USA Today

Two Ways to Avoid Going Broke in Retirement

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July 31, 2019

Many older adults worry about going broke in retirement, about outliving their assets. But they don't have to worry if they follow two key steps outlined in new research from the Stanford Center on Longevity and the Society of Actuaries, those chipper folks who study how long you might live.

What are those steps?

1. Delay Social Security benefits

Whether you're the primary wage-earner of a married couple or a single retiree, you should delay claiming Social Security for as long as possible, though no later than age 70.

Doing so, the researchers say, does two things:

One, the beneficiary will receive the largest possible monthly benefit. That's because Social Security retirement benefits are increased by a certain percentage (depending on your date of birth) if you delay your retirement beyond full retirement age or FRA. So, for instance, those born in 1957 could get 128% of their scheduled FRA monthly benefit if they delay getting benefits from age 66 and six months (the FRA for someone born in 1957) to age 70.

And two, the increased benefit could represent two-thirds to more than 80% of a retiree's total retirement income. And for many middle-income retirees, this may represent all the guaranteed lifetime income they need, according to the researchers.

2. Use withdrawal rules

The second step is for you, the retiree, to generate income from your savings using the IRS' required minimum distribution (RMD) rules, coupled with a low-cost index fund, target-date fund or balanced fund.

The IRS requires that IRA and 401(k) account owners start taking mandatory distributions from their accounts starting at age 70½. Though complicated, the RMD rules say you must start withdrawing a certain amount of money from your retirement accounts each year based on your life expectancy and the amount of money in your accounts.

A few caveats. These two steps, which the researchers refer to as the "Spend Safely In Retirement Strategy" (SSiRS), are intended as a “baseline” approach for middle-income workers who: won’t have much if any traditional pension/defined benefit plan income; have accumulated $1 million or less in their 401(k), IRA or other accounts earmarked for retirement; and might not work with a financial adviser.

Pros. Among the SSiRS' advantages, the researchers say, is that the approach is easy to understand and implement, and doesn’t require the ongoing involvement of a financial adviser. Plus, optimizing Social Security benefits will mitigate some of the more common retirement risks such as longevity (the risk of outliving your assets), inflation, and declines in the value of your retirement portfolio.

But this strategy is not without its disadvantages.

SSiRS doesn’t work all that well when living expenses are uneven and vary from year to year. For instance, the decision to use RMD rules for withdrawals – rather than say the 4% rule where one withdraws a fixed percentage per year from retirement accounts – means your income could fluctuate year to year. So, for example, let's say you are 70 and had $1 million in your IRA as of Dec. 31 of the previous year. In year one of the strategy, you would withdraw $36,496 from your account. But in year two, let's say you had $950,000 in your account. Now your RMD would be $35,849. So, the RMD strategy might not work for retirees who have to cover essential and/or unexpected expenses with the money in their retirement accounts.

Often, actuaries and others will say essential living expenses ought to be covered by fixed sources of guaranteed lifetime income such as Social Security, a pension and/or an income annuity rather than income from retirement accounts.

Another possible disadvantage: You might have to create what the researchers call a “retirement transition fund” in order to delay taking Social Security until age 70. In other words, you might have to withdraw money from your retirement accounts to make up for the Social Security benefit you delayed receiving. And doing so could reduce the amount of money you’ll have for retirement.

What else to consider? SSiRS likely needs to be customized and refined for your own facts and circumstances, as monitored and tweaked when necessary.

You might claim Social Security at FRA instead of 70 and still benefit from the strategy. And you might want to purchase more guaranteed income in the form of a single premium annuity with the assets in your retirement accounts. Or you might need to consider other ways to create income in retirement. A reverse mortgage or an annuity funded with the cash value of a whole life insurance policy could be used to generate income.

Also, if you have an adviser, consider a personalized plan as an alternative to the SSiRS.

What others say about this strategy? Tim Steffen, director of advanced planning at Baird Private Wealth Management, says the SSiRS concepts can certainly work. Using an RMD method for withdrawing assets ensures the money never runs out, he says.

But the key thing the SSiRS strategy tries to protect against is overspending in retirement.

“By having the Social Security and retirement accounts provide an automatic cash flow stream, the retiree knows what they have to work with each year, making budgeting easier,” Steffen says.