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BARRON'S COVER

Retirement: How to Protect Your Health and Wealth

Barron's experts address key issues to ensure your retirement is a healthy and wealthy one.

By BEVERLY GOODMAN
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When you gather four financial advisors to discuss retirement planning in the midst of the market's most volatile period in six years, you'd think the conversation would revolve around investment strategy and long-term outlook. Instead, Tolstoy could have written this script: "Happy families are all alike; every unhappy family is unhappy in its own way."

Our participants, clockwise from top left: Kevin Myeroff, Erna Morgan McReynolds, Brad Kudick, and Cynthia Hewitt. *Photos: David Yellen for Barron's*

How families communicate may be even more important than how your portfolio performs, say the participants of *Barron's* third annual Health and Wealth Roundtable. They talked about how to ensure that your retirement is protected from not just market gyrations, but also miscommunication and emotional decision-making. And, of course, they talked about long-term care insurance, every advisor's favorite debate. This year's participants:

Erna Morgan McReynolds leads the Morgan McReynolds Group at Morgan Stanley in Oneonta, N.Y. She manages $600 million for mostly retirees or those nearing retirement. At times she finds scenarios that require her to intervene, "but sometimes people want things that are very subtle and difficult to understand. In the end, it's their money."

Kevin Myeroff, based in Cleveland, manages $1.5 billion at his independent shop, NCA Financial Planners. His average client has $1 million to $5 million. Though most can afford to pay for any long-term care, he often advises they purchase insurance. "Some people watched their parents benefit from a long-term care policy; others just don't want to be a burden on their kids," he says. "A lot of family issues come into play."

Cynthia Hewitt, of Merrill Lynch's $1.1 billion Hart Group in Wilmington, Del., just hired an estate attorney to handle the increasing number of issues she's seeing among her clients. "There's an issue related to aging coming up once a week," she says.

Brad Kudick's client list consists mostly of near and early retirees in their 60s, who have $800,000 to $1 million in their accounts. Kudick is an advisor at U.S. Bancorp in Milwaukee, and he has found that more and more clients are supporting adult children. "There are often some difficult conversations," he says, "but at times you have to help your client let their kids go."

Barron's: *The recent market volatility has everyone on edge, but it can be particularly precarious for near or new retirees. What are you hearing from clients?*

Cynthia Hewitt: There is a big transition going on. Volatility has picked up after being pretty stable for the past few years; there are changes in the Chinese stock market and the potential for an interest-rate hike. All of that is particularly tough on retirees.

Erna Morgan McReynolds: We've been calling our clients to reassure them, and they say, "Oh, you told us this; we knew this was coming," because for the past 18 months I've been saying to clients that this market can't last, not without volatility.

Brad Kudick: About 60% of my clients are retired, and the other 40% are nearing retirement. Most just call to say, "Hey, is our plan on track?" And it is. At this point, there is no reason to change anything.

Kevin Myeroff encourages clients to live on a fixed income for a year or two before they actually retire.
Photo: David Yellen for Barron's

Kevin Myeroff: We've been seeing a lot of proximity bias. Clients who were invested when the recession hit six years ago, still worry that another, similar event is around the corner. They just want to hear the reasons we're not worried about another recession. For people who came into the market after the recession: All they've seen is increasing markets. So proximity bias has really hurt people both ways, making some too conservative and others too aggressive. Our job is to keep them in line with their goals.

Hewitt: One of the take-aways for me from the 2008-09 meltdown was talking to clients in terms of income generation, rather than returns. People are generally OK with volatility so long as their income is stable.

How do you plan for various short-term income needs in a volatile market? Keeping more cash on hand provides a ballast, but reduces a portfolio's income.

Myeroff: It is not like the old days when you could invest in just income instruments. We always set aside somewhere between six and 18 months of expenses in a money-market fund. If the markets are doing well, we may sell a bit and increase the pot. If they are doing poorly, we may hold off for a little while. We generate the income both through dividends and capital gain. We don't use separate buckets for specific needs, but that is another good method.

Hewitt: We keep about a year of living expenses on hand for folks. I don't want anybody to feel that they've got to make an emergency sale. We might go as high as even 5% to 10% of their portfolio in cash, depending on the needs.

Kudick: We keep 18 to 24 months of expenses set aside in a separate bucket. As markets move up or down, we'll rebalance.

McReynolds: We make sure that people have no less than one year's expenses set aside. We tell them, don't even think about retiring if you can't set that aside. Some people need as much as two years. We take not just what they tell us they need in income, because they're often wrong. They can be so far off.

How do you gauge how much money a client needs to live on? And why is it so hard for clients to estimate their own spending?

McReynolds: A lot of people are embarrassed, or in denial, about how much they're spending and what they're spending it on. Sometimes the spouse doesn't even know.

Myeroff: In my 30 years of doing this, low-income earners know best what they spend, because they have a fixed amount of money. It is the high-income earners that have the hardest time. I always make my clients practice for a year before they retire. I'll open up another checking account and put the $10,000 they say they need every month into that account. They have to live on that, and save some extra because there are some expenses that come annually, like insurance and property taxes. They can cheat, of course, but it only hurts them. It's a test that is really, really important.

Cynthia Hewitt says age-related issues come up so often in her practice she added an estate attorney to her team. *Photo: David Yellen for Barron's*

How many of your clients actually do this?

Myeroff: We try to make every one of them do it. They usually agree—reluctantly. Then comes the inevitable phone call in which they tell me, "Hey, I've got this expensive vacation/shopping spree/whatever coming up, but we would never do this sort of thing in retirement." I tell people: You can't go cold turkey. You can't go from living a high middle-class or first-class life and say that in retirement you are going to ratchet it way down. It doesn't work that way.

How far off are your clients' estimates of their own spending?

Myeroff: Easily between 10% and 15%.

Kudick: It is a different mind shift for people when they transition into retirement. There's a lot of nervousness. It usually takes 12 to 18 months before people feel comfortable in their new "no paycheck" environment.

What are some of the big costs people miss?

Myeroff: In Cleveland, lots of people want to downsize their homes. But they end up downsizing only in terms of square footage, not cost. They also think that once the children are older, we're not going to spend as much money on them. They forget that as grandparents, you wind up spending just as much money.

McReynolds:I'm from upstate New York, where it can be chilly and snowy. Lots of clients decide they want to buy a retirement home in Myrtle Beach [S.C.] or wherever they've spent their vacations. Often, they miss their friends, or they don't like the area year-round, so they try to maintain two homes. Then there's the added cost of maintenance, taxes, sometimes a mortgage. I try to encourage them to rent first.

You mentioned a mortgage. Low interest rates hurt retirees from an income-generation perspective, but are they a boon in terms of financing retirement?

McReynolds: Yes. Many retirees want to be cash buyers—they want to pay for their car, a home, in cash. Yet if you can get practically zero-percent financing, why wouldn't you? When you take big hunks of capital out of your portfolio, you're removing capital that can generate income. That's a risk. Why not let the bank take the risk of loaning you money, so you don't have to take the risk of losing income-generating principal?

Kudick:I agree. Cash flow is the name of the game in retirement. But you have to be careful and not layer on more debt to the point you have a whole set of monthly expenses in retirement that you didn't have prior.

Myeroff:I'll take an opposite view. Mathematically, I know all you guys are right. But the whole concept behind that thinking is that the debt has to cost less than what your money could earn in the market. Our clients have more than enough money. They can afford to not do what is mathematically best, and that option gives them a hedge. Look at it this way: If the markets do great, you could say it was a bad decision to pay cash and have that money in a house rather than the market. But my clients would still have had so much money in the market that they did great anyway. And if the markets go the other way…well, in 2008, all my clients who had their homes paid off were so happy that nobody could touch that home.

Do you often find yourselves advising clients to curtail their spending?

Kudick: There is a growing trend of adult kids moving back home and adding stress to the budget of those who are retired. Those are tough discussions to have. But oftentimes we do have to deliver the news to the family that that kind of support cannot continue.

Hewitt: It often involves talking with family. We recently had a situation in which the wife was spending a lot of money supporting her adult son and his family. It is her second marriage, and her husband knew about her spending, but was not involved. Her son and his wife thought they were spending about $20,000 a year, but it was more like $80,000. We brought the son and daughter-in-law in with the mother to show everyone how much she was actually spending on this family, to say you can't keep doing this, something has to give.

Brad Kudick makes sure his clients' portfolios can withstand a three-year stay in a long-term care facility. *Photo: David Yellen for Barron's*

How do you approach a conversation like that?

Hewitt: It was tricky; that's a hard conversation. I was concerned enough that I brought in her attorney and her accountant for support. But the bottom line is, it is her money.

Do your clients come to you with concerns about their spending, or do you more often notice it first and bring the issue to them?

Hewitt: They're often aware there's a problem, but don't want to bring it up. In this case—and many others—I suggested they use a corporate trustee. The money gets put into a trust with your instructions and is overseen by a professional at a bank or trust company. Let them be the heavy.

Myeroff: The greatest gift a parent can give to their children is not a college education, though that's what most people think. The greatest gift to your children is not to be a burden on them in your retirement. If our clients can afford to support an adult child without ruining their retirement, that's up to them. But generally, we get involved because we realized they are spending more cash than was budgeted, and we have to put the word to the kids that the bank of mom and dad is going to close.

Do you work with your clients' children, as well?

Myeroff: We'll work with the kids, give them a date the "bank" is going to close, and explain how their parents can help them until then. That's a very, very healthy conversation, because if you are enabling the kids, they aren't learning the skills they are going to need to do things on their own. And if you are ruining your retirement in order to support your kids, your kids don't even want that.

McReynolds: We had widow who was left with $30 million. Her son had power of attorney. She lives on Social Security now. Lots of people don't understand powers of attorney, especially that you don't have to be incapacitated before a durable power of attorney can be used.

Erna Morgan McReynolds says that people often make financial decisions that are based on emotion, rather than math. *Photo: David Yellen for Barron's*

Are you saying the son spent $30 million of his mother's money?

McReynolds: Yes.

On what?

McReynolds: Giving money to his kids, buying new houses, all sorts of things.

Was she not aware this was happening?

McReynolds: She had sort of given up. Her husband died, she'd had another child die, and she just thought, oh well, he's family, and she was used to having a man run things. Sometimes there are scenarios where someone has to step in, but sometimes people want things that are very subtle and difficult to understand.

Hewitt: That would have been a perfect scenario for a corporate trust.

McReynolds: You're absolutely right.

How do you ensure your clients have the legal and emotional protection they need?

McReynolds: Our very first meeting with clients, we ask them about a living will, health-care proxy, when the last time their will was updated, who in their family we can talk to.

Kudick: We also discuss all that at our first meeting.

Regardless of a client's age?

Kudick: Yes. There are three documents everyone should have—a will; a health-care proxy, which names someone to make health-care decisions on your behalf if you're not able to; and a financial power of attorney, which will allow someone to make financial decisions if you can't**.**

Hewitt : We ask everyone to have a power of attorney. It's not about age or retirement: You never know when you are going to be hit by—one of my clients says "the beer truck"—and you can't function. For older people, we do try to bring in the children. We've seen accounts frozen; there's a lot of money nobody can access because no one has been named to legally make decisions. It's not a good thing.

Myeroff: You have to be careful in these discussions, because many clients don't really know what they are giving away. A limited power of attorney is for a specific situation or action; for instance, it can allow someone to pay bills from an account but not take money for themselves. Durable power of attorney is pretty much unlimited.

How often do you discuss this with clients?

Myeroff: Many organizations want a power of attorney to be dated within the past six months. There is no clearinghouse for powers of attorney. So if I make you my power of attorney and then decide I don't want you anymore, and I give someone else my power of attorney, you could still show up next with that paperwork, and it's good to go. It's really important to keep it updated, because we've seen people become incapacitated, and the bank or some other institution will want a more recent power of attorney. But once someone is incapacitated, the only way you can get that is an attorney needs to write a note saying the existing one is still valid, but a lot of attorneys won't do that if they don't really know.

What about joint accounts?

Myeroff: Joint tenancy means that both people have equal right to an account. But say you are my child and we want to be joint tenants because I'm getting old and you are worried about my money. If you got in a car accident and are sued, they could take that account. Tenants in common is a little bit different. You don't have access to the whole account, only the part that's really yours. You can decide to require two signatures on transactions.

Hewitt: If one of the tenants, or partners, dies, it goes directly to the other person.

McReynolds: It's a pro and a con because the account then doesn't go through probate. But if there are stocks in the account that have been held for a long time, the new owner, in this case the child, won't benefit from the stepped-up cost basis. [When an heir inherits securities, their cost basis is "stepped up" to the fair market value at the time of death; if the heir decides to sell right away, they'll pay virtually nothing in capital-gains taxes.]

Legal titling of assets is important, of course, but it becomes imperative when talking about long-term care. How do you plan for that? Do you all advocate for your clients to buy long-term care insurance?

Kudick:I do. It's part of our planning early on—we test the portfolio and our plan by factoring in an event, such as a three-year stay in a long-term care facility at age 75 or 80, for one or both spouses.

What age do you start discussing long-term care insurance with your clients?

Kudick: Usually about 50.

Myeroff: It's gone down and down.

Hewitt: As the costs have gone up and up.

McReynolds: We talk about long-term care insurance with everyone. We have a client who was in a serious car accident at age 37 and has been in a nursing home ever since.

Kevin, you were saying that the age that you talk to clients about long-term care has gotten younger and younger.

Myeroff: Just five years ago, we'd talk to people about it when they were between 58 and 63. Now it's as young as 55, because the underwriting on traditional policies [policies that require the buyer to pay an annual premium] has gotten so difficult. They are much tougher on health issues, and they've gotten more expensive.

Kudick: I had a client who, at 75, realized that her kids weren't going to be available to help as much as she might need, but she wanted to protect her assets so that they'd inherit something. We ended up buying her a traditional long-term care policy.

She was able to buy a policy at 75?

Kudick: Yes, but that was 11 years ago. She couldn't get that policy today. Now she's 86 and actually using the policy for home health care. But after paying the premium for five years, she began calling me every year to ask if she should continue paying. She didn't want to pay it. People often just think of it as an expense.

How much was her premium?

Kudick: The annual premium was $4,200. Because of her age, we didn't add an inflation rider to save money. It won't cover 100% of her care if she moves into a facility, but it will cover what her cash flow won't support.

So what does $4,200 buy her?

Kudick: She can collect $3,600 a month for three years.

Hewitt: On average, women spend 3.7 years in a retirement or nursing home, and men 2.2 years. We use hybrid policies, because they're more flexible. With these policies, you pay just one, lump-sum premium, no increases to worry about. And if you decide you need the money more than you're likely to need the long-term care, you can get your money back.

Can you get your money back any time?

Hewitt: Different policies have different restrictions; with some you can get your money back immediately, others you have to wait.

Can you take just some of your money out, and leave the remainder for reduced benefits?

Hewitt: You can, but that gets tricky from a tax perspective. It's better to pull it all out—but I've never had a client need or want to do that. The flexibility is often more for peace of mind.

McReynolds: The annual premiums on traditional long-term care policies can rise every year, and they have increased significantly. We had a new client who came in a couple of weeks ago with policies already in place. Their premiums are set to go up 50%.

Myeroff: We plan for five years of care. The average cost is about $8,000 a month, so five years could cost $480,000. How do you generate that? How likely is it you'll need it? How much can you rely on family to help? A lot of people have loving families that can help; others don't want to be a burden. All those things come into play as to whether or not you need long-term care insurance—but in the end, it is math.

Cynthia, you were seeing so many aging concerns that you hired an estate attorney as part of your practice. What sort of issues were coming up?

Hewitt: More and more people have a lot of their retirement savings in 401(k)s, IRA rollovers, and other tax-deferred accounts. They're tricky in terms of naming beneficiaries. If your beneficiary is your son or daughter and he or she dies or gets divorced, that money can conceivably go out of the family. There is something called a Trusteed IRA, which is as close to controlling from the grave as anything I've ever seen. You can set up a trust to control how your money flows to make sure, say, it goes to your grandchildren.

McReynolds: People often want to give their house to their kids, and they don't understand that when you make a gift, the recipient gets your cost basis. Let's say you built or bought a house for $200,000 and now it is worth $1 million. If you give it to your kids during your lifetime, their cost basis will be $200,000; if they sell it, they'll owe capital gains on $800,000. They'll get clobbered.

Also, our area is near where IBM began, and its stock was sold door-to-door, and a lot of our clients have IBM stock with virtually zero cost basis. This can be good for a charitable remainder trust—they get the deduction for the fair market value of the shares, and the trust can sell the stock without owing any tax. The trust pays an income stream that can be used to live on.

Myeroff: You also have a problem when there are three kids, two of them are surgeons and one is a social worker. The parents get so caught up in wanting to treat everybody equally. I tell them that the only obligation parents have is to love their children equally; they don't have to necessarily treat them equally.

McReynolds: Amen to that.

Kudick: It doesn't have to be equal; it just has to be fair. When we have a family meeting and explain the parents' spending plan through retirement and beyond, it's rarely a problem. The kids almost always understand and agree.

Hewitt: Just put all your cards on the table. I've seen too many times when families get really upside down with each other.

Thanks, everyone.

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