Retirement Income Education Insights

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Retirement planning is complex, with a wide range of solutions. Learn ways you can gain greater insight into helping your clients.

I, ALONG WITH MANY others both inside and outside of The American College, put a lot of thought and hard labor into the recently completed Retirement Income Certified Professional™ (RICP™) designation. For me, this was one of the most interesting and rewarding professional experiences that I have had at The College, as completing the task involved:

• Identifying a process for building a retirement income plan
• Clarifying all the issues that need to be addressed when building a plan
• Determining what advisors need to know to do this work
• Gathering many different voices to teach the concepts—including six faculty members who built competencies along with the nine other faculty members and 38 outside experts who participated in the program

Based on this experience I want to share some of the insights, surprises and questions that I have gathered along the way.
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**THIS WORK IS COMPLEX**
As you start to dig into retirement income planning it becomes apparent that the work is exceptionally complex. The first challenge is that the client doesn’t have experience with retirement. The client is being asked to first visualize and then plan for the unknown—and guess what, the advisor doesn’t know what retirement is like either. Clients are also asked to plan for everything from fulfilling unmet dreams in the early years of retirement to how they will be cared for when they can no longer care for themselves.

There’s no cookie cutter solution, as everyone has a different set of circumstances, goals and resources. Some are well funded and others are not. Some have company pensions or other sources of income, and others just have Social Security, a 401(k) plan and some home equity. And everyone has something to deal with, like an adult child out of work, a grandchild they are putting through private school or a house on the lake the family can’t live without. Once you figure out the goals and put together an income plan, you must also be ready for the landmines along the way. What happens if inflation is high, taxes go up or life goes on for a very long time? And these are just a few of the issues. In the RICPTM curriculum we identified about 25 risks that are faced in retirement.

**THERE IS A LOT OF RESEARCH**
I also learned that a lot of smart people are trying to figure this out. First are the academics looking at interesting questions such as:

- What is a safe withdrawal rate from a portfolio?
- How do you maximize utility (satisfaction) in retirement?
- What is the most tax-efficient withdrawal strategy?
- What is the impact of Social Security claiming decisions?

Then you have companies trying to create the right products for their clients and building processes to help advisors work with their clients. You also have software vendors looking to create helpful tools that are comprehensive, but easy to use and can provide reporting capabilities that make sense to the client. There are advisors looking to capture best practices and regulators trying to figure out how to ensure that the public is best protected.

I encourage everyone to follow the academic research. The New York Life Center for Retirement Income (NYLCRI) website (retirement.theamericancollege.edu) includes interviews with many of the leading researchers talking about their work. The Center also has a resource guide (library.theamericancollege.edu/retirementincome) for locating research, tools, government programs and consumer information. Faculty members Wade Pfau and Michael Kitces do a great job in their blogs of identifying interesting articles and trends. The Journal of Financial Planning and the Journal of Financial Service Professionals include many articles on this timely topic, and the industry organization, Retirement Income Industry Association (RIIA), now has a journal dedicated to this subject, the Retirement Management JournalSM. Pfau, at his website (retirementresearcher.com), has a link list of many of the important voices in the retirement income field.

**THERE ARE MANY PLAUSIBLE SOLUTIONS**
One of the most interesting aspects of retirement income planning is that it’s a relatively new field and there are competing theories and strategies. Advisors identify three primary approaches that they use: the systematic withdrawal approach, the income flooring approach and the bucketing (multiple portfolio) approach. I find myself getting pulled in different directions as I speak with passionate, compelling experts making great cases for their particular solutions. At first I found this disconcerting, but now I think each new idea helps round out our understanding of the field and provides different answers for different types of clients. What I do worry about is advisors using the same approach with every client. Hopefully, advisors will look at a range of solutions and pick the one that best meets the financial and psychological needs for their clients.
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**THIS WORK IS IMPORTANT**
Maybe the most critical lesson I learned is that there may be no more important work that financial services professionals can do. Proper planning can result in a fulfilling life, financial independence and comfort for a client’s children and grandchildren. Mistakes or lack of planning, on the other hand, can be devastating and can mean running out of resources later in life when it’s too late to do much about it. This can result in dependence on others and hardship on family members. It’s important to encourage individuals to plan carefully (research shows many do not plan at all), and make sure that the professionals they work with have the significant knowledge and skills necessary to do a great job for their clients.

There were also some surprises along the way.

**ASSET ALLOCATION ADJUSTMENTS WITH AGE**
Many of us learned the rule of thumb that the equity allocation in a portfolio should generally be 100 minus the person’s age. Even if you don’t exactly follow this rule, conventional wisdom has been that the appropriate equity allocation reduces with age. Research has not confirmed that reducing equity exposure gradually during retirement improves income sustainability; in fact, it may have the opposite effect. A 2007 study by Blanchett (“Dynamic Allocation Strategies for Distribution Portfolios: Determining the Optimal Distribution Glide Path,” *Journal of Financial Planning*, December 2007) showed that static asset allocation during retirement proved to be very efficient. What’s even more interesting is that a 2013 study by Pfau and Kitces (“The True Impact of Immediate Annuities on Retirement Sustainability: A Total Wealth Perspective”) showed increasing equity allocation through retirement (with the lowest equity allocation at re-
RISK OF SHORTFALL
The Employee Benefit Research Institute (EBRI) Retirement Readiness index identifies who is at risk of a retirement income shortfall—meaning the risk of having insufficient assets to meet even basic expenses. It’s not that surprising that some are at risk, but EBRI data from 2012 shows an astounding figure—44 percent (Retirement Income Adequacy for Boomers and Gen Xers: Evidence from the 2012 EBRI Retirement Security Projection Model®). Maybe more surprising is that almost 17 percent of the top income quartile of generation X are at risk of a shortfall. The reason for this large number is likely to be tied to the fact that the study uses stochastic forecasting, meaning that it projects a wide range of life trajectories. Those facing a long life with significant health and long-term care expenses need more resources and are exposed to a greater risk of shortfall. This premise leads to the conclusion that it is critical for even those in the top income quartile to have both comprehensive health insurance coverage and a funding mechanism to address long-term care needs.

SIZE OF THE INCOME ANNUITY MARKET
In the field, some talk about the “annuity puzzle.” What they mean is that many financial services professionals, academics in the field and, more recently, even those in the government, are baffled by why consumers do not choose income annuities as part of their retirement plan. There may be two parts of this story: At the end of 2012 total annuity sales exceeded $211 billion and only about 5 percent or $9.2 billion of that is on income annuities. But the other side is that $9.2 billion was an increase of 8.5 percent (about 8.5 billion) over 2011. With aging baby boomers and new products like the deferred income annuity that allows for locking into guaranteed income at a later date, I expect that trend to continue.

Several interesting questions arose as well.

ARE THERE ANY SIMPLE SOLUTIONS?
With the complexity of the planning required and the constant need for monitoring, I keep wondering whether there are simpler strategies available for the middle class who may not have access to the same type of financial advice that those with more means do. Of course, I don’t have all the answers, but here’s what I say to friends, family and anyone else who will listen.

- Be careful not to choose a retirement date until you have run the numbers.
- Make smart decisions about the timing and form of distribution from your company retirement plan.
- Plan for suitable income after a spouse dies and consider as
part of that plan having the higher wage earner defer Social Security benefits as long as possible.

- Learn more about where you are spending your money; you can’t avoid budgeting once you retire.
- If you don’t have a monthly pension from work, consider income annuities for safety, simplicity and longevity protection.
- Academics are quick to say that annuities are like bonds—a portfolio of income annuities and stock mutual funds provides both for security and the potential for growth.

WHAT DO WE MEAN BY SUCCESS?
I have learned that when we ask the question, “What is the best approach?” the answer depends upon the goal and the appropriate measure. Much of the research to date has measured success by risk of failure—or that you run out of assets before the end of the retirement period. The problem with a simple yes or no to this question is that it doesn’t reveal enough information. Clearly being one dollar short in the year prior to death is a lot different than ending up several hundred thousand dollars short. The good news is that researchers and even software designers are beginning to use other measures. For example, Pfau in a recent study (“An Efficient Frontier for Retirement Income,” September 24, 2012) used six different measures of success. For example, average shortfall is a measure of the magnitude of a spending shortfall. Average spending measures the possibility of increased ability to spend (not just identifying failure), and average remaining value measures the size of a potential bequest.

WHERE IS THE FIELD GOING?
Finally, the last part of the story is where does the field go from here? New products and solutions will certainly continue to emerge, and we will also see additional activity in the following parts of the field.

Retirement income software is still improving. The newest generation of tools can incorporate complex Social Security decisions, address changing expenses and income sources over time and evaluate success or failure on a number of scales. We’re beginning to see software tools that are not about money, but have the objective of helping clients visualize their retirement and learn about retirement risks. We also need better fact finders that ask questions to help identify not just objectives, but also the importance of one goal over another. Better tools are needed to help clients make choices between goals, such as whether it is more important for them to avoid a reduction in spending or have the possibility of increased spending in retirement.

Most research activity has been in testing safe withdrawal rates and in helping clients to maximize their retirement income utility (satisfaction). There is still need for more research that looks at a wider measure of success, as we discussed earlier. There also still needs to be more research about how retirees actually spend in retirement.

Another critical area for the industry is advisor education. A 2012 survey by Investment News and The American College revealed that 93 percent of financial advisors indicated that advisors/wealth managers need to know more about retirement income planning. New certifications such as The College’s RICP designation are in tremendous demand, as illustrated by more than 3,000 students enrolling within six months of the program completion. Expect to see many more advisors seeking out educational programs and earning designations over the next several years. One thing is clear: There’s always a lot more to learn!