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Hedging Your Retirement Bet

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This is not your father's retirement.

Chances are, Dad left the company with a gold watch, a pension that included health insurance and a Social Security check he could count on. His life expectancy past retirement was fewer than 10 years -- so those resources weren't stretched. The picture will be decidedly different for people who retire in the next 20 years -- no watches, no pensions or health insurance in most cases; a shaky Social Security system; and a life expectancy of at least 20 more years. Even if you've planned carefully and your retirement nest egg is hefty, there's always a possibility that you'll outlive -- or outspend - your money.

Checklist

Worried about running out of money? That's a well-founded fear. Take these steps to allay concerns.

Five ways to hedge your bet

1. [Buy longevity insurance](#)
2. [Delay taking Social Security](#)
3. [Ladder your bonds](#)
4. [Get a job](#)
5. [Consider long-term care insurance](#)

1. Buy longevity insurance

The concept isn't new, but insurance companies have tweaked how these single premium annuities pay out to provide nervous boomers with additional cash just when they are likely to need it most.

You give the insurance company a relatively small chunk of change at age 65. The insurance company invests it until you turn 80 or 85 and then begins

paying you monthly payments for the rest of your life. A typical policy might cost \$25,000 at age 65 and pay out \$3,000 per month beginning at age 85.

The money comes at a point in life when you're likely to start having hefty medical bills combined with 20 years' worth of inflation that may have diminished your resources. This approach also makes long-term planning easier because the payout is determined when you buy the policy. You can confidently spend more of your other assets if you know they'll be replenished at a predetermined point.

The biggest drawback is that if the grim reaper comes early, you won't get your money's worth.

"It's really inexpensive," says Ted Mathas, executive vice president and co-head of life and annuity for New York Life Insurance Co., "because half the people will never get there, and if they do, they'll only live three or four years beyond that threshold. So the cost is a fraction of what it might be if they had to manage these assets for 20 years. It provides great security in a defined period of time."

If instead you decided to manage the money yourself, you wouldn't get any guarantee of income that lasts for many years beyond age 85. For instance, if you kept the \$25,000 in a tax-advantaged account earning 8 percent a year, you would have \$116,524 in 20 years. If you then started drawing \$3,000 a month at age 85, earning 4 percent on the money, it would last slightly more than 3.5 years.

What if you last longer? The insurance payout would last as long as you do. But your own funds would dry up in short order.

A number of large insurers are offering these policies, including MetLife, the Hartford and New York Life. Sticking with large and predictably solvent companies like these is important because if the insurance company that sells you the annuity goes belly up, your longevity insurance will die with it.

Shop carefully to avoid having your initial investment eaten up by commissions or frills that you don't really need (ARP Note: Call Doug Moore and his team for NO LOAD, NO FEE Longevity Insurance!). You can buy policies that will return the initial investment to your heirs or provide options for taking the money early if you should need it, but you'll

pay dearly for these, says Len Reinhart, president of Lockwood, a Philadelphia-based asset management company.

He recommends looking for a stripped-down deal that will provide an income stream and cost no more than 3 percent to 5 percent in commissions or upfront load.

2. Delay taking Social Security

If you start receiving benefits at your full retirement age -- 66 for many people retiring in the next few years -- you'll get 100 percent of your monthly benefit. If you delay receiving retirement benefits until after your full retirement age, your check continues to increase.

For instance, if you wait until age 67, you'll get 8 percent more for delaying benefits for 12 months. At age 70 -- the longest you can wait -- you get 35 percent more than you would have gotten at full retirement age and 83 percent more than you would have received if you'd taken Social Security at age 62 when it's first available. These percentages will differ slightly among recipients because working longer increases the amount they have paid into the system and those who earn more get more.

To translate this into dollars and cents, if you turn 62 this year and qualify for the maximum amount of Social Security, your monthly benefits at ages 62, 66 and 70 are \$1,599, \$2175 and \$2926.

Meanwhile, the median life expectancy for those who reach 62 in 2006 is 85 years for women and 80 years for men. But that means 50 percent of people will live longer than that. The cash value of waiting to age 70 compared to age 62 in this scenario is at least \$1,327 per month. If you have other assets or continue to work and can wait until age 70 to start collecting, Social Security will kick in with a hefty premium about the time that you may start to need it most.

But don't spend up tax-advantaged, high-earning savings in order to delay taking Social Security, warns Thomas Dalton, a CPA and a professor of accounting and taxation at the University of San Diego, Calif. Dalton calculates for an article in the CPA Journal that if you're making 8 percent on \$500,000 in a tax-advantaged retirement account, you'll come out ahead by delaying taking Social Security to age 70 only if you live to be 106. However, delaying Social Security is progressively more appealing as the interest rate or savings amount declines. At 2 percent interest, you come out ahead beginning at about age 82.

3. Ladder your bonds

The old-fashioned answer to retirement security was bonds -- especially government bonds, which pay 2 or 3 percent interest. That's the going rate right now for inflation-protected bonds. But you don't lose principal and unless the world as we know it comes to an end, you'll be able to cash them out when you need them for your old age.

Reinhart, whose company manages lots of both individual and corporate pension assets, says that to duplicate the \$45,000 annual pension common among today's mid-level corporate retirees, an employee with a 401(k) plan would have to sock away \$1.5 million. To have the extras that current retirees enjoy, they'll have to save more. Current savers who have hit this level of nest egg often feel rich, Reinhart says, even though they aren't. They are often tempted to put their money in low-earning bonds for the sake of safety. It's a bad idea, he believes. To stay ahead of inflation, he advises putting at least 80 percent of your savings into stocks and stock mutual funds. But if it will make you feel better, put 20 percent of your nest egg in laddered bonds and consider that a safety net for your old age. Here's how it works: Buy equal numbers of Treasury bonds due to mature in one year, three years, five years, seven years and nine years, so your portfolio has an average maturity of five to six years. This gives you the flexibility to trade when rates rise or fall. You can buy most of a ladder through Treasury Direct without cost or commission, but because the government is no longer selling bonds with maturities between five and 10 years, you'll have to get those from the secondary market where you'll encounter big upfront costs. A better alternative might be to take a look at bond mutual funds with an expense ratio that is less than 0.35 percent and no upfront or back-end fees.

4. Get a job

Think eBay, suggests Neal E. Cutler, associate director of the University of North Carolina Greensboro Gerontology program. He advocates delaying retirement and only leaving a full-time job after you've figured out how to make money doing something else. You could sell on eBay, for instance, so that you can continue to accumulate money in your retirement accounts. If you retire at 66 and you sell pre-owned golf balls on eBay for 10 years -- enough to make \$2,000 a year, which you put in a Roth tax-advantaged IRA account paying a conservative 4 percent a year, it will add up to \$24,973 by the time you're 76. Then you can take that \$25,000 -- give or take -- and buy an immediate annuity, which will pay about \$206 a month for the rest of your life -- enough to pay for several rounds of golf a month at the executive course down the street. In the meantime, you can deduct the costs of doing business from your taxes, including, in the case of eBay, Internet access.

5. Consider long-term care insurance

How much medical care we'll need in our old age is the hardest thing for most retirees to quantify. The costs of nursing care or even assistance in living independently can be staggering. A recent government study showed that 40 percent of the people who turn 65 each year will spend some time in a nursing home, with the average nursing home costing around \$60,000 a year.

In a traditional long-term care insurance policy, the company promises to pay a daily benefit to help cover the cost of long-term care if the policyholder is unable to perform a specified number of what the industry calls "activities of daily living": bathing, dressing, eating, getting from a bed to a chair, using a toilet and walking. But all policies aren't created equal. The best ones pay a flat rate per month that allows the insured person who meets the basic qualifications to spend the money as he or she sees fit. That could include spending it on a nursing home, a family caregiver or even a cruise to the Bahamas.

There are also whole life insurance policies and single premium annuity policies that have long-term care riders. The insured person who qualifies as needing care can use some or all of the policy to pay its costs. Again, how the money is spent is generally up to the insured. If the money isn't needed for medical care, then it passes tax-free to heirs.

And in the end, having a legacy to leave behind is the best that we can hope for.