



Outliving The Money
Avoiding Unpleasant Surprises



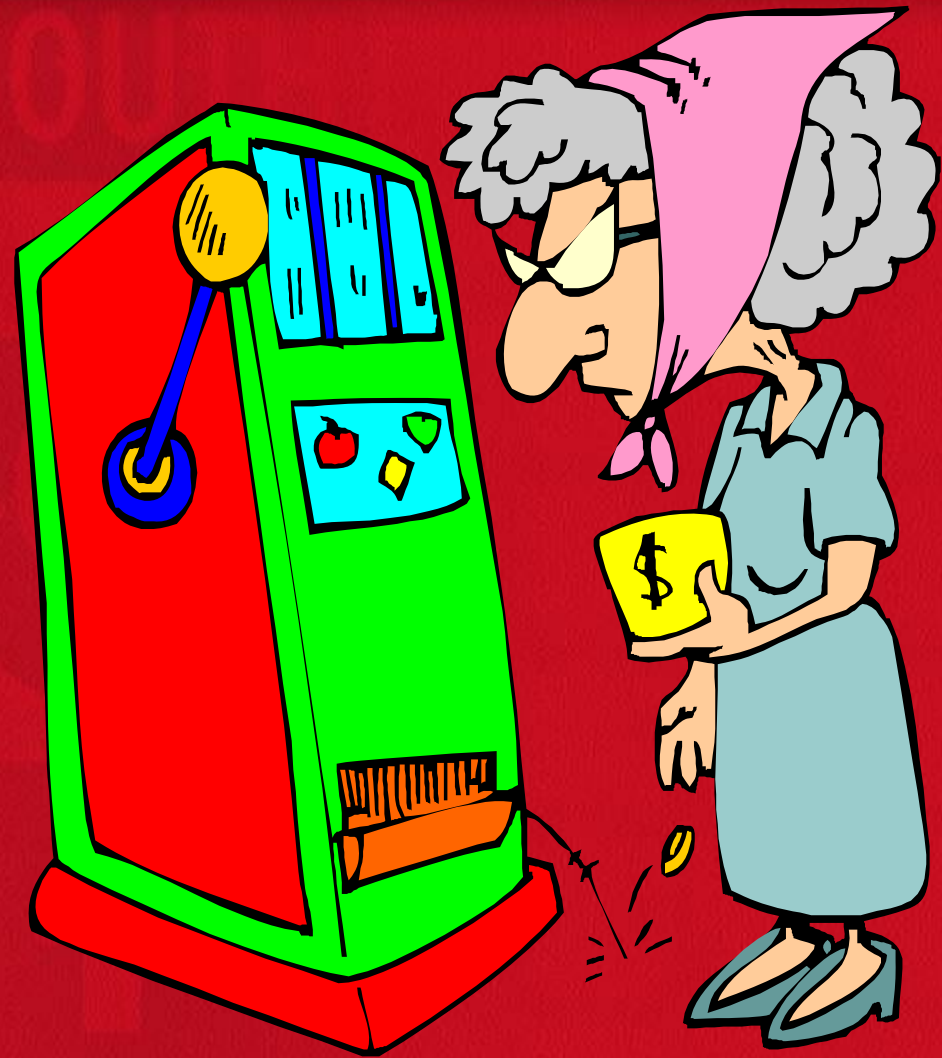
A Recent Article

- ▶ A woman's parents & grandparents all died in their mid-60s.
 - So she retires early.
 - She plans on dying by 65.
 - So she plans on using her money up by age 70.
- ▶ But...



She's still
heereee!

(And mad as
heck!)





Statistics Are Not Your Friend

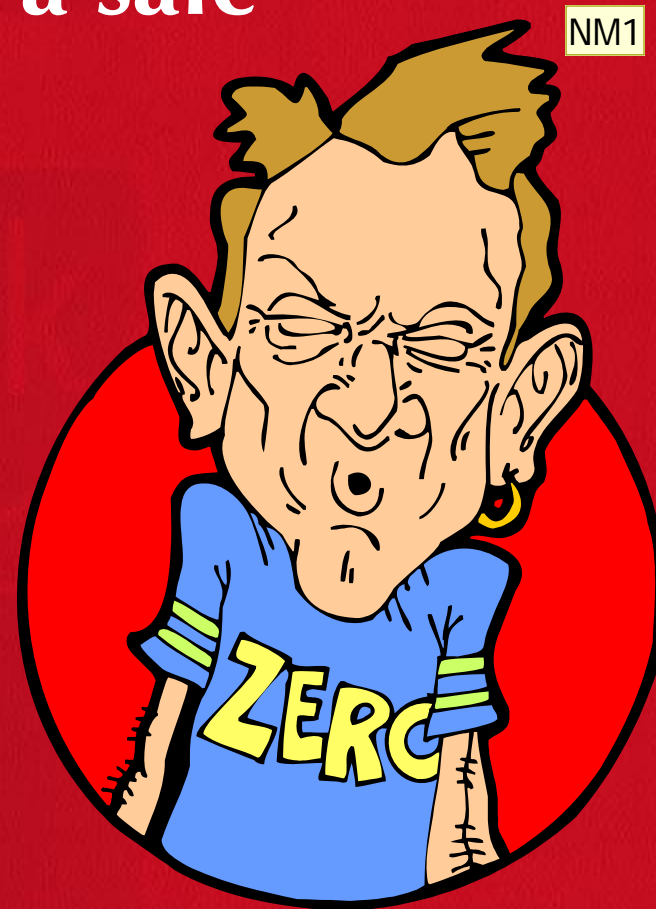
- ▶ Would you risk your investments on a 95% chance of winning in Vegas?
- ▶ People do that at retirement.
- ▶ Popular strategies and their problems.





Do Your Clients Think

5% of their assets is a safe withdrawal?



Slide 5

NM1

not sure what this is related to

Nancy Michael, 5/6/2010

SOUTH

Retirement

401k

DOGBERT IS A CREATIVITY
CONSULTANT

WE DON'T NEED ANY
OF YOUR "INTUITION"
MUNDO JUMBO. WE
NEED QUANTITATIVE
DATA!



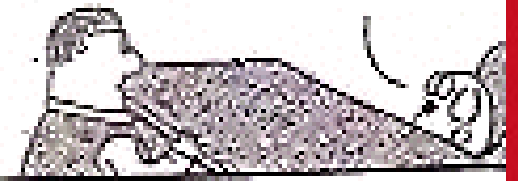
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THE ONLY WAY TO MAKE
DECISIONS IS TO PULL
NUMBERS OUT OF THE
AIR, CALL THEM
"ASSUMPTIONS," AND
CALCULATE THE NET
PRESENT VALUE.



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"OF COURSE, YOU HAVE TO
USE THE RIGHT DISCOUNT
RATE, OTHERWISE
IT'S MEANINGLESS.



GO
AWAY.



Valuing Future Liabilities

- ▶ **Business owes \$1 million in 25 years.**
 - **How & why value it?**
 - Long-term treasuries (risk-free rate)?
 - Yield curve (i.e. long-term AAA bonds)?
 - Estimated portfolio return?
 - **Does it change if riskier assets?**
 - **How does \$425 become \$55?**

Slide 7

NM2

Not sure if the 425 and 55 on last line are dollar amounts.

Nancy Michael, 5/7/2010



Valuing Future Liabilities

► How do you value it?

- Long-term treasuries (4.5%)? **\$332,000.**
- Yield curve (6.5%)? **\$207,000.**
- Estim. portfolio return (7.75%)?
\$155,000.



Valuing Future Liabilities

- ▶ How does \$425 billion become \$55 billion?
 - When the state uses pre-2008 estimated return to value benefits.





How does this relate to retirement?



Is Your Client Ready To Retire?

How to spend that accumulated pot of gold.



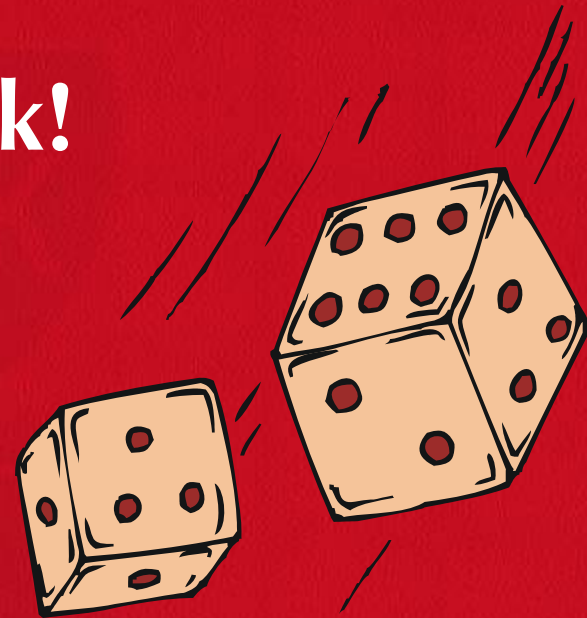


Pot of Gold

- ▶ **If your client's lifestyle—fixed income is under:**
 - **1-3% of available investments,**
 - **They should feel pretty comfortable.**



- ▶ **But how do you adjust a lifestyle based on the assets?**
- ▶ **Actuaries manage risk!**





Current Theories

- ▶ **Net worth of \$500,000–5M, exclud. primary residence.**
 - **If less, spend as little as possible.**
 - **Over that probably does not have to worry about expenses.**
- ▶ **How do you help clients plan ahead?**



Spending That Pot of Gold

▶ Retirement calculators?

- Most use a fixed rate of return.
- Guess life expectancy.
- Optimistic.
 - Mortality improvements project people over age 100.
 - Market losses.



Spending That Pot of Gold

- ▶ **Rule of thumb: 4-5% of assets per year.**
 - **Run out of money: 5% chance.**
 - **80% chance if market drops in first years.**
 - **Numbers ignore mortality improvements!**



Determine the Needs

- ▶ **Basic needs:**
 - **Items that can't be reduced easily .**
 - House payments—how long?
- ▶ **Current (retired) lifestyle needs:**
 - **Travel.**
 - **Spending patterns, etc.**
 - Likely to reduce at some estimated time.



Available Funds

- ▶ **Look at all types of income:**
 - **Social Security.**
 - **Pensions (annuity type).**
 - **Other annuity streams (rental props).**
 - **401 (k), IRAs etc.**
 - **Roth.**
 - **Other investments.**



Estate-Tax Issues?

- ▶ **401 (k) and IRA funds are nasty drains if estate taxes.**
 - **If estate tax is an issue, have them spent and income taxes paid before death 😊**

NM3

Slide 19

NM3

Not sure what green bullet says, but grammatically it doesn't make sense.

Nancy Michael, 5/7/2010



Liquidation Schemes

- ▶ **Planning on 4-5% or more of your assets to live on? Time to look at:**
 - **Medical coverage.**
 - **Long-term care coverage.**
 - **Longevity insurance.**
 - **Formalizing investment policy strategy.**
 - **Avoid problems with market downturns.**



Medical & Long-Term Care

- ▶ **Medicare & face the cost?**
- ▶ **Long-term care expensive?**
 - **Partially subsidized coverage.**
 - **Cover a fixed duration.**
 - **Consider an add-on to an annuity.**



Avoid Down Markets

- ▶ **Keep two years of income liquid for market downturn.**
 - **Historically, market bounces back in two years.**
 - **Avoids need to liquidate investments when down.**



Longevity Insurance

- ▶ **“Immediate annuities”=bad words.**
 - **Love fixed pension payments.**
 - **Don’t want to give insurers big checks.**
- ▶ **Prudent to cover basic expenses with annuities.**
- ▶ **The market place is changing rapidly.**



Longevity Insurance: Features

- ▶ **Unspent value of funds is available for Long-Term Care.**



Longevity Insurance: Features

- **Guaranteed benefits from 65, not annuitized until 85.**
 - **Choice of investments.**
 - **Payments subtracted.**
 - **If fund earns more than payouts, monthly benefit increases.**
 - **Can cash out any time up to annuitization.**
 - **Annuitizes at roughly 7% of starting value.**



Longevity Insurance

- ▶ **So what changed?**
- ▶ **Old policies:**
 - **Big check up front.**
 - **Insurer keeps cash if you die early.**
 - **Could be later of death or 10 years.**
 - **Generally no upside potential.**



Longevity Insurance

- ▶ **New policies:**
 - **Participate in market in early years.**
 - **Liquid to age 85.**
 - **Downside guaranteed income to 85.**
 - **Ongoing guarantee for life at 85 .**
- ▶ **Solves 5% chance of running out of money.**



Helping Clients Plan

- ▶ **People are hesitant to plan.**
- ▶ **Reality of too little cash.**



Helping Clients Plan

- ▶ **Help them look ahead.**
 - **Need to know if taking risk.**
 - **Help them understand the uncertainties.**
 - **Help them understand options.**

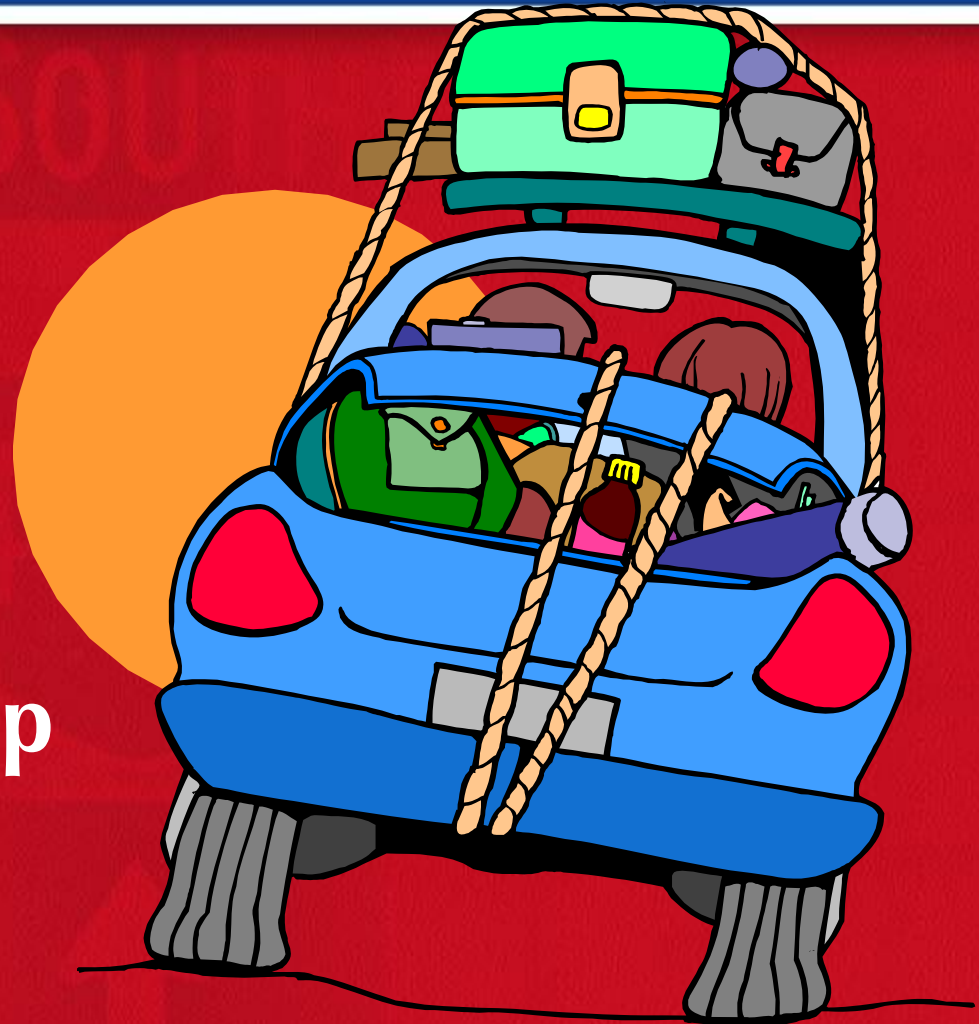
SOUTH

Retirement

401k

Roth Conversions

A Related Side Trip





Convert to Roth Now?

- ▶ **No comp limit.**
- ▶ **Pay taxes now or over two years.**
- ▶ **Income more than five years away is tax free!**
- ▶ **End up with more money?**



Converting: Taxes Now and Later

► Pay taxes now:

- Convert \$100,000 now.
 - Pay 40% taxes from those funds.
- Grow \$60,000 tax free until quadrupled.
 - \$240,000 available.
 - No taxes.



The Roth Conversion

► Pay taxes later.

- The \$100,000 is now \$400,000.
 - If tax rate is still 40%, then \$240,000 after taxes.
 - If tax rate is 30% after retirement, then \$280,000.
 - If tax rate is 45%, then \$220,000.



The Roth Conversion

- ▶ **If converted money pays taxes:**
 - **Win/lose on future tax brackets.**
- ▶ **Medicare premiums income adjusted.**
 - **Two-year offset means premiums significantly increase (\$6,000 per year per couple).**



The Roth Conversion

- ▶ **Pay the taxes with other funds?**
 - Roth account has \$400,000 tax free.
 - The traditional account still has \$240,000 (same tax rate).
 - But you used \$40,000 of outside funds



The Roth Conversion

- You need to add that back to the traditional IRA.
 - Grown to \$93,000 (after-tax accumulation.)
 - Traditional would be \$240,000 + \$93,000.
- Net result: \$67,000 gain with the Roth.



The Roth Conversion

- ▶ **Why consider conversion?**
- ▶ **Paying taxes now reduces estate and no double taxation.**
- ▶ **No minimum distributions: Creates income stream.**
- ▶ **“Effectively” contributes the taxes to the plan.**





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