CHIEF INVESTMENT OFFICE

Financial Decisions Near Retirement

Women and Financial Security Series

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As women near retirement, there are a number of important decisions to be made. Unlike many decisions made earlier in life, some of these decisions may be irrevocable. There is no "do-over" if you change your mind later. Others can be reversed or changed by additional decisions. For women who are part of a couple, it will be important to focus both on the impact on yourself and also on the impact on your partner. Some of the decisions are financial and some are non-financial. Some require a lot of analysis, and support from a financial advisor can be very helpful.

THIS BRIEF ADDRESSES THE FOLLOWING TOPICS BY HELPING TO:

- calculate the potential resources needed and how to fund retirement
- decide when to retire
- decide when to claim Social Security
- plan for long-term care

HELPING TO CALCULATE THE RESOURCES NEEDED AND HOW TO FUND RETIREMENT

Calculating the resources needed: These calculations may be made at any time before the decision to retire, but it is preferable to do them earlier rather than later. That way, if the members of a household do not have as much money as they would like to have, they have time to increase savings or adjust expenses and expectations. Alternatively, they may delay retirement or continue working part-time during retirement. It is recommended to do the calculation about 10 years before retirement and then repeat periodically until things are in balance.

The basic parts of the calculation are estimates of what you would spend during retirement and what income and other resources you may have to cover expenses. This requires estimating how long you may live and providing for the fact that you do not know exactly how long. How much you may spend is a combination of predictable expenses and unpredictable amounts as a result of health and long-term care needs and home repairs. If you plan to spend down your assets to finance retirement, that should be recognized in the resource side. If you do not know your current household spending, assets, liabilities and income, the first part of this effort will be fact-finding.

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Estimating how long you may live: To calculate how much you may need in retirement, you should estimate life expectancy. Many people underestimate how long they will live. It is important to remember that length of life is variable, and some people live past 100 years.[1] Couples need to remember that one is likely to die first, and most often it is the wife who will survive as a widow.[2] Retirement assets need to last through the life of the remaining spouse.

Expecting spending in retirement: You should estimate your spending in retirement based on your situation and expected activities. Expenses will likely be different from the time before retirement. After retirement, there may be no work-related expenses, no more saving for retirement. Most people spend less after retirement, but some spend more. Employer-provided health coverage will likely no longer be available, and often premiums may increase and then change if you become eligible for Medicare. There are also changes after retirement. For example, if a couple has a child who is graduating from college, there are no more current college bills to pay. Mortgages and other debt may be paid off at different times. Remember that expenses typically go up with inflation.

Some people travel a lot early in retirement and then slow down. Some items of expense are often overlooked; for example, many people help family members including adult children, grandchildren or parents. If these expenses are likely, they should be accounted for and included in all estimates.

Expected resources for retirement: Expected retirement resources may include Social Security, pensions and income generated from assets. The Social Security Administration website allows an individual to estimate his or her own Social Security benefit but does not make an accurate calculation for the household when both partners work.[3] Information about pensions is usually obtained from the plan sponsor. Individuals who are covered by a pension in their current job may get an annual benefit statement. That statement may show both the pension earned today and an estimated pension based on continued employment.

Exhibit 1 shows the median annual income from several sources only for people who receive income from that source. For each source of income, typically older men receive more than older women.

Exhibit 1: Median annual income received by source among women and men age 65 and older who received income from the source

Source	Women	Men
Social Security	$14,796	$19,176
Pensions	$12,219	$18,136
Earnings	$27,266	$46,492
All income sources	$21,245	$35,808

Source: Based on 2020 Current Population Survey Annual Social and Economic (ASEC) Survey. These figures are derived from a small sample size and may vary from your individual situation.

Households with investments should also decide to what extent they plan to use asset income, plus whether and how to spend down assets to finance retirement. One option is to use part of the assets to buy an annuity. A lifetime income annuity is a financial contract with an insurance company tthat in exchange for a lump sum payment by the "annuitant" they receive a stream of income over their lifetime. If income from Social Security and pensions do not cover your essential expenses, one could consider allocating some assets to lifetime income annuities.[4] It should be noted that Social Security is indexed for inflation, but most pension payments and annuities are not.

1 The Actuaries Longevity Illustrator is a useful tool that can be used to provide an estimate of life expectancy—longevityillustrator.org.

2 According to a 2020 report by the Women's Institute for a Secure Retirement (WISER) women are three times more likely to experience the death of a spouse than men.

3 Refer to: ssa.gov/OACT/quickcalc/

4 All annuity guarantees and payout rates are backed by the claims-paying ability of the issuing insurance company. They are not backed by Merrill or its affiliates, nor do Merrill or its affiliates make any representations or guarantees regarding the claims-paying ability of the issuing insurance company.

Another option is to gradually withdraw an annual amount from your assets. Many in the financial services industry advocate the "4% rule," which states that households can realistically afford to spend 4% of their wealth each year. We offer what we believe is more nuanced guidance regarding the rate at which retirees can sustainably spend. This is critically dependent on their ages and risk tolerance. We believe there is no one-size-fits-all guidance for spending rates.[5]

HELPING TO DECIDE WHEN TO RETIRE

- Deciding when to retire is a major decision. Affordability is a key component of this decision and is critical in helping individuals define their options. Affordability may be considered together with strategies about downsizing spending and possibly housing.
- But there are a number of other issues and considerations for women:
  - Married women may need to decide whether to retire at the same time as their husbands. It is not uncommon for couples to retire at separate times.
  - Some women retire (or cut their work schedules) because of a partner, parent or grandchild who they expect to spend time with or provide care to.
  - Divorced women may have some of the couple's retirement assets as part of their settlement. However, often affordability is a big issue for divorced women.
  - Defining retirement dreams. It is important to focus on what the members of the household are trying to achieve. For women with partners, that may mean the couple's activities but also each person's own activities.

Many people decide to retire earlier than planned. Some of the common reasons include poor health, family caregiving needs, desires of a spouse or another family member or difficulties at work.

Some people are influenced by the retirement age provisions of Social Security and pensions. These provisions define when benefits would likely be collected and how much provided. They include:

- Social Security retirement benefits are typically claimed between ages 62 to 70. There is a significant difference in benefits depending on claiming age.
- Social Security full benefit retirement age for a person born in 1960 or later is rising to 67; Medicare is available at age 65.
- Most private sector defined benefit plans have a normal retirement age of 65; many have an early retirement age of 55 with a service requirement.
- Military, civil service, police, fire and teacher pension plans often have earlier retirement ages than private sector pension plans.

Later retirement often improves the economic situation because there is the potential for more years for assets to grow, more years to save, higher Social Security income and more years of employer-provided health coverage. Assets are also needed for a shorter time. For people with pensions, income from them may increase as well.

[5] For further details see: Suri, Vrdoljak and Liu "Beyond the 4% rule: Determining Sustainable Retiree Spending Rates." Chief Investment Office, 2022

Benefits of delaying retirement—Hypothetical example: Jane, who is single, will have a 401(k) and Social Security for her retirement income. To make amounts for different retirement ages comparable, all figures in the table are shown in real dollars (that is, adjusted for inflation). The 401(k) retirement income reflects an annuity factor for an inflation-adjusted annuity. Thus, the benefits of delaying retirement include both the increase in value of the 401(k) and the annuity factor increasing with age.

The example shows that Jane would see a 41% increase in monthly income if she delays retirement for four years. This increase is due to a combination of higher Social Security, annuity income and more savings. Starting Social Security at age 62 results in lower payments than starting at age 66.

If Jane retires at age 62, does not purchase an annuity and lives to age 95, she will have a 401(k) balance of $507,359 to spread over 33 years—in addition to Social Security of $914 per month (inflation indexed). If she waits to retire until age 66, she will have a 401(k) balance of $641,421, and she will be spreading this larger amount over 29 years until age 95. She will also have a higher Social Security benefit of $1,241. The increases in Social Security in this example mostly reflect adjustments applied to Jane's benefits for taking Social Security before age 66. The example assumes Jane has more than 35 years of earnings at an inflation-adjusted $40,000 per year. (Note: The highest 35 years of income is used to calculate Social Security benefits.) Because of this, the example does not show a benefit from Jane having more years of earnings.[6]

Exhibit 2: Deciding when to retire: Jane, a single female

Retirement age	401(k) balance	Annuity income per $100,000	Monthly annuity income	Monthly Social Security	Total monthly income	Increase vs. 62
62	$507,359	$310.00	$1,573	$903	$2,476	
64	$570,073	$330.83	$1,886	$1,064	$2,950	19%
66	$641,421	$352.50	$2,261	$1,241	$3,502	41%

This example uses the following assumptions:

- The case study presented is hypothetical and does not reflect an actual client. It is for illustrative purposes only and results will vary.
- 401(k) balance: Jane earned $40,000 per year in real dollars beginning at age 22 and saved an average of 10% per year until age 62 and 15% per year on any earnings after age 62. The assumed real return on the 401(k) is 5% per year.
- Monthly Income: The full 401(k) balance is used to provide monthly income.
- Annuity Factor: This is based on estimated rates for an Single Premium Immediate Annuity (SPIA) with a 2.6% COLA annuity as of 2/9/2022. (Annuity quotes provided by CANNEX.)
- Monthly Social Security: This is based on Social Security Quick Calculation. Assumes $40,000 in real annual earnings beginning at age 22. Assumes monthly benefits start at the beginning of retirement.
- The additional contribution of the 401(k) to retirement income from delaying retirement reflects: 1) growth from investment returns, 2) growth from additional contributions and 3) the fact that, because of the delay, the 401(k) will be spread over a shorter number of retirement years. The analysis is on a pretax basis.

Source: Chief Investment Office

[6] For additional examples and discussion on the benefits of delaying retirement refer too: Society of Actuaries (2017) “Big Question: When Should I Retire?” soa.org/globalassets/assets/files/research/research-pen-big-question.pdf

HELPING TO DECIDE WHEN TO CLAIM SOCIAL SECURITY

Social Security often plays an important role in providing retirement security for women. The Social Security Administration reports that almost 50% of elderly unmarried women who receive Social Security benefits rely on them for 90% or more of their income.[7]

The choice of when to claim: The choice of when to claim Social Security is among one of the most important financial decisions that women retiring make. Social Security retirement benefits are likely claimed between ages 62 and 70. Most people claim at age 62, the earliest claiming age. The longer someone waits to claim Social Security, the higher the monthly benefits. Someone claiming Social Security at the full retirement age (FRA), currently 66, receives a full benefit. Someone claiming Social Security at age 62 receives 70% of the benefit due, while someone claiming at age 70 receives 124% of the benefit (Exhibit 3).

Exhibit 3: How monthly benefits vary based on claiming age

	Age claimed	Percent of full retirement age benefit	Annual benefit payable to claiming age
Earliest possible age	**62**	**70.0%**	**$12,600**
	63	75.0%	$13,500
	64	80.0%	$14,400
	65	86.7%	$15,606
	66	**93.3%**	**$16,794**
Full retirement age is 67	67	100.0%	$18,000
	68	108.0%	$19,440
	69	116.0%	$20,880
Latest possible age	**70**	**124.0%**	**$22,320**

Source: Social Security Administration. Available at socialsecurity. gov/OACT/quickcalc/ accessed February 2022. Source: Chief Investment Office.

Guidelines to consider when claiming: Below are some guidelines to consider when deciding when to claim Social Security:[8]

- Unmarried women whose life expectancy is average should consider waiting until age 69 or 70 to claim.[9]
- For many married women, it makes sense for the higher earner to delay claiming benefits.
- Those who (due to poor health or some other reason) have very short life expectancies should consider claiming benefits at 62, the earliest possible age, but only after analyzing the potential effect on survivor benefits.

HELPING TO PLAN FOR LONG-TERM CARE

While women often spend time caregiving before retirement or early in retirement, they are less likely to have a family caregiver. That makes having financial resources for long-term care particularly important for women.

Duration of care: Research shows that 79% of women and 58% of men aged 65 and older can be expected to need long-term care at some point, and that average lengths for care were 3.7 years for women and 2.2 years for men. More than 70% of nursing home residents are women and over three-fourths (75.7%) of residents in assisted living communities are women.[10]

[7] Social Security Administration "Fact Sheet: Social Security is Important to Women" (2016) ssa.gov/news/press/factsheets/ss-customer/women-ret.pdf

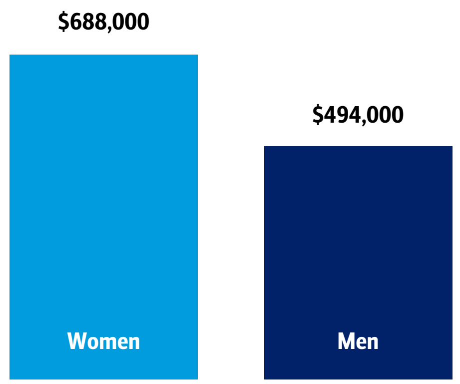
[8] For additional details on strategies to consider refer to: Suri and Vrdoljak "Claiming Social Security" Chief Investment Office, Summer 2021

[9] According to the U.S. Department of Labor (2022) At age 65, women can expect to live an average of 21.7 more years and men an average of 19.1 more years.

[10] Source: American Association for Long-term Care Insurance aaltci.org/long-term-care-insurance/learning-center/for-women.php, Accessed Feb. 2022

Costs associated with long long-term care: On average, women will have healthcare costs 39% higher than the average for men in retirement, paying an additional $194,000 (Exhibit 4).[11] This is because women may live longer and are more likely to spend years alone and have to rely on formal long-term care in their later years. The costs below illustrates a lifetime present value, much of which consists of premiums and copayments that are paid each year.

Exhibit 4: Average out-of-pocket healthcare costs through retirement, including long-term care



Source: AgeWave and Merrill (2021) Women & financial wellness: Beyond the bottom line.

Options for funding long-term care costs: Retirees at all ages, including those age 85 and over, underestimate the likelihood that they will need long-term care and overestimate their ability to pay for it. Retirees also overestimate how much Medicare will pay for long-term care. It pays for the first 90 days only. Medicaid is a last resort for people who have spent down their assets.

Two ways to consider for future long-term care needs are to self-insure by setting aside assets or to purchase long-term care insurance coverage. Long-term care insurance can be a big help, but relatively few people have such coverage. There are several different types of long-term care insurance coverage. This need not be an “either/or” choice.[12]

CONCLUSION

As women near retirement, planning becomes more intense. Women must make decisions, even knowing that market fluctuations or other changes will occur once retirement begins. The plan should allow flexibility for such changes. Women who are part of a couple could link their plans to those of the family, while keeping in mind the likelihood that they may ultimately be alone. Women should understand what resources they have and may need to fund a retirement that could last 30 or more years. When a woman retires, there may be far-reaching implication. If it’s later, she has potential to save more and invest before and less time requiring funds afterward. When to claim Social Security is another very important decision. Women are more likely than men to need long-term care. It is important for women to plan early so that the high cost of long-term care does not threaten their financial security.

TIPS

- Plan for a long retirement.
- Carefully consider when to retire.
- Carefully time your claim to Social Security; spouses should coordinate their decisions.
- Long-term care insurance is particularly important for women.
- Understand how you are going to maintain health insurance in retirement.
- Remember that things change during retirement.

[11] AgeWave and Merrill (2021) Women & financial wellness: Beyond the bottom line.

[12] For a thorough discussion of these and other options, see “Healthcare Costs in Retirement: Preparing Today to Protect Your Wealth Tomorrow,” Merrill A Bank of America Company, 2021.

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