

Get Ready To Get Ready For Retirement

Facing the financial challenges of retirement can pay off in emotional and physical security for the rest of our lives

By Richard M. Weber

Retirement Readiness and the possibilities of re-inventing ourselves can be enhanced by a certain amount of practical prior planning.

The medical care "industry" consumes almost 20% of GDP and Americans will spend a projected \$2 trillion on health care in 2008—an expenditure that has been increasing at a substantially higher rate than core inflation. Since we Baby Boomers are going to consume health care services at an unprecedented rate over the next 40 years, we need to reconcile health care needs with health care resources.[1] The best way to make the most effective long-range decisions is to understand the complex, shifting benefits landscape.

Shore Up Your Health Insurance

Virtually all of us are covered by group health and life insurance; some have dental care, and others group long term care insurance. We probably take those plans for granted, assuming that our premium share is nominal compared to the actual cost. But as we Baby Boomers begin to appreciate that "retirement" (we prefer to call it "thriving beyond midlife") doesn't necessarily begin at the arbitrary age of 65, we have to rethink those benefits. Many of us may chose to work part time as a way to reinvigorate the last third of our life. If we work fewer hours than those needed to qualify for health plan eligibility, health and dental benefits should be available under COBRA—but neither group life nor group LTC are mandated under COBRA. In any case, eligible benefits—at a personal premium of 102% of the plan's actual cost—can be continued for only 18 months.

If you end up with a gap after COBRA and before Medicare eligibility on your 65th birthday (Medicare doesn't believe in a flexible retirement age), you still have options. Working spouses can provide dependent coverage under his or her plan at the next open enrollment period. Otherwise, determine what your state mandates in terms of available health insurance without reference to pre-existing conditions. For example, Massachusetts has some of the best options in that regard for individuals; California allows businesses with just two employees to obtain such coverage. (Spouses make a great addition to the solo practitioner team).

Depending on where you live, a benefit-rich health plan can cost more than \$2,000 a month for a couple in their early 60s. Even high deductible plans combined with a Healthcare Savings Account (an "IRA" for healthcare expenses) can still run close to \$20,000 a year. While dental coverage will likely be available with no eligibility requirements, look closely at the benefit caps and deductibles compared to the premiums you'll pay. The first year or two of coverage will arbitrarily limit "major"

expenses to avoid anti-selection. Even when such limits are lifted, dental insurance is often not economical when premiums are compared to benefit maximums. Remember, though, that our bodies and our teeth need more attention as we get older: bone loss rates accelerate; periodontal disease is more common and expensive. If you choose not to pay dental plan premiums, consider setting aside the amount of premium you're *not* paying as a reserve for those expenses.

Don't Enroll In Social Security Prematurely

According to the Social Security Administration, well over 50% of those eligible at age 62 have elected early benefits. Yet in most cases a decision to elect at age 62 rather than 66 will forever lock in a 25% reduction in monthly income. (If you were born from January 1943 through December 1954, your normal retirement age for full Social Security is 66; those born in 1960 and later will wait until age 67 for normal retirement benefits, with fractional years interpolated between 1954 and 1960). Deferral to age 70, on the other hand, can add 32% to the normal retirement benefit. That's an almost 60% difference in monthly income benefits for those who believe they will live well past age 85.

There can be good reasons to sign up for early benefits, but don't do it just because you're worried about the viability of the program. Although it is often mischaracterized as a financial disaster ready to bankrupt the country, Social Security is projected to be self-supporting until 2040—when early Boomers are turning 94.

Also, while the last major change in benefit structure and funding occurred 25 years ago, given the politically incendiary nature of making *any* changes, it is reasonable to assume that future changes will be initiated progressively. In other words, the cost of early election merely to "protect" benefits is most likely a higher price to pay than necessary.

Therefore, don't elect early benefits simply because you can. While there are exceptions to every rule—and the rules are incredibly complex—most financial advisors recommend that if you expect to earn more than \$36,000 a year between 62 and normal retirement age (negating any benefit to which you would otherwise have been eligible), primary wage earners should consider deferring their benefit election at least until age 66/67. Depending on financial need and a sense of your own life expectancy, some people will defer to age 70 (the latest age for which delaying the start of benefits provides a progressive increase in the benefit itself).

Couples have a trickier task to optimize benefits. A recent paper by Alicia Munnell and Mauricio Soto of Boston College's Center for Retirement Research suggested "...the optimal strategy for most married couples where the husband is the bigger breadwinner is for wives to claim early and husbands to delay claiming. The best outcomes for the couple were found in most cases when men delayed claiming until age 69." Since individual situations may vary greatly, explore specific alternatives directly with the Social Security Administration, which has offices in all major cities.

Finally, don't assume that if you receive a monthly Social Security benefit you will automatically become eligible for Medicare. Medicare is not available until the day of

your 65th birthday unless you are permanently disabled or have permanent kidney failure and have qualified for disability benefits under the disability portion of the OASDI—Old Age, Survivors and Disability Insurance Program—the formal name for Social Security and all of its benefit programs. If you defer Social Security election, however, you're still eligible for Medicare as of your 65th birthday.

Master The Intricacies Of Medicare

While many of the details of Medicare benefits are beyond the scope of this article, you need to understand the basic Medicare structure.

Medicare Part "A" helps to pay for hospital care and skilled nursing, some home health care, and hospice care. This is provided as part of the basic Medicare program.

Part "B" of Medicare is theoretically voluntary, but the vast majority of those covered by Medicare elect it. It covers physician services, hospital outpatient care, durable medical equipment and other services including some home health care. You pay a monthly premium for Part B—in 2008, the premium is \$96.40 per month. Part "B" will likely become a much more significant expense than it has in the past.

Part D, begun in 2006, provides prescription drug benefits to participants for approximately \$25 a month (the cost in 2008) with an annual deductible of \$250. Once the deductible is met, Medicare will pay for 75% of covered drug costs up to \$2,250. Then Medicare's co-payment stops completely, leaving seniors responsible for the next \$2,850 in covered drug costs. If a total of \$5,100 in covered drug spending is reached in a calendar year, catastrophic coverage begins, and Medicare kicks back in with a 95% contribution for the rest of the year. To reach the \$5,100 threshold, a senior will have spent \$3,600 in out-of-pocket costs for covered drugs on top of the anticipated \$300 annual premiums.

Because Medicare was designed as a basic program and cannot cover all the medical expenses you might encounter, private insurers offer a number of standardized "Medigap" policies as well as newer Medicare "Advantage" plans. These plans pick up many of the co-payment "holes" left by Medicare's payment formulas; Medigap policies may also cover some of your deductibles. Some Medigap policies pay for services not covered by Medicare, such as out-patient prescriptions and preventive screening. Once you sign up for Medicare, you will have a 6-month window in which to sign up for a private Medigap policy without regard to pre-existing conditions. Since multiple Medigap policies will not provide additional coverage, don't waste your money on more than one.

Incidentally, and contrary to popular opinion, Medicare offers certain limited benefits for skilled nursing facilities, which are not the same as nursing homes. If you are concerned about paying for services when you're unable to conduct several of the "activities of daily living" such as dressing, bathing, and toileting - consider long term care insurance.

Get Ready To Get Ready

Perhaps the most critical aspect of getting ready for thriving beyond midlife is to have a well-considered budget and resources that can reasonably provide you with a lifestyle

to which you'd like to become accustomed. Balancing the financial debits and credits over the next 30-40 years will probably become a primary activity, if not obsession.

For Boomers, "outliving my money" is their number one fear. To determine if your money will outlast you, take your current gross income and subtract any known and certain sources of income such as Social Security benefits, pensions, deferred compensation, and lifetime annuity payments. The net result should be multiplied by 25. That's the total capital needed to fulfill your income needs with a reasonable degree of certainty that you won't dissipate principal.

For example: let's suppose you currently enjoy a total family income of \$200,000. Using the Social Security Administration's hypothetical benefit calculator, you learn to expect \$36,000 a year in combined benefits for you and your spouse, as well as a \$24,000 a year defined benefit pension from the years you worked in the District Attorney's office. Multiplying the difference by 25 indicates it will take \$3,500,000 of invested capital to meet your total income objectives. While this approach (an implicit average 4% return) is somewhat conservative by historical standards, the volatility of equity markets in the last 8 years combined with historically low interest rates necessitates that you have more capital to provide income with some protection against inflation, as well as preserving that capital.

Underlying this simple approach is the assumption that you will need all your current income well into "retirement" even though a number of retirement guides suggest you should be able to "get by" with as little as 70% of pre-retirement consumption. Yet it's not uncommon—at least at the beginning of retirement—to spend *more*, not less on travel, health care, new hobbies and projects, as well as contributions to grandchildren's activities. In addition, Fidelity Investments estimates that a 65-year old couple retiring this year should set aside at least \$225,000 of their capital for health care expenses not covered by Medicare. It's also practical to consider that income taxes will inexorably rise above the historically low tax rates we enjoy today as we work our way out of extraordinary federal budget deficits.

Are you ready to get ready? It's a formidable challenge, but one that pays off in emotional and physical security for what could be the best years of our lives. If you are not already working with a financial planner, doing so could be the best investment you make in your financial well being.