

Retirement Reality Check

Too many people today have unrealistic ideas about retirement. Some people think it is a slam dunk requiring no more attention than buying a new car and for others it seems like the impossible dream. Since the probability of having to retire at some point is extremely high, it makes sense to get an idea of how that might work out. We suggest doing a reality check at any stage of life to determine what adjustments might be required to meet your rock bottom lifestyle needs.

Obviously those people facing a job loss or other serious financial setback are forced to do this on short notice. It is far better to do this kind of evaluation when you are not under the stress of necessity. Hope is a wonderful and comforting thing, but it is neither a sound financial plan nor a wise investment strategy. In the current uncertain economy we can hope that the combined efforts of global government officials solve the financial crisis soon and well. But what if they don't? What will that mean for you and yours?

Our best advice is to live for the best but prepare for the worst. A good example of this approach is that of homeowners insurance. We certainly don't want our home to burn down and we don't expect it to, but having it insured gives us peace of mind. Obviously we cannot insure everything in our lives even if we could afford to. We can, however, develop strategies to help us make the best of adverse circumstances.

One approach we have found very helpful for many clients is that of fallback positions. Take for example a plan to retire at age 62. If your financial resources are not sufficient when you reach that age, your fallback plan may be to continue work to age 65. If your resources are still not sufficient at that time your fallback plan may be to continue working longer, take a part time job or reduce your living standard to an affordable level. The same type of flexible strategic planning can be applied to other life situations such as having a child enter college right after high school or perhaps working a year or two to help with the finances.

The whole point of the reality check is to review what you would like to have happen against the realistic probability of that occurring. If your first choice comes true – wonderful. If not, you have a series of fallback plans that will enable you to stay in control of your life.

We developed the **Retirement Reality Checklist** many years ago to help people become aware of most of the issues that should be considered when planning retirement. We combine that with a simplified retirement financial evaluation done by one of our professional advisors in our **Free Retirement Screening**.

The **Retirement Reality Check originally** grew out of our **S-T-A-R-S System for Retirement SuccessSM** workshops. Many of the attendees over the years have been faced with early retirement decisions and have wished for a comprehensive checklist that covered as many of the important issues as possible.

As circumstances have changed it has undergone many revisions as company pension plans, medical coverage and tax laws have changed. What has not changed is our total dedication to helping our clients build and preserve their family's *quality of life* through the generations.

If you read the **S-T-A-R-S System for Retirement SuccessSM** literature or attend the workshops, you will notice a lot of repetition and overlap. This is proof positive that we are dedicated to getting our consistent message across and making sure it is understood by everybody.

S-T-A-R-S stands for the five interrelated areas of planning that center on control of your *quality of life*:

Security – Know what is **ENOUGH** and what hidden risks might threaten your *quality of life* and understand your *Margin of Error*.

Tax Protection – Understand how *Cash Flow, Not Income* thinking could save you substantial amounts of income and potentially estate taxes. *It's not what you make, but what you keep.*

Asset Control – Consider *Who Can If You Can't* planning to give you more peace of mind that your successors could effectively take over in case of death or disability.

Risk-Controlled Investing – See how managing *Cash, Risk and Taxes* could help to improve your Net4 returns (net after all costs and market depreciation, income taxes, estate taxes and inflation).

Simplified Money Management – *You Can't Manage What You Can't Find.* Build a reliable, comprehensive system for managing all aspects of your financial life to improve your control and enable your successors to take over and continue your plans if and when needed.

The Retirement Reality Check *is intended to be used only as a tool to help you identify these concerns and should not be taken as advice. Many highly technical financial, tax and legal issues will very likely require professional assistance.*

S-T-A-R-S System for Retirement SuccessSM

Simply check “Yes” or “No” before each question that applies to you. If you are not sure, mark it “No”.
Skip those that don’t apply to you.

Notice that Early Retirement Issues are listed separately at the end of each section.

Security

Lifestyle Issues

- | Yes | No | |
|--------------------------|--------------------------|--|
| <input type="checkbox"/> | <input type="checkbox"/> | You know what you are retiring from; have you considered what you are retiring to? |
| <input type="checkbox"/> | <input type="checkbox"/> | Do you plan any other kind of employment after retiring? |
| <input type="checkbox"/> | <input type="checkbox"/> | Will your spouse be employed after you retire? |
| <input type="checkbox"/> | <input type="checkbox"/> | If necessary, would you and/or your spouse be able to get another job to make it work? |
| <input type="checkbox"/> | <input type="checkbox"/> | Will you still be able to meet important commitments (college education, care of parents, etc.)? |
| <input type="checkbox"/> | <input type="checkbox"/> | Do you plan to stay in your current residence when you retire? |

Medical Issues

- | Yes | No | |
|--------------------------|--------------------------|---|
| <input type="checkbox"/> | <input type="checkbox"/> | Have you done a complete study of all your group and personal life insurance coverage at retirement? |
| <input type="checkbox"/> | <input type="checkbox"/> | Will your group medical insurance remain unchanged after retirement? |
| <input type="checkbox"/> | <input type="checkbox"/> | Will your share of premium costs stay the same? |
| <input type="checkbox"/> | <input type="checkbox"/> | Are agreements for medical coverage in writing? |
| <input type="checkbox"/> | <input type="checkbox"/> | Do you have any protection from the possibility of being wiped out by the cost of long-term health care not covered by group insurance or Medicare? |

Financial Issues

- | Yes | No | |
|--------------------------|--------------------------|---|
| <input type="checkbox"/> | <input type="checkbox"/> | Have you seen a current copy of your Earnings and Benefit Statement from Social Security Administration? (Form SSA-7004)? |
| <input type="checkbox"/> | <input type="checkbox"/> | Do you know your Social Security Full Retirement Age (FRA) and the impact of taking benefits before that age? |
| <input type="checkbox"/> | <input type="checkbox"/> | Do you have an accurate estimate of your retirement pension plan benefits? |
| <input type="checkbox"/> | <input type="checkbox"/> | Have you weighed which pension option you should choose (single, 50% survivor, years certain or reduced joint and survivor)? |
| <input type="checkbox"/> | <input type="checkbox"/> | Could your survivor(s) live on the reduced pension? |
| <input type="checkbox"/> | <input type="checkbox"/> | Have you calculated the potential of using existing and/or new life insurance to replace a survivor pension and provide an estate for your heirs? |

- Have you made projections of all sources of cash and income, using conservative yield and growth estimates, over the term of your normal life expectancy?
- Have you projected all your estimated expenses (for the same period) at a realistic estimated rate of inflation?
- Are you confident that your sources of cash will keep up with these expenses after inflation?
- Have you determined which expenditures you must pay (committed) and which are optional (discretionary)?
- Are you convinced that your reliable cash flow will be enough to meet your lifestyle needs?
- If not, do you know how long it would take to totally deplete your capital?
- Have you considered the possibility of a reverse mortgage on your home to obtain more income?

Early Retirement Issues

- | Yes | No | |
|--------------------------|--------------------------|---|
| <input type="checkbox"/> | <input type="checkbox"/> | Have you consulted other family members who might be affected by your decision to retire early? |
| <input type="checkbox"/> | <input type="checkbox"/> | If you don't take an early retirement, is your job secure? |
| <input type="checkbox"/> | <input type="checkbox"/> | Have you calculated the impact of early retirement on Social Security benefits? |
| <input type="checkbox"/> | <input type="checkbox"/> | Will your group medical insurance remain unchanged after retirement? |
| <input type="checkbox"/> | <input type="checkbox"/> | Will your share of coverage costs stay the same? |
| <input type="checkbox"/> | <input type="checkbox"/> | Are your agreements for medical coverage in writing? |
| <input type="checkbox"/> | <input type="checkbox"/> | If your group coverage ends, have you studied how to cover medical costs prior to reaching the Medicare eligibility age of 65? |
| <input type="checkbox"/> | <input type="checkbox"/> | Have you determined whether or not early retirement incentives might make it possible for you to retire now and still maintain your standard of living? |
| <input type="checkbox"/> | <input type="checkbox"/> | Have you compared the dollar cost of leaving now as opposed to waiting until your normal retirement age? |
| <input type="checkbox"/> | <input type="checkbox"/> | If not, are you willing to lower your standard of living if necessary to take an early retirement now? |

The most important concept in financial planning is that of ENOUGH. Virtually every new client says they want to be sure they have “enough” to meet personal and family goals. So, the first step toward achieving a feeling of security is to decide what exactly **ENOUGH** means in your case and what it will take to achieve it.

The second step is to determine how much flexibility you will have and what strategies you could use to adjust to changing conditions. This enables you to build in a ***Margin of Error*** to increase confidence in success.

The third step is making sure that there are no “bogey men” hiding under the bed that might jump out and steal away your security. A complete review of all your risk management strategies such as medical, long-term care and liability coverages can improve your confidence that you are protected from losses.

Tax Protection

Yes No

- | | | |
|--------------------------|--------------------------|---|
| <input type="checkbox"/> | <input type="checkbox"/> | Have you studied all the various retirement account distribution methods to make the best use of tax regulations? |
| <input type="checkbox"/> | <input type="checkbox"/> | Have you done side-by-side calculations comparing an IRA rollover with a lump sum distribution, to keep taxes as low as possible over the long run? |
| <input type="checkbox"/> | <input type="checkbox"/> | Are you aware of special tax saving rules that may apply to employer stock in retirement accounts including 401(k)s? |
| <input type="checkbox"/> | <input type="checkbox"/> | If you plan to sell your home, have you studied the special tax savings available for gains on your principal residence? |
| <input type="checkbox"/> | <input type="checkbox"/> | Are you aware of the methods for keeping as much as 85% of your Social Security benefits from being taxed? |
| <input type="checkbox"/> | <input type="checkbox"/> | Have you studied the effects of post-retirement employment on Social Security benefits? |

Early Retirement Issues

Yes No

- | | | |
|--------------------------|--------------------------|--|
| <input type="checkbox"/> | <input type="checkbox"/> | If you are under age 59-1/2, have you taken the 10% premature distribution penalty tax for early withdrawals into account? |
| <input type="checkbox"/> | <input type="checkbox"/> | If you are under age 59-1/2, are you familiar with special exceptions to the 10% premature distribution penalty tax under Internal Revenue Code Section 72(t)? |
| <input type="checkbox"/> | <input type="checkbox"/> | If such provisions do apply to you, have you calculated what distributions you could take without paying the 10% penalty tax? |
| <input type="checkbox"/> | <input type="checkbox"/> | If you are between the ages of 55 and 59½, are you familiar with the special distribution rules that may help you save taxes? |

The goal of **Tax Protection** is to help you to protect yourself from paying more taxes than necessary. The most important thing to keep in mind when it comes to tax planning is: ***“It’s not what you make, it’s what you keep.”*** That is why it is vital to be aware of all the tax traps as well as the potential tax saving techniques. The key strategy is to determine the best method to obtain cash for lifestyle needs at the lowest long-term tax cost. We refer to this as: ***Think Cash Flow, Not Income.***

Important tax decisions should always be reviewed by a qualified tax professional.

Asset Control

- | Yes | No | |
|--------------------------|--------------------------|--|
| <input type="checkbox"/> | <input type="checkbox"/> | Have you made arrangements for someone competent and qualified to manage your money in case something happens to you? |
| <input type="checkbox"/> | <input type="checkbox"/> | Have you made sure that person would be legally empowered to do so and would have access to all the necessary information? |
| <input type="checkbox"/> | <input type="checkbox"/> | Do you have a Durable Power of Attorney so that your spouse or other trusted person could manage your personal affairs if you are unable to do so? |
| <input type="checkbox"/> | <input type="checkbox"/> | Have you reviewed all the beneficiary designations of your insurance policies, annuities and retirement plans? |
| <input type="checkbox"/> | <input type="checkbox"/> | Have you consulted an attorney about potential changes to your personal and financial situation if you retire? |
| <input type="checkbox"/> | <input type="checkbox"/> | Do you have an up-to-date will? |
| <input type="checkbox"/> | <input type="checkbox"/> | Have you considered the possible need for a living trust? |
| <input type="checkbox"/> | <input type="checkbox"/> | Have you considered the possible need for a living will and durable power of attorney for health care? |

It is absolutely crucial to establish in advance *Who Can If You Can't!* Matters of both person and property are handled by the Probate Court, which is an expensive and time-consuming place to have financial control issues settled.

A well-designed **Asset Control** strategy consists of *Advance Directives* and complementary *Planned Succession Management*. Intelligent use of **Advance Directives**, which includes wills, trusts, durable powers of attorney and health care powers can reduce the emotional and financial burdens in these matters. **Planned Succession Management** includes having your financial management system and your legal empowerment documents accessible and understandable to those whom you choose to become successors. This would also mean having a written statement of your goals and a defined investment and management policy for them to use as a roadmap.

Such preparation would mean that your chosen successor managers would not only have the legal authority to do the job, but also would know what the job was and how to do it the way that you would have it done.

Risk-Controlled Investing

- | Yes | No | |
|--------------------------|--------------------------|---|
| <input type="checkbox"/> | <input type="checkbox"/> | Have you made an in-depth study of your present savings and investment plans? |
| <input type="checkbox"/> | <input type="checkbox"/> | Are you sure that your investments are solid and well enough diversified to reduce all types of risks? |
| <input type="checkbox"/> | <input type="checkbox"/> | Are you confident in your own ability to manage your retirement investments? |
| <input type="checkbox"/> | <input type="checkbox"/> | If not, have you studied the many investment management options including control, competence and cost? |
| <input type="checkbox"/> | <input type="checkbox"/> | Are you sure that your holdings are not overly concentrated in one investment, especially company stock? |
| <input type="checkbox"/> | <input type="checkbox"/> | Have you determined the most effective means to improve your after tax return of your assets consistent with your risk tolerance? |
| <input type="checkbox"/> | <input type="checkbox"/> | Have you examined the various alternatives to convert non-productive assets into income producing assets? |

From our Chief Strategist's perspective of 50 years in investment research, we are convinced that investing is essentially about three things in this order of importance:

- **Cash**
- **Risk**
- **Taxes**

Obviously we would like to see our investment assets grow at least enough to keep up with inflation, but we should never forget that along the way, they need to provide the cash for our lifestyle needs. It is wise to maintain a balance between these two needs.

It is also very tempting in retirement to seek big investment returns to meet our needs, but this often results in taking on more risk than we can handle. If we manage risks appropriately, the rewards should take care of themselves. Risk reduction is essentially a matter of diversification, or spreading the risk.

The most important point to keep in mind is that, *it's not what you make; it's what you keep – Net⁴*. That is, what's left after all costs, expenses, market losses, income taxes, estate taxes and inflation.

There is no investment or strategy that can assure success under all circumstances, but one proven investment strategy is to focus on seeking an acceptable total investment return consistent with risk considerations and to make tax-efficient plans for cash needs periodically as the portfolio is rebalanced.

Be aware that there is no such thing as a "safe" investment and that no single strategy has proven profitable in every market; so be suspicious of any such promises.

Simplified Money Management

Yes No

Have you made a realistic cash flow analysis of what it would cost to maintain your standard of living in retirement after inflation?

Have you gathered statements for all bank, brokerage and mutual funds accounts, as well as all company savings plans, 401(k)s and personal retirement plans, to determine all of your available income producing assets?

Have you made a combined estimate of all your sources of income and other potential sources of cash on a monthly basis?

Do you have a simple and effective system for keeping tabs on all your assets at all times?

Do you have a written index of important contacts and locations of all financial papers so that a successor could take over?

You can't manage what you can't find! That is the key to **Simplified Money Management**. Most people in the process of accumulating assets have scattered them all over. One of the biggest problems for many in getting a financial plan started is simply getting their data together.

Lack of a clear understanding of your financial situation results in several costly problems including:

- **Lack of control**
- **Missed tax savings opportunities**
- **Poor investment management**
- **Inability to have someone else take over in emergency**
- **Waste of valuable personal time**

Having all your financial data assembled in a manner that can be easily handled makes good management possible.

To be effective your system should help you to have a complete knowledge of all your assets:

1. Whose name each asset is registered in.
2. What is the current value of each asset?
3. How productive is each asset?
4. How much risk does each asset carry?
5. What would be the income tax consequence of turning each asset into cash?
6. Who could manage it if you were unable to and how would they know how?
7. How it would pass in an estate?
8. What would the estate tax consequence of each transfer be?

Having all this information readily at hand will enable you to achieve greater control over your investment, income, tax and estate planning issues and to enjoy a more successful retirement.

Any questions you marked with a "No" are potential areas of concern. Working on these could help to assure you of better control over your *quality of life* under challenging circumstances and a more successful and pleasant retirement. If you live in the Greater Cincinnati area and would like to review your areas of concern, we would be happy to offer a free two-hour consultation in our office. Just call for an appointment.

About the Author



Charles D. Vaughan, CFP®

Charles Vaughan began his career in the investment business in 1960 as a security analyst trainee for a local brokerage firm while attending the University of Cincinnati. He received a BA degree in economics in 1962 and became a Registered Representative of the New York Stock Exchange and continued evening school graduate studies in finance.

Having begun during this period when investment choices were limited and trading costs were fixed, he has held onto the belief throughout his 50-year career that business should be built on long-term client relationships, superior research and client service. He developed the **S-T-A-R-S System for Retirement SuccessSM** on this principle and has been adapting it for more than 20 years to meet client needs.

Charles D. Vaughan was the author of the “Investments” column for the *Cincinnati Business Courier* from its founding in May 1984 through May 1991. In all he has written nearly 300 columns and articles and conducted dozens of classes on various financial topics including 11 courses at the University of Cincinnati – **Osher Lifelong Learning Institute**.

He is President and Chief Strategist of **THE RETIREMENT SOURCE®**, a comprehensive financial planning and wealth management firm, with a team of advisors, incorporated in 1988, Registered Representative and Investment Advisory Associate of Crown Capital Securities, L.P. - Member FINRA and SIPC- Registered Investment Advisor.

Credentials: Certified Financial Planner® Practitioner (CFP®) 1983
Certified Fund Specialist (CFS) 1994
Chartered Retirement Planning Counselor (CRPC) 1998
Accredited Asset Management Specialist (AAMS) 2002
Accredited Wealth Management Advisor (AWMA) 2007

Memberships: Financial Planning Association
Greater Cincinnati Planned Giving Council
Cincinnati Estate Planning Council

