

Retirement Readiness Report

Helping older employees get ready to retire successfully

A free report for employers, unions, and pension funds, produced by RetirementWORKS®, Inc.

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Welcome to the forty-third issue of the *Retirement Readiness Report*, offered as a free resource, to help you think about how your organization supports the transition into retirement.

We encourage you to contact us at any time if you have ideas, criticisms, or other comments about this publication, or wish to update your email address (or be added to or removed from the list).

If you missed issues #1 thru #42:

They're available at:

<http://www.retirementworks2.com/support.asp?id=newsletter>

Next:

Employees in the middle

Financial advice at retirement:

The good, the bad, and the ugly

Employers, plan sponsors, and unions generally don't give out individualized financial advice at retirement. They don't want the liability and perhaps, to their credit, realize that for the most part they aren't qualified to do it.

But they often do provide access to financial advice from third parties. Upper management may receive the services of personal financial advisors, paid for by the employer. Participants in 401(k) and other defined contribution plans usually have access to websites sponsored by a financial institution that offer some kind of retirement analysis. Employers with other kinds of retiree benefits (defined benefit plans, or post-retirement medical benefits) normally provide detailed information about those benefits and any options associated with them, and while they typically stop short of giving individual advice, they often offer generic guidance, which retiring employees are then responsible for applying to their own situations.

In theory, all of this is to the good. In practice? Not so much.

The quality of the advice that retiring employees get is suspect in several ways, which we explain below. The true costs of inadequate advice are important to understand first, however. Not only does it directly lead retirees to make defective decisions that are likely to harm them in the long run (if not sooner), but it also discourages them from looking elsewhere for *good* advice. After all, if you're already getting guidance that looks and sounds plausible, maybe even expert, why go to the trouble . . . and probably the expense . . . of finding more advice somewhere else?

To emphasize a point we have alluded to in earlier editions of the *Retirement Readiness Report*, reliance on poor advice is particularly

damaging to retirees, because they probably won't realize until pretty far down the road that things are not working out. And by the time they do realize it, it will be far too late to repair the problem. Young people, and wealthy people, usually have options for recovery from errors. The typical elderly person does not. Bad advice will boomerang on them when they are least able to do anything about it.

So with all that in mind, what is it about retirement advice that people get now that makes it inadequate, even potentially very damaging?

There are four main problems: such advice is usually superficial, is typically focused on the wrong things, almost always is too limited in scope, and is rarely integrated in a way that would avoid even pretty obvious errors.

Let's take a look at what each of these means.

Superficial advice results from processes that are quick and easy (and usually cheap), but not adequate to the task because *reality* is not quick and easy (or

usually cheap). Whether you are working with website software or a live human being, you cannot expect to answer just five or ten or even twenty questions and then receive reliable advice on complicated financial questions.

When you can afford to retire, how much you should be budgeting for expenses in retirement,

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how you should handle your retirement savings, and whether you face future risks you should plan for . these are typical retirement concerns, and they are deeply complicated.

Any planning approach that uses superficial analysis to advise retiring or retired employees might just as well substitute a much simpler question:

Heads or tails?

Focus on the wrong questions is just as common and important

a problem. Even highly professional financial consultants (as well as the super-sophisticated software programs that many pension funds make available to plan participants) mostly deal with this one question: How much can someone afford to withdraw annually from their retirement savings?

What's wrong with that question? To start with, most retirees don't have enough retirement savings for such funds to be a really important source of retirement income. In that case, they often don't want to spend any of it at all, saving it for a rainy day . or for some particular future need, like assisted living or long-term care somewhere down the road.

Furthermore, those who do have a substantial amount of savings and plan to use it to supplement their Social Security or other income, still shouldn't be asking how much they can take out and spend each year. Most people who retire will live for at least another 20 more years, many of them for 30 years, and some for 40 years or more. What are the odds that over such a timespan a

level (or smoothly inflating) savings withdrawal will actually meet their needs? Pretty close to zero. Things happen . both predictable things, and unpredictable things. We don't know what people will need in the future, but we can be almost certain that it won't be a smooth outflow from their savings. Advice that assumes that this is what they need is simply asking the wrong question . and providing a dangerous answer. Dangerous, obviously, if the withdrawal amount is too high, because then the retiree will run out of money some day. But almost equally disadvantageous if the withdrawal amount is too low, because then, during the years when the retiree is healthy and active enough to be enjoying life, s/he is scrimping unnecessarily.

Limited scope is also a common and important a problem. The **How much can someone afford to withdraw annually from their retirement savings?** question is a good example of that. Even if it were a sensible question, it's only one question. It presumes that everything else is immaterial. Yet most households have more like

a dozen major questions that they should be considering as they enter retirement.

These include common questions and, for many families, additional atypical questions.

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Common questions include ones like when to retire, whether expenses need to be trimmed back in retirement (or conversely, whether this is a time to splurge), whether to move to a different location or into a smaller house or either sell or buy a second home, when to start taking Social Security, what option to take from a defined benefit plan and/or what to do with funds sitting in a defined contribution plan, whether to get additional medical insurance as a supplement to Medicare, whether and how to provide for long-term care if the need should arise. And so on.

The more unusual questions may apply to certain kind of families, for instance: those that have a special needs child who must be provided for long after the parents are gone, those with parents or other elders who need care, those where two spouses are of very different ages or expect to retire at very different times, those where there is a family business that might or might not continue into retirement, those that have complicated medical issues that introduce uncertainty into all kinds of life and financial decisions, etc.

At least professional financial advisors usually address more than one question, for those who can afford such advice. But even so, most of them have their own specialties and are really focused on investment management, or maybe insurance and annuities. Few can competently address the full range of concerns that the typical retiree has.

This is all the more true, of course, for employee benefits people, who are generally not authorized to discuss anything beyond the specific benefit plans

the employer offers. This is good as far as it goes, of course, but it is not nearly enough. Furthermore, it also suffers from the fourth problem:

Integration of advice simply means that when advice is given on one topic, it should take account of other issues and decisions that are being made, or need to be made (either at the same time or down the road).

To take an obvious example: a couple is trying to decide whether they can afford to keep living in their current home while one of them is also wrestling with the question of whether to accept an early retirement offer . and if so, whether to look for another job. Clearly, these decisions need to be made as a group, not in isolation from one another.

This is true of most decisions that occur in retirement, including those that present themselves as primarily non-financial in nature. Most life decisions have financial implications . often very important ones . and most financial decisions have an impact on other financial decisions.

To take a more obscure example: a retiring employee is eligible for a lump sum distribution from a defined benefit plan, and is thinking of rolling it over into an IRA and converting it to a Roth IRA to prevent any further taxation. This will generate a tax obligation now, though. Whether it makes sense depends on what the current tax rate is, and what will be done with the proceeds. But another part of the decision depends on what other financial moves are being made. Suppose the retiree is also thinking of selling a nice middle class house that is fully paid for, and moving into an apartment. If that were to happen, there would be a big influx of cash, which would probably be invested and generate taxable income, putting the retiree into a higher tax bracket later. In that case, the Roth plan would probably be a bad one. But you don't know that unless you are looking at the whole picture in an integrated way.

It is possible to get an integrated analysis of retirement issues, but there are not many places to get it, especially inexpensively. Presumably due more to of lack of

awareness than anything else, good approaches to retiree advice are edged out by the prevalence of bad ones.

An Aon Hewitt study earlier this year said that most employers already offer, or will soon offer, solutions that help employees determine how much they can spend in retirement. Too bad these employers don't realize that they are actually doing damage to their retirees this way.

About RetirementWORKS[®], Inc.

We are the consumer subsidiary of Still River Retirement Planning Software, Inc., of Harvard, Mass., which has specialized in retirement plans and retirement planning since 1994.

Our philosophy is that retirement needs to be viewed from the retiree's point of view, in all of its complexity. So we offer the most powerful and useful financial software available anywhere for retirees and near-retirees, and advice concerning non-financial aspects of retirement. But we do not sell any financial products or services other than software, and have no financial stake in any advice that is offered.

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