Proposal Highlights Need for Retirement Income Education

No standard definition of “best interests” exists in the area of retirement income planning. A number of variables are involved in retirement income decision-making.

By David Littell and Jamie Hopkins

The reintroduction of the Department of Labor’s proposed changes to the Employee Retirement Income Security Act’s (ERISAs) fiduciary rules illuminated a variety of challenges ahead for retirement planning professionals.

The proposed rule changes were reintroduced in April after a five-year hiatus. They seek to expand the range of the ERISA fiduciary requirements to include scores of pension advisors, broker/dealers and other financial service professionals not previously held to the ERISA fiduciary standard. In addition to, and in support of, the DOL’s proposed changes, the White House published a memo highlighting areas of concern regarding conflicts of interest and the impact of fees on retirement savings. While the proposed rules are not law yet and will likely be modified before they are finalized, a new level of scrutiny has been placed on retirement advisors, and the industry must act accordingly.

As a fiduciary, one is required to act in the best interests of his or her clients. While almost everyone agrees with this notion, there is no standard definition of “best interests” in the area of retirement income planning. For example, when planning for a client’s retirement, not everyone agrees that certain insurance products or investment products — such as annuities, real estate investment trusts and long-term care insurance — should be a part of the retirement income plan.

We see several competing approaches to building a retirement income plan. Life cycle investment theory leads to solutions that use low-risk investments such as Treasury bonds and annuities to meet basic income needs. Other practitioners believe clients are better off staying more heavily invested in equities, and taking systematic withdrawals from their portfolios to meet income needs.

Another concern is that certain decisions that may be prudent at the time they are made may be challenged as market conditions or other variables change over time. For example, using a portion of a portfolio to purchase an income annuity to meet basic expenses may be the right decision to meet client objectives, but if soon after the purchase, interest rates rise and so does the stock market, the decision may look a lot less prudent.

At the same time, if you advise a client to invest heavily in equities, and taking systematic withdrawals from their portfolios to meet income needs. Other practitioners believe clients are better off staying more heavily invested in equities, and taking systematic withdrawals from their portfolios to meet income needs.

In order to meet a client’s retirement savings and income needs under a fiduciary standard of care, the retirement advisor will need to adopt a comprehensive process that involves extensive fact-finding, considers income and other financial goals, and addresses the numerous risks faced in retirement. While the exact strategy employed by every retirement advisor will not be identical, nor should it be, the client’s needs should come first.

To ensure client ownership of a plan, the advisor needs to offer alternative courses of action and explain the tradeoffs involved in each choice. Ultimately, a plan must tell a story about how each of the client’s goals will be met, and how the plan will work if the market drops, inflation rises or a long-term care event occurs. If a client chooses not to address certain risks, then that decision needs to be included in the plan as well.

Furthermore, documentation will be incredibly important in order to show that each recommendation was for the client’s benefit, even if the client later decided against your advice.

The need to understand a variety of complex legal, financial and other issues will require many retirement advisors to seek out additional education and training in order to take a more confident view of comprehensive retirement planning.

The newly proposed fiduciary rules and the dynamic nature of retirement income planning will require advisors in the retirement income field to pursue a more rigorous education in order to view the world in a more comprehensive manner. Even if the rules do not change, the impact of more specialized education and training is extremely important for the retirement planning industry as a whole. A spotlight has already been placed on the need to provide quality retirement and financial planning services for all types of clients.

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