16 Retirement Income Risks

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16 Hazards That Could Disrupt Your Retirement Income – And What to Do About Them

It turns out that planning your retirement income is a big exercise in "Risk Management." We all face lots of uncertainty in our retirement years, so any good retirement income plan needs to address many of the main retirement income risks head on. What follows are the main risks that any good retirement income plan should explicitly address…..***does yours?!***

INVESTMENT RISKS (3)

Risk 1: The Stock Market Could Crash ("Market Risk")

Stocks are great long-term generators of wealth. But they can crash at any time. If the crash comes at the wrong time – just as you enter retirement – it could permanently reduce your nest-egg's capacity to generate an acceptable standard of living.

Strategy: Cover your necessities, basic needs and short-term obligations with low-risk income sources like Social Security, Bond Ladders, Pensions & Annuities. Accept some market risk for non-discretionary spending. But even that is spread among thousands of investments all over the world using index mutual funds and ETFs.

Risk 2: Interest Rates Could Rise ("Interest Rate Risk")

If interest rates rise, bond values fall. It also becomes more expensive to borrow money. Conversely, If interest rates fall, bond values generally go up. But if a bond matures, you would probably have to accept a lower interest when you reinvest.

Strategy: Hold bonds to maturity in a "Bond Ladder," and use the proceeds to cover income needs as they come up.

Risk 3: An Extended Bear Market Could Strike at The Wrong Time (“Sequence of Returns Risk”)

Getting hit with a bear market early in retirement is much worse than getting hit with one late in retirement. The necessity of making regular withdrawals from your nest egg means you can’t wait for markets to recover. This means you must sell when stocks are low. That can permanently reduce your portfolios’ capacity for sustaining you in retirement.

Strategy. Diversification is the best measure against sequence of returns risk. Use a Bond Ladder and “buffer assets” – assets that are not directly tied to the stock market – to act as a strategic reserve. In the event of a market decline, consider tapping home equity, for example – or the cash value in a life insurance policy – while you wait for the stock market to recover. That way, you aren’t forced to sell stocks at a discount just to raise money to live on.

RISKS OF OUTLIVING YOUR RESOURCES (3)

Risk 4: You Could Live to be Very Old (“Longevity Risk”)

Americans are living much longer than we were even a single generation ago. A third of today's 65-year-olds can expect to live past age 90, and one in seven will make it to age 95.[i] Retirement portfolios have to stretch 25-30 years or longer. Without proper planning, living too long can be a real hardship. Outliving your income is a real-world nightmare for many senior citizens.

Strategy: Develop and maximize sources of income you can’t outlive. This includes deferring social security, maximizing your pension payments, and considering an annuity.

Risk 5: Your Purchasing Power Could Fall Significantly (“Inflation Risk”)

When you’re working, your job offers some built-in protection against inflation: Wages tend to increase at least as fast as inflation. Once you’re retired, however, inflation slowly eats away at your spending power like a cancer. At 3%, inflation will chew your spending power in half over 24 years.

Strategy: Stocks and real estate are great hedges against inflation, so make sure to own these asset classes. Deferring Social Security is a great inflation hedge as well.

Risk 6: You Might Spend From Your Portfolio Too Fast ("Excess Withdrawal Risk")

In most cases, for a 65-year old retired couple, an annual retirement withdrawal rate of about 4 percent is reasonable and sustainable – especially if there is a substantial pension and/or Social Security benefit that can never be outlived. However, once you start withdrawing more than that, your chances of outliving your retirement nest egg goes up rapidly.

Strategy: Use "Monte Carlo" analysis to understand how much you can afford to withdraw from your portfolio. And then adjust when appropriate.

RISKS ASSOCIATED WITH AGING (4)

Risk 7: You Could Face Unexpected & Significant Medical Bills ("Health Expense Risk")

Medicare doesn't cover everything. Even with Medicare Part A and B, you could face major costs for prescription drugs. If you have a prescription drug plan, your doctor may recommend a newer drug that may not be covered on your plan's formulary, or for an off-label use that your carrier doesn't cover. If you have private insurance, you could still have a prescription drug issue, or face significant cost-sharing bills, up to your out-of-pocket limit.

Strategy. Medicare supplement (Medigap) or Medicare Advantage (Part C) plans and prescription drug (Part D) coverage can help cover your risks if you're eligible for Medicare. But you need to make sure you meet the enrollment deadlines, or you could face significant penalties.

Risk 8: You Could Need Extended Long-Term Care ("Long Term Care Risk")

An estimated 70% of Americans will need long-term care at some point during their lifetime. Families may not be in a position to provide advanced level care – especially as your needs or those of your spouse become more intensive. Meanwhile, the average nursing home costs over $90,000 per year – higher here in New England, where many of our clients reside, according to the 2019 Genworth Cost of Care study. The average length of stay in a nursing home is 2.2 years for men, and 3.7 years for women – but you *might* need care a lot longer than that.

Strategy. There are several types of long-term care insurance available. A qualified long-term care insurance policy not only helps provide resources to fund the costs of long-term care, but can also help preserve the family home against seizure by state Medicaid asset recovery officials. It may be necessary to structure income using Medicaid-qualified annuities, or consult with an elder law attorney to best position family assets to minimize the costs of long-term care.

Risk 9: You May Suffer From Cognitive Decline ("Frailty Risk")

As we age, it is more and more likely that our mental and/or physical health will deteriorate. At some point this could mean we are no longer able to execute sound judgement in managing our financial affairs.

Strategy. Give control to someone your trust through a power of attorney. Place assets in a living trust, and remain the trustee until you decide to step down in favor of a prechosen successor. Simplify your finances, and use direct deposit and automatic withdrawals. Make sure all your estate planning documents are in good order.

Risk 10: You Could be the Victim of Elder Financial Abuse ("Elder Financial Abuse Risk") Elder financial abuse costs upwards of $2.6 billion every year. Sometimes, the abuser is the elder's own family member. In addition to the dollar value of the theft, fraud or abuse, the emotional cost in terms of broken trust and shattered relationships is immense.

Strategy. Stay organized, and ensure that powers of attorney documents, living wills, advanced care directives and other important documents are in place to protect the elders' interests. You can also help protect yourself by staying organized, opening and reading your own mail, and setting up direct deposit, so family members and fraudsters cannot intercept your checks without your knowledge.

PUBLIC POLICY RISKS (2)

Risk 11: Tax Rates Could Go Up ("Tax Rate Risk")

Tax increases could take a variety of forms: Congress could lower standard deductions, reduce tax credits and deductions or increase marginal tax rates. They could impose a new wealth tax or a tax on larger retirement accounts. They could impose a national sales tax, Value-Added Tax, or increase taxes on gasoline or water.

Strategy. Roth Conversions can be an excellent way to protect yourself from future tax rate hikes by locking in low rates now.

Risk 12: Congress Could Cut Social Security ("Social Security Risk")

Congress could cut Social Security in some way. This could take the form of a straight-ahead cut to benefits, an increase in the retirement age, increasing the tax on Social Security benefits, or means-testing.

Strategy. Make sure your retirement income plan is resilient enough to handle cuts to Social Security. Good financial planning software can run this sort of "resiliency" test.

FAMILY RISKS (2)

Risk 13: You Could Lose Your Spouse ("Loss of Spouse Risk")

Widowhood or widowerhood is a reality of life. Women born in the Baby Boom generation can frequently expect to be widowed for 15-20 years or more. Without proper planning, the loss of a spouse can be a financially devastating event.

Strategy. In addition to life insurance strategies, make sure to maximize your Social Security "survivor benefits."

Opt for joint-and-survivor beneficiary designations on pensions and annuities, so that any income continues to accrue to a surviving spouse. Review wills, trusts and other documents to ensure the surviving spouse's interests are protected.

Risk 14: You Might Need to Support Someone ("Unexpected Responsibility Risk")

You may end up with a boomerang child, or unexpected custody of a grandchild or other relative. 62 percent of those aged 50 and older are still providing financial support to a family member.

Strategy. Define what level of assistance is affordable and sustainable. In some cases, life insurance protection may be necessary for dependent grandchildren or even adult children.

EMPLOYMENT RISKS (2)

Risk 15: You Could Be Forced to Retire Early ("Forced Retirement Risk")

Studies show that roughly half of American workers are forced to retire involuntarily. Causes include layoffs, injury, illness or the need to take care of an ailing family member. Fewer than 10% of those forced out of the work force involuntarily say they were financially prepared at the time.

Strategy. While there is no foolproof way to eliminate the risk of involuntary retirement, diligent saving and investing and practicing good health habits throughout your career can significantly reduce the risk. Studies show that those who work with a financial advisor experience much better investment returns than those who do manage their investments themselves.

Risk 16: Your Employer Could Become Insolvent ("Employer Insolvency Risk")

As many former employees of Enron, Arthur Anderson, Bear Stearns or Lehman Brothers can tell you – companies can go bankrupt unexpectedly, laying off many or all their employees. Your 401(k) assets should be safe (except anything you have in company stock), but your

last paycheck, bonuses, and nonqualified executive compensation is at risk. And, of course, the loss of your primary income is significant by itself.

Strategy. Limit direct ownership of your employers' stock. Also, remember that many non- qualified executive compensation/salary deferral plans involve the risk of loss. If your company goes bankrupt, you're just one in a long line of creditors. This doesn't mean don't participate in these programs – they can be excellent! Just keep the risk in the back of your mind, and don't rely entirely on the fortunes of a single company that you may not even be able to control.

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