that make it difficult for them to continue their careers. Others retire early because they lost their jobs and couldn't find satisfactory new positions. After searching for a while, they left the labor force.

Retiring later is a model used by a growing number of people who still are planning and have a choice about when to retire.

Phased Retirement Is Here

A second retirement model growing in popularity is not to retire at all, at least not before health requires it. Leaving a long-time employer and settling down to a few years of travel, relaxation, or just sitting around isn't the game plan for many Americans any more.

Here is a more typical "retirement." A person in his or her late 50s or early sixties will leave an employer after working for that employer for 10 years or more. That employer will be one of four or five during the career. The next six months to one year will consist of relaxing and enjoying life, essentially taking a sabbatical or "career break." The period might include traveling, taking up a long-planned hobby, or spending more time on the activities that used to occupy only weekends and vacations. Then the person will search for a more meaningful way to spend some of his or her time.

The next phase of life has many possibilities. All of them are viable and in use today. It might consist of work in the same occupation the person previously had or in a related field. But it is just as likely to be something in a completely different field or industry. The new work might be full-time. In many cases, however, the work is in a lower-paid position with fewer responsibilities and fewer hours.

Some will keep this new job until it is time for a full-time retirement. Others will keep the job for a few years. Then, the person might shift to another position after deciding the current position is no longer fulfilling. The person might move to a completely unrelated position that involves learning new things. Over time, the hours worked might ratchet down. Even minimum-wage work might be sought at one point just to stay active and earn a little extra money. Eventually, the person might stop working altogether or decide to spend the time on volunteer activities for a charity or the community.

For some this is a planned process. Many others intend to retire and can afford to do so, but in their planning they neglected to consider how they would occupy their time in retirement. They return to the work force because they became bored and realized they had to "reboot" their retirement plans. They need to take some time to decide what would be a meaningful and successful retirement for them. Some people retire two or more times before getting it right.

There are many other scenarios. An executive who loves golfing might "retire" and take a job at his local course or club. Another executive might become a consultant, or take a job with a smaller business that needs an experienced hand, or even take a much lower-paying job to help run a charitable organization. Some hope to work at basically the same jobs for the same companies while working fewer hours, and some employers are trying to restructure positions to accommodate this.

Those who study retirement refer to all these possibilities as *bridge jobs*.

Starting a business in retirement is another course to take. One might start a small, part-time business that is not much more than an attempt to make money at a hobby. Another might have the ambition to build an operation with dozens or hundreds of employees.

These are just a few examples of possible phased retirements. There are likely to be as many retirements as there are retirees.

No longer is there a definite line between work and retirement, and there isn't a standard retirement age. People are more likely to retire in phases or stages, sometimes called *downshifting*.

Retirement Activities to Avoid

This book focuses on actions you can take to make your retirement successful and better. For a few minutes, however, let's take a look at retirement advice from a negative perspective. Let's consider the actions you want to avoid if you can, those that have been proven to derail retirement plans.

Sometimes the best way to have good results is to avoid mistakes and losses. We have enough experience with retirement to know which actions and events are most likely to cause retirement to suffer a downward spiral. Avoid these and you're well on the way to a successful retirement. Of course, not all these events are within your control. Yet, you can be aware of their potential to upend retirement plans and plan for them by having flexibility in your plans and carrying insurance or other protections when appropriate.

We discuss each of these in more detail in the chapters noted.

Debt

Once it was rare for someone to retire with debt, even a home mortgage. Now, the number of retirement-age Americans with substantial debt is increasing. Some carry debt in retirement as a strategy. They believe leveraging their assets and income increases their standard of living without incurring much risk. Others are less strategic about their debt. They don't pay down their debt before retirement, and they aren't careful about incurring debt in retirement.

It's important to realize that in retirement your finances are less flexible. You have little or no potential for earning more income. Negative financial surprises are likely to occur, especially high medical or long-term care costs. If you're already carrying a fair amount of debt when these expenses arise, you'll have few options for dealing with them. For most people, it's better to eliminate debt before retirement and try to avoid it in retirement, except to deal with emergencies. Details about planning your spending are in Chapter 2.

Spending Too Rapidly

Surveys of retirees and preretirees indicate that many believe they can safely spend 7 percent or more of their assets each year without the risk of running out of money. Financial planners and academics who have studied retirement spending believe the safe spending rate is much lower. This issue is so important we discuss in detail in Chapter 4.

Uncovered Major Medical Expenses

Medicare doesn't cover all your medical expenses, which is something many people don't realize as they enter retirement. Of course, you can't really control when you need medical care. That's why medical expenses and long-term care expenses are the wild cards of retirement planning. We discuss how to plan for these expenses in Chapter 6 and 7.

Helping Others

People want to help their children and grandchildren. Since the financial crisis of 2008 and even before, there's been a trend of *boomerang kids* in the United States. These are adult children fully or partially supported by their parents, either while living on their own or in the parents' homes.

Retirees need to know there's a line of support they can't cross without endangering their own financial security. Too many are in danger of overextending themselves to help their younger loved ones. That's understandable, but it's dangerous. You're likely to spend down your nest egg too fast, and that will leave both you and the younger generation without any financial support.

Help for younger generations must be affordable for you and shouldn't be open-ended or without expectations of results from the youngsters See Chapters 2 and 4 for discussions of how to plan spending and Chapter 11 for ways to help the younger generations.

Flying Solo

Married couples do better financially in retirement than singles. That's partly because divorce is expensive, requiring the same income to support two households. But it's also because too many retirement plans don't include the contingency that one spouse will pass away, costing the household Social Security and other income sources. A solid plan includes financial security for a surviving spouse. See Chapter 3 for some help on providing guaranteed income to the surviving spouse.

Fraud

Financial crooks generally target older Americans. Older Americans usually have enough money to entice the crooks, and they're more vulnerable than younger people. Studies show that people generally are more optimistic and trusting as they age, making them susceptible to fraudulent pitches. Others have reduced cognitive functions, so they don't make decisions as well as they used to. Realize you're more of a target for fraud and establish safeguards (see Chapter 13).

Second Homes

Classic retirement goals often include becoming a "snowbird" or having a vacation home. Too many people, however, don't understand the full financial burdens of these goals. A classic mistake is not to factor in the periodic repairs and maintenance required of the second home. These expenses mount as the home gets older and become significant in retirement when incomes are likely to be lower and finances are less flexible (see Chapter 14).

New Businesses

People with successful careers often consider starting businesses in retirement to stay busy. Before traveling this road, be aware of the high potential for failure and the loss of capital. A retirement business should use only capital that isn't needed to maintain the planned standard of living. Be sure to plan your spending carefully as discussed in Chapter 2 and establish a sustainable spending plan as discussed in Chapter 4.

The New Retirement and You

You can have the retirement you desire. You can have financial independence and security. But you have to plan. Key issues must be carefully analyzed before decisions are made. The earlier you start planning, the better. But it's never too late to plan to improve retirement.

You can opt for the traditional retirement of living off your investments and other sources of income you have while filling your time with leisure or fulfilling activities. Or you can opt for the many other possibilities—or a combination of them. Regardless of the retirement you choose, you won't be alone if you don't participate in the traditional retirement that became common after World War II.

Keep in mind that retirement is a relatively new development. As recently as the turn of the twentieth century, few Americans lived past age 50. Only the very wealthy actually retired. We all are learning new things about retirement every day. Your plan needs to include flexibility, because many things will change. All retirement plans are educated guesswork. Regular adjustments are required as we learn more and facts and circumstances change. Even after you are retired, the plan will have to be modified to keep up with changes, so don't view yourself as being locked in to an inflexible retirement plan.

Now let's get to work. We know that the rules of retirement have changed and will continue to do so. We know every facet of retirement has been affected by change in the last decade or so, and each facet probably will be affected by change again. Let's look in detail at the key parts of retirement finances and the decisions that should be made now in order to enhance the retirement years.

ABOUT THE AUTHOR

Robert C. Carlson is editor of the monthly newsletter *Retirement Watch*. He is also the managing member of Carlson Wealth Advisors, L.L.C. Mr. Carlson is chairman of the board of trustees of the Fairfax County Employees' Retirement System, which has over $3 billion in assets, and was a member of the board of trustees of the Virginia Retirement System from 2000 to 2005, which oversaw $42 billion in assets at the time.

Mr. Carlson was trained as an attorney and accountant, passing the CPA exam. He received his J.D. and an M.S. (Accounting) from the University of Virginia and received his B.S. (Financial Management) from Clemson University. He also is an instrument-rated private pilot. He is listed in several editions of *Who's Who in America* and *Who's Who in the World*.

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CHAPTER 1

The New Rules of Retirement

Keep my principal secure.
Pay me income.
Protect me from inflation.

These are the goals of more and more Americans age 40 and above. As Americans enter or approach their post-career years, their focus shifts from earning higher income and investment returns to preserving their hard-earned nest eggs. They want to receive steady cash flow from their nest eggs and control their expenses. They want to ensure they'll have enough income and assets to meet their lifetime goals.

Steady, secure income means financial independence. That's why interest in developing a continuing, stable stream of cash is booming.

Unfortunately, your job is becoming harder than ever. Your job is to establish and maintain financial security and independence in those post-career years. Not too many years ago, it was fairly easy to establish and maintain financial independence in retirement. Retirees had assistance and support from former employers and the government. Most of them had pensions. It also was fairly easy to convert a preretirement portfolio into a reliable stream of cash flow that helped replace your working years' income. Things are different now.

Much has changed and continues to change in the economy, the markets, government policies, and employer practices. The Federal Reserve has kept interest rates dirt low since 2008, and it is likely to be years before rates return to historic average levels. The government is cutting programs and increasing fees and taxes. Employers are slashing benefits. Wall Street and the markets aren't helping much. The rules and choices are becoming more complex. All the factors of retirement finance are changed or changing.

Tough, complicated decisions need to be made about IRAs, 401(k)s, medical insurance, investments, taxes, estate planning, and more. Many of the decisions are irreversible. Make a bad decision or two, and the rest of your retirement plan might not matter.

In 1989, only 30 percent of Americans ages 30 and older were on track to be financially unprepared for retirement, according to the Center for Retirement Research. In 2015, 52 percent of Americans over 30 were considered unlikely to be able to maintain their living standards in retirement. About two-thirds of those aged 45 to 60 said in 2015 they will retire later than they had planned, according to the Conference Board. In 2011, that number was only 42 percent. Government data show that after many decades of declining, the average retirement age has been increasing.

Even those who think they're prepared for retirement often aren't. Almost half of all Americans die with financial assets of less than $10,000, according to recent research by James Poterba, an MIT economist. Many Americans enter retirement with what seemed to be substantial and adequate financial assets, but because of mistakes and unforeseen events they spend faster than they anticipated or should have. They end up with few assets.

It doesn't have to be that way for you.

You can be financially secure during your post-career years, free of the worries that will plague many others in the coming years.

But you can't rely on what worked in the past. Following tired "rules of thumb" and traditional cookie-cutter approaches is the road to income insecurity. Don't travel that road. The markets and economy, tax law, estate planning, health insurance, Medicare, Social Security, long-term care, annuities, and all the other financial aspects of your post-career life are being transformed. You need to use strategies and tools that are different from those that worked for previous generations of retirees.

Six Threats to Lifetime Income Security

Most importantly, you need to know how to deal with today's six key threats to lifetime income security. Most of the threats aren't new, but they've been increasing, and so is the danger to your financial security.

Retirement Threat #1: The Foundations Are Crumbling

For decades, Social Security and Medicare provided the secure financial foundation of retirement. They still do. Today, however, those programs are in financial trouble, and they will have to change at some point.