

# Diverse Risks and Considerations in Retirement

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When I was very young, I wondered what I would be when I grow up. As I got older, I wondered what I would do to prepare for retirement. Now that I am fully retired, I continue to wonder what the future holds.

What I learned so far is that one's life is marked with so many milestones, starting at birth and ending at death. Throughout that time, one experiences varying rates of growth in physical, intellectual, moral, social, financial and other senses of well-being.

Financially speaking, planning starts at birth, even if one relies on others such as family as a major if not sole resource up until young adulthood, whence one begins in earnest to plan for his/her own future.

Financial planning entails saving and spending goals that may be protracted over time, and include secondary education, gainful employment, starting a family, buying a home, child care and education, travel and recreation, health care and retirement.

Enter budgeting. During childhood, one looks to his/her allowance to fund small wants, and for bigger wants, works small jobs if able to supplement said allowance. During the long period from young adulthood to middle age, such wants grow in magnitude and urgency and credit is increasingly used as a budget tool to meet current needs with the promise of steadily growing wages to repay loans. Even then, unless one has sound budgeting and planning, the risks of being overextended, experiencing sudden loss of income or unexpected health costs can be disastrous and untenable.

One is usually well advised to set aside funds not only for a "rainy day," but for a number of special purposes or spending goals. Hence, the concept of saving and investing said funds in buckets, for liquidity as well as

earnings and growth commensurate with intermediate and long-term needs, applies not only through one's working life but even in retirement.

For most, retirement means the steady flow of wage income ceases and one must rely instead on income from Social Security, pensions and other distribution from retirement assets that heretofore grew from tax-deferred contributions and earnings but are now being drawn down to meet retirement needs and risks for the rest of life. However, the basic tenets of saving and investment remain, albeit with a different focus.

As a recent retiree, I want to share my personal experiences to date, with focus on some of the key questions and considerations I grapple with when planning the rest of my future in retirement.

## Activities While Retired

How is my health? If healthy, do I continue to work part time or totally quit gainful employment? Depending on what I decide, I can have more income but less time to volunteer and for travel or leisure.

If in poor health, I know that not only will my activities be limited, but my spending needs will most likely be higher and require additional outlay from my retirement savings.

## Retirement Spending

What are my expected basic expenses in retirement? Depending on my employment status, some or all of my work-related expenses will change, such as commuting, taxes and cost of health coverage. I will also need to make personal provisions for payment of certain of these items, such as income taxes and medical insurance premiums, which previously were automatically withheld from my paycheck. On the other hand, I may expect to incur new or higher expenses from more leisure or volunteer activities. I will also need to examine whether or not my other risk protections are necessary and/or adequate. For example, do I have provisions for inflation effects on my spending levels in the future, particularly the cost of health care? Have I considered my Medicare eligibility and enrolling in same, as well as its impact on my insurance protection for medical, dental and critical care or catastrophic care costs? Do I have insurance protection or provisions for long-term care? Do I have personal insurance to safeguard against homeowner or renter, automobile or other personal property loss? How much if any life

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insurance coverage do I maintain, such as for bequest purposes, so that I may examine my retirement spending needs realistically? For example, am I being cautious with my spending so I do not outlive my assets, not because I dread not leaving enough to my heirs? Do I have existing debt, such as a home mortgage, car loan or credit cards? Based on the foregoing, I can tally my total insurance premiums, debt amortization, taxes, etc. in addition to my basic spending needs, perhaps adding some provision for discretionary spending as well.

### Sources of Income

What benefits am I eligible for? For example, depending on the age I claim Social Security retirement benefits, if eligible, I know that such benefits, otherwise payable at my full normal retirement age, may be actuarially reduced by as much as -25 percent if I choose to claim early at age 62, or increased by as much as +35 percent if deferred to age 70. But first, I ask myself whether my spouse has commenced his Social Security benefits, and further if my claiming for a spouse benefit, which is generally half of my spouse's retirement benefit, fits in with my current spending levels and health considerations. This may help me decide to forego claiming my own retirement benefits until I attain age 70 when they are much higher, thus providing the best form of longevity insurance protection for me.

**Medicare** is an important source of health protection that provides coverage of the majority but not all of my medical spending. I will also have supplementary insurance coverage for medical and other purposes. I note that Medicare premiums are deducted from my Social Security benefits.

Another source of income is a **defined benefit pension plan**, which consists of a vested pension benefit from one or more of my former employers that may have offered such plans in the past, or more recent benefits that are increasingly made available today, such as a **cash balance plan** and/or a **defined contribution plan (401k, 403b, thrift plan)**, where I have the option to select the timing and form of payment for my plan benefits, as either cash, applied toward an income annuity or a periodic benefit stream payable in my retirement.

**Deferred annuities (IRAs, nonqualified)** provide another source of current or future income. As with

defined contribution plans, IRAs are subject to required minimum distribution (RMD) rules, which means I must distribute a required percentage (per the IRS life table) starting generally in the year I attain age 70 1/2 (or retirement, if later under defined contribution plans).

**Investments (bonds, stocks, mutual funds and equity real estate)** can generate income from interest, dividends, capital gains, rent and depreciation, etc. For example, where I have reinvested mutual fund earnings in the past, I can choose to receive in cash all future dividends and realized capital gains especially as they are taxed anyway in the year earned.

**Savings (bank, CD)** constitute my main source of liquid (rainy day) funds and help me better manage the distribution of my aforementioned sources of retirement income.

### Financial Consideration

How adequate is my retirement paycheck, i.e., my current sources of income to cover my basic spending today, plus a margin for inflation?

Regardless, I will want to review my current spending for reasonableness and potential changes, particularly in connection with planned activities or pursuits at least in the next one to three years. I may also need to consider ways to increase my income if inadequate now or expected to be in the next year or so. Having backup funds, preferably cash in bank reviewing or short-term investments, worth at least six months of my living expenses, is useful in cases of emergency (e.g., home repair, out-of-pocket health spending and other unexpected but necessary expenditure), as well as to bridge the time gap until I start my RMD and/or Social Security retirement benefit.

If I have investments that automatically reinvest dividends and capital gains, even though they are taxable to me in the year they are earned, I may consider having these distributed to me instead, thus providing additional income or deposits to my cash pool.

What other considerations do I have when reviewing my investment portfolio and/or deciding if/when and how to change my investment fund allocations by short-, immediate- and long-term buckets? For

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example, as I draw down my short-term bucket for immediate needs, I may want to shift some funds among the other buckets. I will also need to consider when and how I distribute my retirement savings, either to increase my income as needed to cover projected expenses or more importantly, when I have no choice but to start the RMD of my tax-qualified retirement accounts, and pay any taxes that have been previously deferred on said funds.

### Decumulation

I will want to preserve my tax-qualified funds for last, that is, until my RMD. Until such time, I will first consider my taxable savings, such as bank deposits that constitute my back-up fund.

Next I will look at my other taxable savings held outside my retirement accounts, such as investments in bonds, stocks or mutual funds. If I sell these investments that have shown capital growth since I held them, I will be taxed on such realized capital gains. I will want to sell first any long-term assets, i.e., assets I have owned for more than one year. Capital gains rates are lower than for ordinary income, while short-term capital gains are taxed the same as ordinary income. However, I may also figure in whether my income tax bracket in retirement has dropped significantly from when I worked.

If selling real estate held for investment, long- versus short-term capital gains tax considerations also apply. I will also consider any income that I will forego relative to what I can earn if I invest the sales proceeds elsewhere, or apply such proceeds toward an income annuity, as well as any maintenance costs and tax differentials. Similarly I will need to weigh the costs and benefits if I decide to sell real estate that I occupy as my primary residence, so I can rent instead or move to senior housing. Under certain circumstances, I may look at reverse mortgages as a potential tool but need to understand the use, terms and restrictions of this complex product.

What other disposable assets of value do I have? For example, do I own a car that I no longer need to get around, or personal property that I do not use, and can trade-in for cash equal to its depreciated value? This

will save me maintenance costs on fuel and insurance costs. How much life insurance do I need for bequests to my survivors and heirs? Unless my policies are paid up, I may also consider potential income from cash value proceeds as well as savings from reduction of all or part of my costs of insurance.

I may have retirement savings held in nonqualified annuities, for which I made after-tax contributions but tax on income is deferred until these funds are distributed to me. At the time of distribution, I will be taxed on the portion that is constituted by accumulated income earned on such funds.

If I have a 401(k) plan where I made after-tax contributions that I have not rolled over when I separated or retired, and I am one or more years away from my RMD, I can bypass current taxes by rolling over my 401(k) account to a Roth IRA,<sup>1</sup> for the portion attributable to after-tax contributions, and an IRA, for the qualified or tax-deferred portion including accumulated earnings on after-tax contributions. I will need to hold the Roth IRA for at least five years—and past age 59 1/2—after which all withdrawals are income tax free. If I want to consider smoothing my tax payments, I have the option to convert, in kind, said after-tax contributions in my 401(k) plan to a designated Roth 401(k)<sup>2</sup> within the plan, meaning my earnings will no longer be tax-deferred but currently taxed. The same withdrawal rules for Roth IRAs apply to a designated Roth 401(k).

For RMD purposes, the rules apply to all of my funds held in employer-sponsored retirement plans, including my 401(k) and thrift plans, as well as traditional IRA or IRA-based plans. The first such distribution must occur on April 1 (i) in the year following the calendar year in which I reach age 70 1/2. Subsequent distributions (ii) start on Dec. 31 in the first year following the year I reach age 70 1/2. For defined contribution plans, my required distribution starts generally on the later of (i) or (ii) the year I retire. Such rules state that the entire RMD, not necessarily from any specific retirement account, must be distributed each year over my federally prescribed life expectancy. I can delay the first distribution until the April 1 following the year I reach

1 [“Rollovers of After-Tax Contributions in Retirement Plans.”](#) Internal Revenue Service, last updated Sept. 2, 2015.

2 Ashlea Ebeling, [“The In-Plan 401\(k\) Roth Conversion Strategy.”](#) *Forbes*, Jan. 3, 2014.

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age 70 1/2, but I must also take RMD by Dec. 31 of that year and each subsequent year.

In a manner of speaking, RMD provides automatic smoothing of my payment of deferred taxes that are now coming due. More importantly it enables me to smooth out my benefit distribution over my expected lifetime, as opposed to a lump sum distribution where there is a strong temptation to spend unnecessarily and increase my risk of outliving my savings. I need to weigh carefully choosing between immediate cash versus a benefit stream because managing my retirement savings over my lifetime must take priority over what may be impulsive spending today. Thus, I may invest my distribution until needed, or annuitize all or part of it to generate additional income. If I decide to annuitize, I have to make additional decisions on the timing of purchase (e.g., serial), frequency and form of payment—annuity income for a fixed period, life with or without certain period, joint life with percent continuation to survivor, cash refund or guaranteed withdrawal, to name a few.

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## Conclusion

All of the above will need careful consideration and ongoing planning from several perspectives, including tax, legal, health, bequest, etc. which can impact my own retirement. How do I make my money last so I do not outlive my retirement savings? I will also want to make provisions for my spouse or partner, especially after I am gone.

I know that I will continue to have additional questions and lessons to learn. By sharing my approaches, I do not profess that they are correct or appropriate for anyone, including myself, rather I hope I have at the very least raised awareness of what I think are some of the more important issues and concerns in retirement. Thus, I encourage others not only to ask questions and search for answers—there is a lot of information available on the Internet, government websites, and trusted benefit, financial and professional advisers—but also look forward to engaging others in a thoughtful discussion of their experiences and potential ideas for the development of practical tools and solutions.