Retirement Planning Tips for Baby Boomers

2020 edition (4th)

Preface

If we had generous pensions, retirement planning would be a lot easier.

Introduction

I have worked in investments and finance my entire career having earned a CFA in 1983. I have worked for an endowment fund (University of Texas); multiple insurance companies (American National Insurance Company-Galveston, TX; Union Central and Ameritas-Cincinnati, OH) as well as managed three different equity income mutual funds. I worked for a private money manager in Oklahoma-TJIM Investments. My last stint was with Calvert Investments a socially responsible firm that was sold to another firm.

After Calvert my current career is retirement planning. Five years ago at the age of 55 - I earned my RICP® (Retirement Income Certified Professional) designation. Whereas the CFA was intended for active equity outperformance, the RICP® is geared to understanding how investments tie in with the complexities and uncertainties of retirement planning.

I am utilizing my 40 years in the investment field and combining it with relevant RICP® research and am actively planning my retirement. I have been researching retirement as a practitioner as well as a pre-retiree. I have begun my Roth IRA conversions, purchased long-term-care insurance, purchased a longevity annuity and a period certain annuity for myself and plan to delay filing for Social Security until age 70. Having a CFA/RICP® and the time and ability to understand the choices we have and implementing them for my retirement should be helpful for other Baby Boomers like myself.

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CEO Next Quarter Century, LLC. "Planning for the next quarter century, NOT the next quarter"

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Chapter 1

Retirement Goals

What if I were to tell you that—

You can maximize your spending in retirement even with a volatile stock market and low interest rates, have guaranteed income, defend against higher taxes, not be a burden to your children, leave a legacy and not worry but enjoy retirement—Is that something you might be interested in?*

*Martin Landau-Entourage

Chapter 2

How to Maximize Spending in Retirement

To maximize spending, should you have 100% invested in equities since they have historically provided the highest total returns? Probably not. As equity returns are not guaranteed, owning exclusively equities can be risky if the market drops. (This is labeled "sequence of returns" risk which is especially harmful early in retirement). Income from an equity portfolio may be insufficient to pay for essential living expenses which means that stocks may have to be liquidated in a bear market which could shrink the portfolio and force spending cutbacks.

The traditional way to balance this equity risk was to combine equities with fixed income by constructing a portfolio 60% equities and 40% fixed income, with bonds laddered by maturity. In 1994 Bill Bengen -a financial planner- calculated what withdrawal rate would allow a financial portfolio to survive 30 years. He took 30-year spans starting in 1926 to 1994 and demonstrated that a portfolio constructed of the S&P 500 (50%) and government bonds (50%) could distribute a 4% payout (growing annually with inflation) and not run out of money. This was a groundbreaking study and is still referenced today. However, as interest rates are very low and equities are not inexpensive and 30 years might be too short a time horizon, maybe 4% is too generous a payout. So perhaps this 4% withdrawal rate needs to be reduced.

There are many ways to combine fixed income and equities to maximize spending. A slightly different version of a 50/50 portfolio is to have a short- term "bucket" of liquid assets to pay for immediate expenses. A long- term "bucket" of equities to provide growth and inflation protection. The middle or intermediate-term "bucket" combines fixed income and conservative dividend paying equities to refill the short-term bucket. Having guaranteed income-Social Security, pensions and annuities- helps reduce the demand on this middle bucket.

Summary

Even though 100% equities might provide the highest expected rate of return it should be combined with guaranteed/fixed income to provide current income for essential expenses. A 60/40 laddered bond portfolio doesn’t provide enough income due to low interest rates so adding guaranteed income from pensions, annuities and Social Security to supplement the intermediate-term “bucket” is essential to maximize sustainable income.

Chapter 3

Guaranteed Lifetime Income

Pensions, Annuities, and Social Security

Since you have earned a pension at work (or not) deciding to take it is straight-forward. I will only explore Social Security and annuities in future chapters. Pensions -which are disappearing-are plans that pay the worker and/or spouse for life. If everyone had large pensions, retirement planning would be much easier. Pensions are usually guaranteed by your former employer.

Annuities can be considered "personal pensions" since they also provide lifetime income. There are many forms of annuities, primarily fixed and variable, but a common feature is to provide income for life. Unlike pensions, annuities are guaranteed by insurance companies. Annuities provide income from three sources: interest income, return of principal, and mortality credits. The returns may be greater than bonds since the returns are increased by other participants dying (mortality credits) and therefore "contributing" their principal to the survivors and after death there is no remaining principal for survivors.

The simplest annuity is a "SPIA" -single premium immediate annuity. You give the insurance company a lump sum and they pay you back your principal and income for as long as you live. These are best when bought at age 70 or older as they are based on life expectancy and pay out higher rates –but for a shorter life. They help to maximize spending as you will not run out of this income as you spend it down.

Social Security is also tied to a lifetime. It is income for a couple or an individual for as long as one lives, with inflation protection backed by the government's taxing authority.

Summary

Guaranteed income whether by a pension, an annuity or Social Security is lifetime income backed by your employer, an insurance company or the U.S government-respectively and can be used to lessen the income demand on the intermediate-term bucket.

Chapter 4

Guaranteed Lifetime Income-Longevity Annuity-**QLAC**

Think of an annuity as a "personal pension" from an insurance company to maximize spending. I will explore a specific longevity annuity called a **QLAC**.

QLAC definition

A **QLAC** stands for **Q**ualified **L**ongevity **A**nnuity **C**ontract. It is a class of deferred income annuities where the client puts away money that in the future will be "annuitized" and starts to return income like a pension that "dies" when the owner dies. It is the ultimate in putting money away and "not ever running out of money". Think of it like a retirement "Dead Pool." It maximizes income by adding large "mortality credits" (principal contributed by others who have pre-deceased you.)

How to qualify

A **QLAC** must come from a "qualified" account like an IRA or 401k.

Tax advantages

Required Minimum Distribution (RMD) advantage

Deferred income annuities have been available for years but legislation passed in 2014 incentivized the **QLAC**. Before, an RMD-Required Minimum Distribution-

(at age 72) would be necessary on the annuity even though no income was being received. The **QLAC** is NOT included in RMD calculations. If an IRA contained $540,000 but $135,000 of that was invested in a **QLAC,** only $405,000 of the remaining IRA would be included for RMD calculations. The **QLAC** may be purchased without incurring a tax for conversion into a **QLAC**. When receiving income from the **QLAC** the income is taxed as ordinary income.

QLAC Amounts-2020

Maximum amount	Maximum % of qualified account primarily (IRA)
$135000/person	25%

For $540,000 -or more- IRA the maximum amount is $135,000.

Age limits

The longest the **QLAC** can be delayed is 40 years. The latest someone can begin a **QLAC** is age 85. Someone could buy a **QLAC** at age 45 that begins paying at age 85. Someone might buy a **QLAC** near age 60 and have it pay at age 80-85. The reason to purchase a **QLAC** that starts at such a late age is to benefit from “mortality credits”- not only do you receive interest payments and the return of capital BUT you also receive principal payments from those who purchased a **QLAC** but have passed away. I consider these “mortality credits” like lottery winnings for surviving. The returns are high because you have survived. (If you did not survive, you contributed to someone else’s “lottery” winnings.)

Examples

Can purchase a **QLAC** of $50,000 starting at age 80 and a **QLAC** of $85,000 starting at age 85.

Can buy in increments of as little as $10,000 currently.

A reason given for choosing age 80 versus age 85 is that the internal rate of return at age 85 is higher but only if you live into your 90's.

QLAC's v DIA's comparison

Treasury change in 2014

Deferred Income Annuities prior to 2014	**QLAC**'s in 2014 (A type of DIA)
Assessed RMD on income not received	No RMD's until receive income from **QLAC**

Details

Negatives

If you die prematurely, then others receive the principal you would have received. **QLAC**'s are best if you live a long life.

You must be able not to need the income from the investment- for decades possibly.

Due to low long-term interest rates, the returns do not benefit as much as they have in the past from compounding interest. But by benefiting from "mortality credits" you receive the greatest guaranteed income by receiving the principal only "if" you survive.

If inflation is rampant the low fixed income returns will lose purchasing power.

Positives

QLAC's are insurance for living too long!

Can spend the rest of your investment portfolio knowing that the **QLAC** will be there even if other financial assets are depleted.

If interest rates stay low then at least you would have earned a return from mortality credits.

The guaranteed income received in old age will be easy to understand which should be beneficial as financial mental skills could be waning.

If assets are large, then the **QLAC** can be thought of as a fixed income holding like a zero-coupon bond that matures and has a high payout.

By avoiding RMD payments, can grow the income tax-deferred longer.

The **QLAC** start date may be pulled forward once-in certain circumstances- if needed or pushed back if not needed.

How to choose the insurance company? COMDEX

What is COMDEX?

COMDEX is the financial rating system of the insurance industry. A COMDEX score is a ranking from 1-100 that compiles the various ratings from the ratings agencies. It is a composite from the major ratings agencies including: A.M. Best, Standard and Poor's, Moody's, and Fitch. Choose an insurance company with the highest rating-all else being equal. When investing for decades the claims-paying ability of the insurance company should be paramount.

(Even though I worked for multiple insurance companies and managed multiple mutual funds I had never heard of COMDEX until I worked for a highly rated insurance company. The insurance companies with low COMDEX scores refer to other ratings while insurance companies that are highly rated point out their high COMDEX scores).

Planning Point

If doing Roth conversions but would like a **QLAC**, make sure to fund the **QLAC** when the IRA balance is large enough to purchase the **QLAC** in large enough size. If a client has reduced the IRA via Roth conversion, they will only be able to calculate 25% of a reduced IRA balance. Otherwise one would wait till turning 72 and then purchase a **QLAC** right before RMD's begin.

The **QLAC** can be a good supplement to Social Security and long-term care insurance. You can layer a smaller LTC insurance policy with delayed Social Security and a **QLAC**. Choosing a start date of 80 years of age allows you to delay five more years or pull forward earlier if necessary.

(After having purchased **QLAC**’s for ages 76, 80 and 85 and a hybrid long-term-care insurance policy, I found that I can start Social Security at age 62 and NOT delay till age 70 as I will have sufficient deferred income for my 80’s. By having long-term-care expenses covered I should not need another major source of income in my 80’s. I have the option of starting Social Security early because I have the later years covered-and don’t have to be overly-reliant on Social Security’s uncertain political future.)

Summary

A **QLAC** helps defer RMD’s.

A **QLAC** is an annuity that benefits from mortality credits and can help maximize guaranteed income which will help augment the intermediate bucket.

Buy a **QLAC** if you plan to live a long life. People who buy annuities live longer. (Probably because the healthier buy annuities).

Purchasing a **QLAC** might give you the option to begin Social Security at an earlier age as opposed to waiting only to age 70 for longevity insurance.

Purchasing a **QLAC** might give you the option to buy a less expensive LTC policy since the **QLAC** probably starts around the time LTC would be needed. (Or might be pulled forward 5 years if needed).

An excellent website to see what annuity rates are available is www.immediateannuities.com. (New York Life has a 100 COMDEX and is a market leader.)

Purchasing a **QLAC** will help your portfolio survive a negative stock market.

Chapter 5

Social Security-

Basics

Earliest age to start SS	Latest age to start SS to maximize
62 years (75% of Full Retirement Age amount)	70 years (132% of Full Retirement Age amount)

The advice given to those couples of average life expectancy is to delay filing for the “high earner” until 70 to maximize income for whoever lives the longest. Delaying Social Security from age 62 to 70 increases monthly benefits 76%! Since Social Security is usually a couple’s government pension it is extremely important to understand that the survivor of the two (worker or spouse) will receive the higher payment for the rest of his/her life. This is called the Survivor benefit.

The advice given to those couples of average life expectancy is that it is not necessary to delay filing for the “low earner” since it is unlikely that both survive into their 80's. If the “low earner” is still working they should continue to delay filing. The difficulty of this now (due to recent rule changes) is that if a spouse didn’t work and only receives a spousal benefit, they must wait until the worker files!

This advice to delay filing for the high earner but file early for the low earner is based on the following odds:

For a 65- year- old couple the odds of one person making it to age 80 are 50%. The odds of one of them making it to 90 are 25%. You might hedge the longevity bet by starting the higher earner’s Social Security at 70 and the lower earner’s Social Security as soon as possible-perhaps even 62. That way you are protected for a long life but not penalized if one of the couple dies earlier than expected.

Couples-Social Security Filing Chart by Age based on estimated death

Estimated age at Death	Earners Filing Age High Earner	Lower Earner
Both die by age 75	62	62
Both live past age 80+	70	70 or FRA
1 dies pre-75, 1 after 80+	70	62

Single-Social Security Filing Chart by Age based on estimated death

Estimated age at Death	Filing Age
70	62
80	FRA (66/67)
90	70

Why does every planner advocate waiting to file till age 70?

The 8% annual increase in payments plus cost of living increases is too attractive to pass up.

Social Security is excellent longevity insurance-from the government.

Interest rates are lower than previously and life expectancy is longer.

How to maximize Social Security and afford the delay?:

Start Social Security for the lower earner as early as 62

And/Or

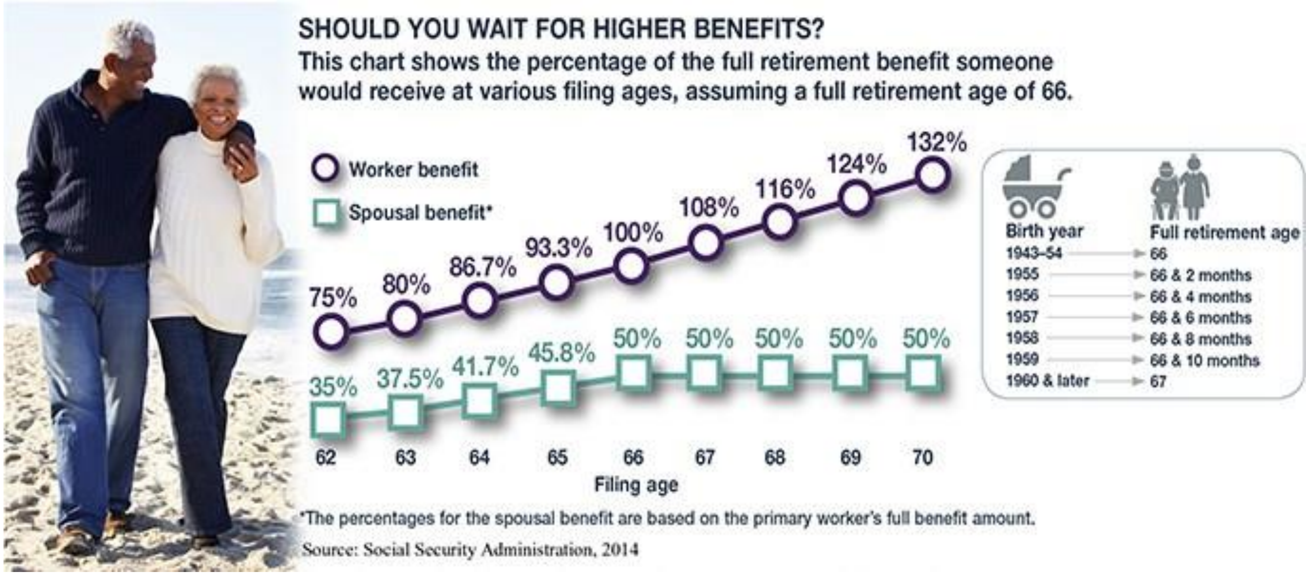
Withdraw income from retirement accounts till age 70 to bridge the income gap.

Unless one can guarantee an 8% rate of return on investments from a retirement account it makes sense to “earn” that by delaying and earning that from Social Security. At age 70 you can withdraw a smaller amount from the retirement account which should lead to a larger account to bequeath or spend.

Full Retirement Age

Current Full Retirement Age is between 66-67 years

Many positives come from achieving Full Retirement Age. The most important is the spousal benefit. IF the spouse of a worker starts Social Security at this age, that ((50%) of worker’s FRA amount)) is the maximum amount to be received. Waiting to 70 for the spouse to collect benefits does NOT increase benefits. For the spouse to collect benefits the worker must have filed for benefits (2016 rule was changed).



Divorce and Social Security

Eligibility-Spousal

Married 10+ years (not “almost” 10 years must be 10 years minimum!)
Age 62 or older and divorced 2+ years (“ex” must be at least 62 years old)
Can file for spousal benefits even if the “ex” hasn’t filed.

Filing has no effect on the “ex” and they are not even informed.

Eligibility-Survivor

Not re-married before age 60
Eligible for 100% of deceased's ex FRA at your FRA.

(It might be decades but you should monitor your "ex" to see if you might get higher survivor benefits on their death. Unless you are receiving spousal benefits on your "ex" it is unlikely that Social Security will proactively notify you of survivor benefits.)

Social Security's final loophole-if you are old enough

For those born before January 1, 1954 the Free Spousal or Restricted Application benefit is still available. For people this age who are at their Full Retirement Age it is possible to get spousal benefits IF their spouse has already filed. This would be advised because the recipient receives spousal benefits and at age 70 can apply for their own benefits which would have continued to earn delayed retirement credits. This can be combined with having the lower earner file and the higher earner filing and restricting their application-assuming they are born before 1954. (This is possible currently married or divorced spouses who meet the other requirements.)

Summary

The earliest age to start Social Security is age 62

The latest age to start Social Security and maximize worker benefits is age 70

FRA (Full Retirement Age) is the age for Social Security spousal benefits to be maximized. (50% of the worker FRA benefits-regardless of the age of the worker).

To maximize spending and guaranteed income and have a larger IRA balance delay filing for Social Security till age 70 for the higher earner.

Loophole- Restricted Application/ Free spousal possible if born before January 1, 1954.

If divorced and want to collect spousal benefits must have been married 10+ years.

If divorced and want to collect survivor benefits on a deceased "ex" spouse must not remarry before age 60.

Social Security is excellent longevity insurance at an affordable price and is usually the biggest component of the intermediate term bucket. As pensions have vanished, Social Security has had to be the sole guaranteed income piece for too many workers.

(If you want to really analyze your own Social Security choices I suggest www.maximizemysocialsecurity.com. There is a fee but it is what I use to show clients their best filing options.)

If you have a simpler Social Security situation then Mike Piper's https://opensocialsecurity.com/ is also very good and is free.

Social Security Advice

The 800 # for Social Security is 800.SSA.1213. (There is only 1 number!)

Be prepared for a long wait.

One of my clients went into Social Security and received false information. They advised him to file at 66 since "your benefits rise 8% each year" versus waiting to file till age 70. Either Social Security wants people to file as early as possible just to keep the line moving or they don't know the rules. I would advise EVERYONE to get a second opinion from someone who is not in the government. The small fee paid will be worth it.

To see what your SS benefits would be if you retire early-and might be earning $0 till age 62 there is a handy calculator on SS's web site. Go to SSA.GOV/estimator and plug in future earnings estimates and it will calculate your benefit amounts.

Chapter 6

Medicare/Medigap and Long-Term Care Insurance

Medicare-filing

The number one mistake I have heard about Medicare is when you should file for it. Unless you have employer paid medical insurance you should file for Medicare – **3 months before you turn age 65!**

Medicare is a government benefit and you should file 3 months in advance to allow the paperwork to be processed. Do NOT wait to turn 65 unless you want to wait months to be covered. Do NOT wait to file for Medicare until Full Retirement Age-unless you want to pay a permanent penalty for delaying filing for Medicare.

The penalty amount could go up 10% for every 12-month period when you were eligible for Part B but didn't enroll. You might pay your Part B penalty premium for as long as you have Part B!

Medicare Premium

Medicare Part A- $0 (for most people)

Medicare Part B- $144.60/month in 2020

Unless your income exceeds $87000/single or $174000/married

(IRMAA) Medicare Surcharge

If your income in retirement in 2020 exceeds $87,000 (single)**,** $174,000 (married) your Part B and Part D premiums will be more expensive. This is called IRMAA- Income Related Monthly Adjusted Amounts. This" means testing" currently affects a small percentage of taxpayers and is instructive in how Congress will attempt to rein in entitlement programs- "means-testing" and very sneaky. There is an SSA

Form 44A that you can file if you have just retired and your income will be much lower. Otherwise Medicare will "assume" that you are still earning a much higher income. IRMAA "looks back" 2 years and uses that income to calculate the surcharge. Income at age 63 will be used to calculate IRMAA at age 65.

Medigap

Medigap insurance is private insurance that supplements Medicare. It is highly advisable to purchase Medigap at 65 so that potentially expensive medical bills are covered. It is "guaranteed issue" for 6 months after starting Part B meaning that there is NO underwriting done when signing up for a Medigap plan at that time. After 6 months you can be denied for health reasons. The plans are standardized so that each "letter" plan can be compared head-to-head. Medigap only covers medical bills, not long-term care expenses. (My latest readings and discussions with practitioners point to Plan G as the favorite choice if you qualify. Three reasons for this. Plan F is being phased out in 2020 and will not be adding newer /healthier participants which will mean the remaining participants are less healthy and more expensive. The second reason to choose Plan G is that when premiums for Plan F begin to rise the healthy will opt for Plan G and Plan F will have sicker members. The third reason is that the premiums for Plan G are lower than Plan F by a greater amount than the deductible. For these three reasons the choice -if you qualify- is Plan G.)

Long-term-care

Definition:

The tax-qualified long- term care insurance policies "pay-off" when you are unable to do 2 of 6 ADL's- (Activities of Daily Living) or are cognitively impaired. Long-term-care insurance is also highly recommended to protect from being a burden on your children, a financial drain on the spouse/estate and to provide home custodial and health care to delay being institutionalized.

ADL’S include	Percent of elderly care recipients who need help with
Bathing	42%
Dressing	37%
Transferring-walking	32%
Getting out of bed	32%
Toileting	21%
Eating/meal prep	12%

LTC facts

Medicare does NOT pay for long-term-care.
Medicaid for long-term-care is for the indigent.
Long-term-care is primarily custodial care NOT medical care.
Long-term-care originally was nursing home care and that negative connotation persists.
Long-term-care can be in the home, assisted living, or nursing home.

LTC does NOT mean just nursing home.

According to the American Association for Long-term-care Insurance, for newly opened Long-term-care insurance claims the breakdown is as follows:

Home Care	51%
Assisted Living	18.5%
Nursing Home	30.5%

I would think that most people would rather stay at home if they needed assistance than be institutionalized. Since this is more expensive, if you have no assets or LTC insurance, odds are that you would be institutionalized at the government’s expense.

Having LTC insurance to pay for someone to come to your residence and take care of you is a better alternative than being institutionalized. The comparison is not between long-term care and being healthy but it is between aging at home on insurance versus being placed on Medicaid, spending your own money or guilting a family member to take care of you without compensation.

Age of typical purchaser of LTC insurance:

59 years

This age dovetails neatly with having children independent (hopefully) so that you can focus on providing for your own elder care.

Statistics from Longtermcare.gov:

Someone turning 65 today has almost a 70% chance of needing some type of long-term care services and support in their remaining years.
Women need care longer (3.7 years) than men (2.2 years).
One-third of today’s 65-year-olds may never need long- term care support, but 20% will need it for longer than 5 years.

I also suspect that long-term-care use might be underreported if family members are providing the service and are probably not filling out paperwork.

Only 11% of 65-year-olds have LTC insurance for multiple reasons:

Stand-alone policies have dramatically increased in price which has given the industry a terrible reputation.
By the time individuals know they need long-term-care insurance, the policies may be too expensive or they don't qualify due to health reasons.
Many men think they won't need it and are the decision makers. (Women are the majority of recipients so should push for it.)

Women should be more forceful in LTC planning and delaying Social Security till age 70. These can be extremely beneficial for them if not for their husbands. (Actuarially women live longer and are usually younger than their spouses.)

Long-term-care options –No insurance

Self-fund
Purchase annuities-like a QLAC- timed to pay for when you will need long-term-care.
"Ask" your kids/spouse to take care of you -for free.
Go broke and depend on Medicaid/government to take care of you.

Long-term-care options -Insurance

Ok option-**Stand-alone Policies**	Better options-**Hybrid LTC Policies**
Pay with annual premiums	Pay with annual premiums or lump sum
Premiums CAN rise- and have	Premiums are locked in- CANNOT rise
Coverage is individual	Coverage can be individual or joint
Benefit duration- limited	Benefit duration can be unlimited
If coverage not used-no refund	If coverage not used-return of lump sum or second-to-die death benefit

Hybrid Policies

Many wealthy don't want to buy long-term-care insurance and consider it an unnecessary expense. These high-deductible/hybrid policies are more cost-effective than self-funding assuming there are funds which can be dedicated to the policies. If there is never a need for LTC then self-funding is the best option, which is true for any form of insurance. Since the odds of needing LTC are very high and the expense involved if needed is also very high it seems prudent to purchase insurance to limit the downside risk.

With hybrid LTC policies the wealthy can buy LTC that is paid for by "second-to-die" joint life insurance that: If not used by either person, the wealthy would not have wasted spending because a beneficiary collects a tax-free death benefit.

Thinking about long-term-care insurance involves making a financial decision to limit the potential expense to take care of yourself if and when you are physically or mentally unable.

(I wrote a short book about Hybrid LTC's-available on Amazon).

Best LTC policy to buy-in hindsight:

If you never needed long-term-care you shouldn't have bought any long-term care insurance. (You might be worrying about needing it your whole retirement though.)
If you needed a few years of long-term-care you probably should have bought a stand-alone policy that exactly matched the time you and your spouse needed coverage. (You might be delaying using funds to make sure you didn't run out of coverage.)
If you needed extensive long-term-care you will be glad you bought an asset based/hybrid long-term-care policy that can last indefinitely. You will also probably begin coverage as soon as possible-not worrying that you would run out of funds.

If you have purchased a stand-alone LTC policy but feel uncertain about keeping it, you might inquire about adding a smaller hybrid policy to provide additional protection. It is possible to fund a hybrid policy from your IRA.

I attempted to buy life insurance with a long- term -care rider and was denied. I later purchased asset-based/hybrid long-term care and was accepted. Not all long-term-care insurance health screens are alike.

Maximizing spending

If long-term-care costs are covered, the retiree does not have to maintain as large of a portfolio-–to self-fund-LTC in the later years.

Having LTC insurance allows someone to spend at a higher rate in the early retirement years knowing that funds will be available to provide for the major expenses if care is needed. (I show that my assets can decline to age 80 on the assumption that major expenses I will incur will be primarily regarding long-term-care-which is covered by a hybrid policy and bolstered by a QLAC that starts at ages 76,80 and 85.)

Similar to a QLAC, when purchasing LTC insurance it is important that the insurance company has a high COMDEX score.

I look at LTC insurance as the ultimate long term “bucket” -a fourth bucket- with leverage that can be used earlier if need be.

Final Thoughts

Combining a QLAC, delaying Social Security to 70 for the high earner and purchasing LTC insurance and Medigap should be a good defense against running out of money in your later years (medical and longevity risk).

Chapter 7

Tax efficient accounts-

Health Savings Accounts

Definition:

A tax-deductible savings account to pay for medical expenses tax-free and that can grow tax-free.

How to qualify:

You must have a high-deductible health insurance policy that is classified as “high-deductible” ($1400)-2020.

Tax implications:

The amounts you contribute are tax deductible from income.
The account can be invested and the earnings from it grow tax-free.
When you spend from a Health Savings Account it is not taxed if spent on medical expenses. (deductible, co-pays, prescription drugs, vision, dental.)
Especially beneficial for high-tax bracket workers.

It can be used to pay for Medicare Part B, Part D, and Part C. It can be used to pay for LTC premiums-within limits. It CANNOT be used to pay for Medigap nor health insurance premiums.

Medical implications:

Anyone should have an HSA whether to spend while young, to accumulate tax-free earnings, or to save to pay for medical expenses in retirement.

Having an HSA permits you to accumulate money so that you can afford to pay your high deductible and therefore pay lower medical premiums.

HSA Contribution Limits-2020

$3550 for an individual
$7100 for a family
+$1000 “catch-up” if over 55 years old

Ok options-**Medical Flex-spend**	Better options-**Health Savings Account**
Use-it or lose it (+$500) carry-over	Can carry-over indefinitely
Plan ceases with employment	Plan stays with employee

Health Savings Accounts-details to know

You have until April 15th to make contributions for the prior year.
You can usually open an HSA at work or you can open one at a bank or brokerage. Fidelity has a "no-fee" HSA.
If you pay cash for medical bills and save the receipts, you may withdraw the amount later from your HSA and get tax-free growth until that time.
If you are not currently on Medicare, you can contribute to an HSA. Medicare is the cut-off, not age 65. You can contribute to an HSA while working past age 65 and stop funding the HSA 6 months before you file for Medicare as there is a 6 month look-back if you are over age 65!!
Another important point to know is that if a beneficiary of an inherited HSA is a non-spouse, then the HSA will be fully taxable-there is no stretch deferral like an inherited IRA.

Summary

The triple threat in retirement of high taxes, medical expenses and longevity are all reduced with an HSA. Contributions are tax deductible, earnings grow tax-free and payments for medical expenses do not trigger a tax. It makes it easier to afford a high deductible and you can also pay long-term-care premiums from an HSA. The only restriction is that you must have a high deductible health insurance plan to contribute to an HSA and not be on Medicare Part A.

Chapter 8

Tax efficient accounts-

Roth IRA

Definition:

A Roth IRA is similar to an HSA except it is not tax-deductible. It is tax-free growth and withdrawal usually after age 59.5.

Income limits-2020

Single	Married
$124000-$139000	$196000-$206000

(Roth IRA accounts are highly advantageous for those starting out in low tax brackets who expect over time to be in a higher tax bracket).

Contribution Limits-2020

$6000	+$1000 catch-up at age 50 and up	Must be earned income

To further add to the confusion, it is possible to contribute to a 401k Roth at work-if available, at any income level. There is no income ceiling. Can have both a Roth 401k Roth and Roth IRA at contribution limits.

Tax advantages

The chief advantage of a Roth is tax-free growth and income that will not be taxed again. If tax rates rise in the future, you have already prepaid your taxes at today's rates.

Roth IRA income is non-taxable income. It does not count as income when calculating Social Security or Medicare taxation, whereas municipal income does. The Medicare surtax (IRMAA) is not levied on Roth income.

Roth conversions

If you can't open a Roth IRA due to high income or no earned income or you can't open a 401k Roth since it is not offered at work, there is another way to get a Roth IRA-conversion. A Roth conversion-traditional IRA to Roth IRA-is available for ANY income level, BUT the amount converted is taxable as ordinary income. There is not even a penalty for converting before age 59.5. Partial conversion is permitted-and recommended- to prevent being taxed for a lump-sum which would boost you into a higher tax bracket. Be aware that if you do a Roth conversion after age 62 this may boost your income to higher tax bracket when you pay your Medicare premiums. (IRMAA has a 2-year lookback when setting rates.)

Roth conversions-personal perspective

I have begun doing Roth conversions for myself and have learned a few things:

Open the account at least by age 54 to start the five-year clock on being able to withdraw earnings tax-free at 59.5. (When a 401k Roth is rolled into a Roth IRA the start date is when the Roth IRA was established. If you wait to roll the 401k Roth into a new Roth IRA at retirement, you must wait 5 years from that date to access the earnings tax-free).

If you open the account at the end of the year you get credit for the full year as far as the five -year minimum holding period.

Try to transfer as much of the account as early as possible in subsequent years to accumulate tax free income for the full year.

If you are transferring individual holdings in January you might try to pick the prior year's losers which are down in price and should rebound.

Put your highest yielding securities (MLP's and REIT's) in the Roth to grow tax-free income.

Older option-**Tax deferred IRA**	Newer option-**Roth IRA**
Best if in highest tax bracket	Pay taxes in advance at lower tax rate
Can't withdraw principal without penalty before 59.5	Can withdraw principal ANYTIME without penalty
RMD's at 72	No RMD's till inherited

Roth details

Can withdraw the principal anytime but if you earned a profit on that $6000 then you can't withdraw that amount tax-free, until it has been "seasoned". There are even exceptions to that. You may withdraw up to $10000 lifetime in "earnings" tax-free if the money is used to acquire a first principal residence.

After a Roth IRA has been "seasoned" (after 5 years AND over the age of 59.5) money-including gains- can be spent tax-free-forever. I highly recommend opening a Roth by age 54 or much earlier to start the 5-year holding period clock.

More details

A Roth conversion can reduce estate size (because you will be paying federal income taxes) and therefore it may aid in estate planning.

You cannot convert an RMD from an IRA to a Roth.

Summary

Roth accounts are an excellent defense against higher taxes. For workers in the lower tax brackets Roth IRA's are more attractive than traditional IRA's since the current tax break is less. For retirees and high-income earners having accounts that are non-taxable will be very helpful when withdrawing in retirement in a tax-efficient manner and to avoid the Medicare surtax. I prefer a Roth over a deferred account since if the goal of investing is to maximize the size of the account then it would seem counterproductive to want a tax-deferred account to grow since this is creating a massive tax bill of ordinary income. I prefer to pay a little tax now rather than a lot later. (Paying tax on the seed instead of the tree). Similar to LTC insurance I would rather pay taxes today for something -taxes-that I expect will only be more expensive in the future.

Chapter 9

Leaving a Legacy

Death preparations and estate planning from an investor's perspective

Avoid Probate

Many lawyers will tell you that probate isn't as bad as it used to be. I have even heard some lawyers say that they can write wills when they are younger and their retirement plan is to probate those wills! Personally I see no upside to going through probate.

In probate the "will" can be made public.

In probate the process might last a year or longer.

In probate your estate is at the mercy of the legal system including legal expense.

You are in a much better negotiating position in advance when you have a choice. After death the beneficiaries might end up paying the fees you tried to save in advance for something you might not have wanted if you had planned in life.

How to avoid probate

The most popular way to avoid probate is to supplement a "will" with a Living Trust. The financial assets that would normally have to go through probate bypass probate and can more quickly pass to the intended beneficiaries.

Living Trusts are slightly more complicated than a "will" but are vastly more functional.

Assets must be re-titled to the Trust but upon death your beneficiaries will receive the assets sooner and with less expense.

Beneficiaries and Wills

Only 60% of baby boomers even have a “will”!

Contrary to much popular misconception, naming someone as a beneficiary in a will does NOT supersede naming a beneficiary on financial accounts in a contract.

For example:

If there is a financial contract (life insurance, qualified retirement account or annuity) probate can be avoided.

A beneficiary for life insurance takes priority over being named in a “will”.

A beneficiary for an IRA takes priority over being named in a “will”.

Ditto for a 401k BUT a spouse must sign off if not named as beneficiary whereas that is not the case for an IRA. (Except in Community property states.)

You can sign a “payable on death” form for bank accounts to bypass the “will”.

FDIC coverage can be increased if multiple beneficiaries are listed-check with your local bank.

Annually check beneficiary forms to make sure the correct beneficiary is listed.

(Check to verify that the beneficiaries are who you currently want. The listed beneficiary might be an ex-spouse or a deceased parent).

These “transfer on death” contracts for brokerage accounts supersede a “will” and can bypass probate.

If “transfer on death” and “payable on death” forms are used for most financial accounts you should still have a “durable power of attorney” in case of incapacity.

The best way to avoid requiring an expensive and time-consuming conservatorship is through estate planning that includes a durable power of attorney. That way, the agent you select is responsible for managing your finances as you wish, rather than leaving financial decisions and management up to a conservator or the court. The durable power of attorney must be done before it is needed-if you are incompetent then your only choice will be the conservatorship route. This is another reason to get an estate plan done. (I have had this in place for five years thanks to my lawyer but it is more clear that this planning is another way to avoid going through the court system. It is not really a luxury, it is necessary planning.)

Safe Deposit Boxes

If you put the “will” or Living Trust in a safe deposit box it might not be accessible to the heirs after death. You might keep the “will”/or Living Trust at your lawyer’s office or in a lock- box at home. (Friends of mine have taken to calling it a “Death Box”.)

One way to keep track of financial assets and monthly bills is to set up a separate email account exclusively for them. I just did that this year and it is much easier to keep track of the accounts. I can leave the email information to make it easier for relatives to see what needs to be closed and what assets you have upon death.

Inherited IRA’s

When an IRA is inherited by a spouse it is possible to continue the same rules of the account holder.

When an IRA is inherited by a non-spouse it is no longer possible to use a “stretch IRA”. The government closed the “stretch IRA” loophole in 2019. The time limit for withdrawing funds from an inherited is limited to 10 years. (with a few exceptions). There are no required withdrawals annually but the account must be fully withdrawn after 10 years. You cannot combine this non-spouse inherited IRA with your own traditional IRA due to the different RMD rules.

Charities and IRA

If you want to donate to a charity it is possible to withdraw from an IRA and not pay tax IF the check goes directly to the charity but only if you are over age 72. You can “only” do this up to $100,000 per year. This increases the amount you can donate and doesn’t increase your taxable income. The charitable donation can be used to satisfy the RMD without being added to income. It is called a QCD-Qualified Charitable Distribution.

529c Plans and Grandparents

It is a very common misperception that you can only buy a 529c plan sponsored in your state. Not true. You might want to buy your state’s plan to receive a credit against your state income tax but you can buy any state’s 529 plan and use it in any state. (There is an excellent website on 529c plans-“www.savingforcollege.com” which compares the state plans).

It is possible for wealthy grandparents to contribute $150,000 (which is 5 years in advance as a couple) to a grandkid’s 529c plan which can pay for college tuition, room and board and grow tax-free. (Annual amount per person increased in 2018 from $14000 to $15000).

By doing so the money is earmarked for education AND reduces the size of the grandparents’ estate. The Utah 529 plan ranks high consistently.

Update.

Now it is possible to use a 529 plan to pay for education before college (K-12) but only $10000 per year.

Summary

Avoid probate with a revocable living trust. Use "transfer on death" and "payable on death" forms for financial accounts. Check the beneficiary forms on your accounts annually. Make sure you have all the powers of attorney the lawyers recommend. Estate planning is too important to do just once and assume things will be fine. Consult an estate planning lawyer, a CPA, and a financial advisor. The intricacies and finality of estate planning can lead to many mistakes. There are too many stories of poor planning leading to unintended consequences and lengthy probate. (I know of a case in which a 401k had no listed beneficiary even though he had a child. There was no spouse. Instead of the child rolling over the 401k to her account, the money was received in 5 years and the taxes were assessed as an estate at 39%!)

This should not be used as a basis for legal and/or tax advice. In any specific case, the parties involved should seek the guidance and advice of their own legal and tax counsel. There are some excellent estate planning lawyers who can do so for a reasonable fee. Don't try to do it yourself! I didn't.

Chapter 10

Age Checklist Rules:

Retirement Plans, Social Security and Medicare

How it all fits together

Age 54

Start a Roth IRA by this age to access the full account tax-free by age 59.5 (five year holding period + age 59.5) This is recommended even if you have a 401k-Roth to establish the start date.

Age 55

Early 401k Withdrawals before age 59.5

At age 55 if you have a separation in service (quit, fired) you may set up your 401k in a SEPP -substantially equal periodic payments. It is called 72t and permits you to access your 401k before age 59.5 without paying the 10% penalty. (I had always heard there was a reason not to combine my IRA and 401k. The ability to withdraw from a 401k at age 55 is the major one).

Age 59.5

Access IRA/401k without paying 10% penalty

Almost every worker is aware of this age. However not everyone is aware that just because there is no 10% penalty doesn't mean the account is 100% yours. When you withdraw from the account you are subject to ordinary income taxes-not capital gains taxes. Tax planning becomes important when deciding when to withdraw from these accounts.

Age 62

Social Security can be started.

This is the earliest to access Social Security as a worker or a spouse. The monthly amounts are substantially less than they would be if you waited till Full Retirement Age (for spousal) or if you waited till 70 (for worker). For the lower earner in a couple who has retired, filing at 62 can help the couple wait till 70 to file for the higher earner. The fact that you can access your IRA at 59.5 to possibly delay filing for Social Security is helpful in retirement planning.

IRMAA

Last year to do Roth conversions without potentially bumping into a higher IRMAA-Medicare surcharge bracket.

Age 64.75

Apply for Medicare and Medigap NOW!

Age 65

Medicare and Medigap

Medicare Premiums are “means-tested”-IRMAA. Higher incomes pay sharply higher premiums. Roth IRA’s, HSA’s, and cash value life insurance withdrawals can help alleviate the “means-testing” premium.

Start pre-planning for this at age 64. This is hugely important for three reasons.

At the original sign-up period for Medigap you do not get penalized for pre-existing conditions. If you wait to sign up 6 months after the original enrollment period your medical condition may lead to a higher Medigap rate.

Signing up at 65 for Medicare lets you avoid the lifetime penalty for late sign-up. Failure to sign up for Part D also leads to a lifetime penalty.

If you are no longer covered for health care at work, sign up for Medicare Parts A (no cost) and B (monthly premium) at age 65 to avoid penalty for late sign-up. The penalty is cumulative and should be avoided.

When you sign up for Medicare it is highly advisable to also sign up for private Medigap (Medicare supplement) insurance or Medicare Advantage which can cover the deductibles and co-pays that Medicare does not cover. Failure to do so will leave you open to potentially catastrophic medical bills.

Call a Medigap specialist who can help. There is no extra fee for this.

Age 66-67

Full Retirement Age for Social Security

Depending on your birth year this is the age at which someone who will be receiving Social Security as a spouse and not as a worker should file for Social Security. Unlike worker Social Security, there is no increase in benefits for waiting till 70 for spousal benefits! Can do Free Spousal if born before January 1, 1954.

Age 70

Delay Social Security till this age for the higher earner

As a worker delaying the start of Social Security from 62 to age 70 increases monthly benefits for you (and the surviving spouse) by 76% for the rest of your life (or the life of the surviving spouse).

As a single person it is less important to delay till age 70 as the odds are less that you live into your 80's. As a married couple it is more important for the higher earner to delay till age 70 since it is highly likely that one of the couple survives to age 85+.

The higher Social Security payment can be used to supplement long-term-care funding. That way you may not need as expensive of a long-term care plan.

Age 70.5 may make QCD from IRA to charity and avoid taxation

Age 72 (Changed from 70.5 beginning in 2020)

Must begin RMD's (Required Minimum Distributions)

At age 59.5 you CAN access your retirement account without a 10% penalty. At age 72 you MUST access your retirement account or pay a 50% penalty!

The RMD is based on your life expectancy. At age 72 you must withdraw a small percentage of your IRA-and pay taxes. At older ages you will have to take greater percentages of your IRA coinciding with a reduced life expectancy.

The RMD withdrawal cannot be placed into a ROTH.

If you are still working and have a 401k, you do NOT have to take RMD's from it until you leave employment. You may even roll existing IRA's into the work 401k account and delay RMD's on those accounts.

The RMD is calculated as a percentage of aggregated similar accounts. For example you would aggregate your IRA's for one percentage, then you would aggregate your 401k's for another percentage. You cannot just take one dollar amount to cover them all. You must take a dollar amount per aggregate type however. It is recommended to combine similar accounts so that the RMD calculation is simplified.

Age Summary Guidelines

54-initiate a Roth IRA to start 5-year holding period

55- 72t early 401k withdrawal (if separated from employment) without penalty-possible

59.5- IRA access without 10% penalty

60- Consider LTC insurance around this age or when kids "self-sufficient"

62 - can start Social Security (get a second opinion before filing!)

Maximum Roth conversions since won't affect IRMAA brackets

64.75- apply for Medicare and Medigap NOW! (Call a Medigap specialist)

65-start Medicare/ Parts A/B and D….Medigap (Plan G) (unless still employed) Stop contributing to HSA account

66/67-Full Retirement Age- maximum Social Security spousal benefit

(potential loophole Free Spousal if born before January 1, 1954

70- Maximum Social Security worker benefits

70.5 QCD may be done for charity

72-Must start withdrawing RMD’s from IRA (or pay 50% penalty)

Annually when you re-check your Medicare Part D drug plan it might be a good time to monitor your beneficiaries on your accounts to make sure they are the ones you intended. If there are many changes it might be time to update the will. Keep in contact with Medigap specialist.

I have also comprised a recommended product list chronologically to prioritize an action plan.

1. Roth IRA -start when in low tax bracket-and before age 54. Maximum Roth conversions by age 62 to avoid IRMAA surprise.
2. Health Savings Account if have a high deductible health insurance plan.
3. Life insurance/529 plans when have children and have maxed out Roth accounts.
4. Hybrid LTC insurance after children are semi-independent.
5. QLAC if IRA balance sufficiently large.
6. Social Security-research to maximize it.
7. At 64.75 sign up for Medicare/Medigap/Part D. (Plan G is optimal). Stop funding HSA account upon Medicare effective date.
8. Re-check Part D annually (OCT 15-Dec 7) as medication and prices will change. Medigap specialist is very helpful and no extra cost.
9. At 72 plan required minimum distributions (RMD’S) from IRA/ 401k. At 70.5 may make charitable donations with a QCD.

10. Have a Living Trust and a “will” in place to ensure legacy wishes properly carried out. Check beneficiary designations annually.

Retirement Age Grid

	Medical	Medical	Longevity	Longevity
Ages	60	65	70	75
Government		Medicare	Social Security	
Insurance	LTC	Medigap +D		Annuities
Favorite	Hybrid LTC	Plan G	High earner	QLAC 75-80

Conclusion

To maximize spending in retirement, you will probably be combining guaranteed lifetime income for stability -and to offset fixed expenses-and equities for growth and inflation protection. To defend against longevity risk, delay collecting Social Security to age 70 for the high earner and/or buy a QLAC to start at age 80. To defend against higher medical inflation, buy Medigap (Plan G) and hybrid LTC insurance. To defend against higher taxes and “means testing”, open an HSA and a Roth account. To protect your legacy (and avoid probate) get a Revocable Living Trust through an estate planning lawyer and check the beneficiary designation on your accounts and Part D drug plans annually.

The mere fact that you are reading this is helpful for your retirement preparedness. Statistically those who plan have a higher likelihood for success. Ignoring or avoiding planning for retirement are not solutions.

Thanks for Reading. I appreciate any questions or comments

Please send to: James@NextQuarterCentury.com

Founder of Next Quarter Century, LLC.

Chapter 11- Sample Asset Allocation Portfolio

20 year/5% per Year

Age	Asset	%		
60	Cash	5%		
61	Cash	5%	10%	Cash
62	CD Ladder	5%		
63	CD Ladder	5%		
64	CD Ladder	5%	15%	CD Ladder
65	Balanced Fund	5%		
66	Balanced Fund	5%		
67	Balanced Fund	5%		
68	Balanced Fund	5%		
69	Balanced Fund	5%	25%	Balanced Fund
70	Total Stock Market	5%		
71	Total Stock Market	5%		
72	Total Stock Market	5%		
73	Total Stock Market	5%		
74	Total Stock Market	5%	25%	Total Stock Market
75	International Equity Fund	5%		
76	International Equity Fund	5%		
77	International Equity Fund	5%	15%	Int’l Equity Fund
78	Other	5%		
79	Other	5%	10%	Other
80	QLAC			QLAC

I have read about many different designs for a retirement asset allocation. They usually mention different buckets or time segmentation of assets. Many wealth management firms charge 1% of Assets Under Management for putting client's assets into different index funds and rebalancing on a quarterly or annual basis. The breakdown above would satisfy many different goals of retirees.
The sample allocation above contains:

2 -year buffer (cash bucket) to pay expenses if the stock market has 2 negative years. Value not subject to market risk.

3 -year CD ladder (intermediate bucket) that matures after 2 years to provide a higher yielding cash buffer. Value not subject to market risk.

Cash and CD ladder provide 5 years/25% buffer not subject to market risk.

5- years in Balanced Fund (35% Equity/65% Bonds) defensive portfolio.

5- years in Total Stock Market Fund

3- years in International Equity Fund

2- years in "Other"- individual holdings.

If possible have a QLAC begin at age 80 for income for life.

There are excellent Balanced Funds, Total Stock Market Funds and International Equity Funds that charge very low fees.

If you write to me at:

James@Nextquartercentury.com I can tell you some Schwab and Vanguard funds that would be a good fit. Gratis.