How to avoid bankruptcy in retirement — and safeguard your golden years

November 22, 2024 at 1:18 PM

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How to avoid bankruptcy in retirement (elenaleonova via Getty Images)

Going broke before you die is a big concern among many older folks. Nearly two-thirds of Americans are worried they'll run out of money before they run out of breath, according to a recent Allianz Life study.

With growing inflation, limited income and significant money setbacks, it's no wonder many of us worry we won’t be able to afford retirement. But what are you supposed to do if you can’t find a job or you’re physically unable to work? You may not have a lot of options.

If you’re afraid you won’t be able to pay your bills or outstanding debt during your golden years, filing for bankruptcy might be an option for a fresh start. But it’s not an ideal option for seniors, and so you’ll want to explore all other options first.

Here’s how to avoid bankruptcy in retirement so you can enjoy your golden years rather than run away from them.

Prepare now for your future self

There’s no better time than now to prepare for the future. That looks different for everyone, depending on how old you are, your ability to work and how much you’ve already saved up.

If you’re unsure how to start, ask yourself:

1. **How much have I already saved for retirement?**
2. **How much should I have saved for someone my age?**
3. **Based on when I plan to retire, how much should I be saving every month until then?**
4. **How can I rearrange my budget and lifestyle to prioritize my future self?**
5. **What will these changes mean for my family and finances right now?**

🔍 Is a financial advisor worth it for retirement planning?

Yes, in most cases. A financial advisor can help you manage your money as you plan for retirement, while giving you a sense of how much you can spend during retirement to make your savings last. Their market expertise may also help maximize your savings. If you're anxious about retirement, working with an advisor can also give you peace of mind by assuring you that you're on the right path. Start with our guide to finding a trusted retirement advisor.

Get matched with a trusted financial advisor in 4 simple steps

How to avoid bankruptcy in your golden years

Preparing for a comfortable retirement now is one of the most effective ways to avoid insolvency when you get older. But even as you're taking on those initiatives now, there are other ways to avoid bankruptcy as a retiree.

1. Plan early

When you're young, it isn't easy to think about what your life will be like when you're not working anymore. But there comes a day when you may have to stop working, whether you want to or not.

Take some time — even if it's just a bit every few years — to assess and reassess your retirement plan. Make sure you're working toward the right goals for you, not necessarily what someone *else* told you is the right thing to do.

For instance, do you want to retire when you're 60 so you can travel for a few years after you stop working? Do you want to switch industries or a second-act career later in life? Are you thinking about working fewer hours so you can spend time with your grandchildren or visit family across the country? What job gives you that flexibility to come and go as you please? Don't wait too long to plan accordingly.

2. Prioritize debt payoff

Carrying a lot of debt into retirement can be a heavy burden. Whether it's a home, car or education loan, figure out a debt payoff strategy while still bringing in a regular income.

Debt repayment strategies vary based on how you want to tackle your debt. Some folks may have high-interest credit card debt, and using the debt avalanche method might be the best strategy to go with. Depending on how much you owe, a debt consolidation loan might help streamline your payments with a lower interest rate, helping you to save money and time before retirement.

Others may have a large debt, like a mortgage. In that case, making larger or extra mortgage payments every year can help you pay off your home sooner. Some people may want to downsize to a tiny home in retirement, which helps pay off debt but could bring on new costs. So be careful as you make plans to readjust your lifestyle.

Dig deeper: 5 debts to prioritize paying off before retirement — for more worry-free golden years

3. Plan your withdrawal strategy

Most retirement strategies plan for saving, not spending. So it's not always easy to remember that there will come a time you have to spend the money you've spent so long to save up for.

There are a few different retirement withdrawal strategies. There's no wrong way since everyone's approach to finances is different. Here are a few popular ones:

1. **The 4% rule for retirement.** With this popular strategy, you withdraw 4% of your retirement portfolio during the first year of retirement. You then withdraw the same dollar amount every year — adjusting for inflation — after that. But it assumes a typical 30-year retirement,

among other factors you'll want to consider.

2. **Fixed-amount withdrawals.** This strategy advises making fixed withdrawals at regular intervals, whether monthly, quarterly or annually. Taking a set amount of money out means you can only spend that amount for that period until your next withdrawal.

3. **Required minimum distributions (RMDs).** Required minimum distributions are the minimum amounts you must take when you hit a certain retirement age — that's 70 to 75, depending on your birth year. RMDs tell folks how much they need to take out from their tax-deferred retirement accounts. For instance, a traditional IRA and employer-sponsored retirement plans like 401(k)s have RMDs but a Roth IRA does not.

Dig deeper: How to plan your retirement withdrawal strategy in 4 smart steps

What happens to your retirement accounts in bankruptcy?

Most employer-sponsored retirement accounts are protected from bankruptcy. So if you file bankruptcy in retirement, your retirement accounts won't get seized to pay off any outstanding debt. The Employee Retirement Income Security Act (ERISA) keeps your money safe from creditors and bankruptcy court, as long as you have a qualified account.

Qualified plans include pensions, traditional and Roth 401(k)s and some 403(b)s. However, nonqualified plans include traditional and Roth IRAs and some 403(b)s. While all of these accounts are protected from bankruptcy, nonqualified accounts are only protected up to a certain amount. For traditional and Roth IRAs, the exemption is $1,512,350 per person, with the limit adjusting every three years. The next limit will be adjusted again in 2025.

Each state has its own standards for pursuing these plans, so what happens to the money in your account depends on where you live.

Alternatives to bankruptcy

Bankruptcy is usually a last resort for many folks who don't feel there is any other way out of their financial situations. Before you file for bankruptcy, consider other alternatives.

1. Debt payoff strategies

Depending on your debt, a do-it-yourself approach might work just fine. Consider the debt avalanche or debt snowball methods.

Since high-interest debt tends to eat away at most of your extra money, the **debt avalanche method** focuses on paying down debt with the highest interest first. With this method, you'd write down all your outstanding debt — including credit card debt, medical bills, loan debt or anything you want to pay off — in order of interest rate, noting the total amounts to pay off, minimum monthly payments and due dates. You'll make minimum payments on all your outstanding debt, then put any extra funds toward the debt with the highest interest rate. You'll do this every month until the highest-interest debt is paid off, and then move on to the next debt with the highest interest until all your debt is paid in full.

The **debt snowball method** works similarly, though you order your list by the amount owed. You'll make minimum payments on everything, with any extra money going towards the smallest-dollar debt. You'll do this until the smallest debt is paid in full, then move on to the next smallest debt until all your debt is paid off.

In a nutshell: Debt snowball vs. debt avalanche

	Debt snowball method	Debt avalanche method

How it works	Order debts by size of balance and prioritize extra payments toward smaller debts first until all debts are repaid	Order debts by interest rate and prioritize extra payments toward debts with higher APRs first until all debts are repaid
Best for	Those motivated by frequent wins	Those focused on saving the most you can on interest
Main drawback	May not save as much as debt avalanche	Can be difficult to stick with

Some folks work best with little victories, which is why the debt snowball method is popular. However, the debt avalanche method is for folks who can stay on course and want to save more money in the long run.

Dig deeper: Debt snowball vs. debt avalanche: Which payoff strategy is best for getting control of your debt?

2. Debt management

You can get on a debt management plan to consolidate your debt with the help of a nonprofit credit counselor. These plans combine all your unsecured debt into one manageable plan, usually reducing interest rates and unwanted collection calls. You'll make one lump-sum payment to a credit counseling agency each month, and that agency uses the money to pay your debt on your behalf, working to lower your financial obligations and get you on the right track.

Stay alert to scammers who demand upfront payment or hefty fees. In many cases, creating a personalized plan for your debt management is low cost and sometimes free. Find a reputable counselor or agency through places like the National Foundation for Credit Counseling (NFCC), the Financial Counseling Association of America (FCAA) or the U.S. Department of Justice.

3. Borrow from your retirement accounts

Rather than take out a personal loan, look at your retirement accounts to start taking withdrawals. See if you can withdraw without facing an early withdrawal penalty.

If it's too early to take withdrawals, see if you can take out a 401(k) loan. A 401(k) loan is a type of loan that allows active employees to borrow from a retirement account balance, making you both the lender and the borrower. It's still a loan you'll need to repay, but remember you're borrowing from your future self, so those funds you take out won't get a chance to grow and earn interest — even when you do pay back your loan.

Dig deeper: 401(k) withdrawal rules: What to know before cashing out — or borrowing from your balance

Where to get help in retirement

Sometimes, you just need to talk to someone. It might be time to consult a professional, like a bankruptcy attorney, to learn about your options and where you stand.

Don't be afraid to ask for help, especially when it comes to getting the things you need to get by. Here are helpful resources to help you navigate challenges in retirement:

- **Local senior assistance programs.** Many communities support programs specifically designed to assist low-income seniors, and each state has its own office or agency for the aging. To find these programs, contact your local Area Agency on Aging.

- **Government resources.** Federal and state programs offer financial assistance for seniors, such as Supplemental Security Income (SSI) or Low-Income Home Energy Assistance Program (LIHEAP), which can help with basic living costs.

- **Volunteers of America.** Among the nation's largest human-service organizations, Volunteers of America provides a wide range of services for the elderly, such as meal programs, transportation, help with Medicare enrollment, nursing care and affordable housing.

- **Benefits Checkup tool.** The NCOA offers an online benefits tool that can connect you with programs to help pay for health care, medicine, food, utilities and more. Just enter your ZIP code to get started.
- **2-1-1 hotline.** This FCC-supported hotline is your three digits for information and social services that can help with food, finances, transportation and other necessary support through more than 200 local organizations, including United Way, Goodwill and community action partnerships. Simply dial 2-1-1 for help or search for help by ZIP code.

FAQ: Retirement planning, bankruptcy and your future

Still not sure where to turn for support in retirement? Learn more about how to protect your retirement savings and more with these common questions.

What are the main types of bankruptcy?

There are several forms of bankruptcy processes, though the average person will typically file for one of two types:

- **Chapter 7 bankruptcy.** The most common type of bankruptcy, a chapter 7 filing involves liquidating — or selling — your assets to pay off your creditors and debts.
- **Chapter 13 bankruptcy.** Also called a wage earner's plan, a chapter 13 filing is for those with regular income. It allows you to restructure your debts, keeping some of your assets while committing to a repayment plan of three to five years.

Each type stays on your credit report for up to 10 years.

Is my retirement safe from bankruptcy?

In most cases, retirement funds, pensions and even Social Security benefits are safe from being taken from creditors to repay your outstanding debt, but it depends on the accounts in question and how much you have in those accounts. Talk with a reputable attorney for legal advice or trusted retirement professional for guidance to determine whether bankruptcy is the right option for you.

Is credit repair the same as credit counseling?

No. Credit repair companies are for-profit enterprises that focus only on filing disputes with lenders, creditors and credit bureaus for a fee. In many cases, you can do this work yourself to clean up your credit.

Credit counselors, however, work for nonprofit organizations and counseling agencies to provide free help with budgeting, building credit and managing debt for long-term success. You can find a certified credit counselor through the National Foundation for Credit Counseling.

Can I take a hardship withdrawal from my 401(k) to pay off debt?

You can use your 401(k) to pay for an immediate financial need, like medical expenses for you or a family member, funds for buying a home, tuition costs, eviction prevention, home repairs, funeral expenses, and others. You can avoid an early tax penalty if you make a hardship withdrawal from your 401(k), which is a necessary financial need.

What is the difference between debt consolidation and debt settlement?

Debt consolidation and debt settlement are two types of debt management strategies for paying off high-interest debt, but they differ in key ways. While a *debt consolidation loan* works to simplify multiple debts into a single payment, ideally at a lower overall interest rate, *debt relief or debt settlement* involves negotiating with your creditors to accept less than what you owe, typically on debts that you're past due on, taking a fee of 15% to 25% of your total settled debt — a stiff fee, but one that could be worth it if you don't feel you have other options.

Sources

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About the writer

Dori Zinn is a personal finance journalist with more than a decade of experience covering credit, debt, investing, real estate, student loans, college affordability and personal loans. Her work has been featured in the New York Times, the Wall Street Journal, Yahoo, Forbes and CBS News, among other top publications. She loves helping people learn about money.

Article edited by Kelly Suzan Waggoner