Key Competencies for Proper Retirement Income Planning

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Key Competencies for Proper Retirement Income Planning

by David Littell, JD, ChFC®, CFP® and Kenn Tacchino, JD, LLM

> Learn what the experts say about key financial advisor strengths in retirement planning

The New York Life Center for Retirement Income at The American College recently brought together retirement experts and practitioners from various branches of the financial services industry to discuss the knowledge, skills and competencies needed to provide successful retirement income planning, or decumulation planning, for a client. The conversation was fascinating as the group discussed their thoughts about what it takes to provide answers and strategies for clients dealing with the financial planning challenge of maintaining their standard of living throughout retirement in the face of unknown longevity, inflation, market conditions and other variables.

Not all members of the group agreed on every issue, nor were they representing their official company position during the frank discussions. However, all participants agreed that further examination of the emerging field of retirement income planning is essential and timely.

We decided it might be enlightening to pose some of the issues discussed as a series of questions. If you’re working in the decumulation area, or are planning to go into it, these questions can be a checklist to test your knowledge. If you find gaps, you can learn more about many of these subjects at no cost by viewing the videos available at The American College’s New York Life Center for Retirement Income Web site (www.theamericancollege.edu/retirement-income-center). You may also want to consider earning a Chartered Advisor for Senior Living (CASL®) designation to raise your level of expertise.

WHAT IS A RETIREMENT INCOME PLAN?
Most planners are aware of what needs to be in an estate plan or the steps required for a comprehensive financial plan, but one major topic of the day was that we don’t yet in the industry have a clear consensus of what is retirement income planning.
Everyone did agree that a retirement income plan was not handing a client a computer spreadsheet showing that they had an 83 percent chance of not outliving their assets. We all saw the need for retirement income planning to go beyond industry bias (investment-only solutions from wire houses and insurance-only solutions from insurance companies).

During perhaps the most interesting part of the day the group decided to tackle a definition of retirement income planning. What resulted was the following:

- A retirement income plan develops stable sources to meet the client’s income needs.
- The plan must ensure that stable sources of income can last a lifetime.
- The retirement income plan should optimize the remaining portfolio so that it addresses the client’s ability to meet discretionary spending or legacy goals.
- The plan must address the major risks that retirees face.
- Because retirement income planning is process-oriented, dynamic and holistic, comprehensive planning is required.

Developing a plan requires following the steps of the financial planning process, from forming a client relationship, identifying goals and gathering data, to analyzing the client’s situation, offering alternatives, implementing and monitoring the plan. With retirement income planning, there needs to be an increased emphasis on understanding the client and helping the client to determine goals and objectives. Another intensified focus of retirement income planning centers around monitoring the client’s plan and making adjustments. Unexpected investment events, spending too much, health changes and other changes in the client’s situation can all require plan modification. Maybe more than any other planning process, retirement income planning requires a lifetime partnership between the advisor and the client.

DOES THE ADVISOR UNDERSTAND WHAT MOTIVATES THEIR CLIENTS?

Retirement income planning means wading into issues such as what money means to your client. A client’s “money personality,” risk tolerance, level of anxiety about outliving income and general psychological makeup need to be understood and factored into the decision process. Planners need to delve into what motivates clients to save, spend and to feel secure financially. This process may be more difficult when working with couples, as each partner may have totally different ideas and concerns. All of this requires a tremendous amount of communication and may require discussing uncomfortable issues with clients. It can help a planner to have some background in the field of behavioral finance. In the end, if the plan doesn’t meet the clients’ psychological needs it will not be perceived as successful.

HAS THE ADVISOR TAKEN THE TIME TO UNDERSTAND THE CLIENT’S RETIREMENT VISION?

A successful retirement income plan must meet the client’s goals and objectives. Some clients will be able to clearly state what they want to achieve, but many others are going to need some help in shaping a picture of their retirement. A successful financial advisor can, and should, help the client identify their goals, envision their retirement years and help them set up a blueprint for the rest of their lives. The group agreed that this process is time-consuming but critical for success. The process can be facilitated through a systematic approach using sophisticated fact-finding and planning tools.

Also, clients may have an easier time envisioning the first few years of retirement. That may include work for some, or an extended trip around the world for others. However, planning for issues that occur later in retirement, which are not always pleasant, is also critical. Caregiving for the client’s frailty or the frailty of a loved one may not be on a client’s radar. But it needs to be. Planning must include the go-go, slow-go, and no-go phases of retirement, and apply appropriate strategies and products for each.

Have advisors helped a client develop a budget that identifies both basic and discretionary expenses?

Retirement income planning is about budgeting for the remaining years. While a client is still working, the budget process is not as rigid because the client can recover from overspending by earning more future income and adapting living circumstances to income limitations. The group agreed that many Americans today are not budgeting at all.

Developing a reliable budget for the early years in retire-
ment, having a sense of changes in lifestyle that will occur over time and distinguishing between necessary and discretionary expenses is a monumental task—and one that your clients may not look forward to. However, all of this really is required to develop a retirement income plan.

Each client is going to have a different interpretation of what are necessary and what are discretionary expenditures—and that is ok—as the goal is to meet their individual planning needs.

WHAT MAJOR RISKS DOES THE RETIREE FACE?
One of the recurring themes for the day was that a retirement income plan must address the risks and uncertainties of retirement. One panel defined this as “stress-testing” the plan. The risks discussed included:

- Longevity risk
- Early death of a partner
- Rising health care costs
- Increased need for health care
- Expense of long-term care
- Impact of market volatility
- Sequencing of returns risk
- Liquidity risk
- Inflation risk

WHAT ARE THE KEY DIFFERENCES BETWEEN THE ACCUMULATION PROCESS AND THE DECMULATION PROCESS?
The accumulation phase of retirement focuses on encouraging clients to save to meet a targeted amount. The investment recommendations center on maximizing return within the clients’ risk-tolerance parameters. The decumulation process is entirely different. The focus is on ensuring that clients can meet their income needs and maintain their standard of living throughout their lifetime. Even the risk/return paradigm is different in retirement income planning. Return is measured as the amount that can be withdrawn from the portfolio each year, and risk is the possibility that the portfolio will be exhausted before the end of the client’s life.

The panelists at the Retirement Income Summit were concerned that while many planners were familiar with the tactics and strategies for the accumulation phase of retirement, they were less familiar with the vastly different process of planning for retirement income needs. Carrying forward the same accumulation strategies into decumulation planning will not be successful. For example, investing regularly using the dollar cost averaging strategy can work well when accumulating assets, but taking systematic withdrawals over time as the price of assets varies will have the effect of spending down assets more quickly. Additionally, time horizon and tax planning considerations change significantly from the pre-retirement to the post-retirement period.

DOES THE ADVISOR UNDERSTAND THE STRATEGIES AND PRODUCTS AVAILABLE TO SOLVE RETIREMENT INCOME ISSUES?
The advisor needs to be familiar with a wide range of strategies used to create and protect retirement income, including the following:

- **The systematic withdrawal strategy**: choosing an appropriate withdrawal rate and ways to modify the strategy to increase portfolio sustainability.
- **Lifetime income annuities**: understanding the implications of mortality credits.
- **Longevity insurance**: how deferred life annuities can limit the client’s risk and increase portfolio sustainability.
- **Deferred annuities with lifetime guaranteed benefit provisions**: understanding how this strategy allows for growth and protection.
- **Multiple portfolios**: creating different portfolios (buckets) to address different time periods and/or concerns in retirement.
- **Noninsurance approaches** to creating stable sources of income, including laddered bonds, Treasury Inflation-Protected Securities (TIPs), structured products (synthetic annuities) and mutual fund income funds.
- **Long-term care insurance** and other funding methods to address the added expense of long-term care.
- **Medicare supplement options**, as well as controlling retiree health-care costs through appropriate choices under Medicare.
- **Life insurance**: appropriate uses to provide for survivor income and/or legacy objectives.
- **Reverse mortgages**: appropriate uses for tapping into home equity to meet current income or liquidity needs.
- **Techniques to protect assets from claims of creditors or lawsuits**: for example, incorporation and contract provisions.
- **Strategies for maximizing Social Security benefits**: for example, choosing a start date or options available to working couples.
• **Strategies for maximizing pension distributions**: for example, timing and the form of payment.

• **Tax harvesting strategies**: what types of accounts should be withdrawn first (e.g. taxable, tax deferred [IRA], tax exempt [Roth]).

• **Legacy strategies**: strategies to insure that a client’s estate plan is meeting its goals and objectives.

**DOES THE ADVISOR UNDERSTAND WHAT THE SOFTWARE PROGRAM IS ILLUSTRATING?**

We discussed concerns that advisors may not understand what the retirement software they are using is illustrating. For example, many programs today use Monte Carlo analysis, but whether advisors understand what the output from such program means is unclear. Also, advisors should be using software tools that are consistent with their planning process.

**DOES THE ADVISOR HAVE SUFFICIENT PRODUCT KNOWLEDGE?**

Retirement income planning requires expert product knowledge. New products are being designed constantly in this evolving field and advisors need to keep up. One concern here is that advisors are only familiar with product options from their own part of the industry. For example, those in the brokerage industry may not be familiar with insurance solutions, and insurance professionals may not be familiar with investment products that can provide for stable income. Another concern is that advisors get in a comfort zone with certain products and offer only those to their clients.

**DOES THE RETIREMENT INCOME PLAN ENSURE ENOUGH LIQUIDITY?**

A key to retirement planning is balancing finances so that the client has enough income and available assets to meet contingent events. Having an emergency fund continues to be an important consideration in retirement. Also, careful fact-finding is required to determine whether a client may have future liquidity needs to purchase a second home, to pay for long-term care expenses or to help a grandchild pay for college education expenses. In addition, certain retirement income solutions, such as life annuities, are an inexpensive way to guarantee lifetime income, but may come at the price of the loss of liquidity.

**CAN AN ADVISOR HELP A CLIENT MAXIMIZE SOCIAL SECURITY BENEFITS?**

Retirement income planning means properly appreciating the relevance of Social Security benefits in the overall plan. It also calls for a full understanding of Social Security rules and planning strategies. One critical choice for clients will be when to start Social Security benefits. Recently, many experts have been writing about the advantages of deferring benefits, but more than half of Americans are beginning benefits as early as they can, at age 62. For married couples this decision affects benefits throughout their joint lifetime. When men have the larger Social Security benefit, choosing to begin benefits early may harm their wives because women tend to live longer and will inherit (as the death benefit) the reduced Social Security benefit that their husband was receiving.

**DOES THE RETIREMENT INCOME PLAN ADDRESS THE CONTINGENCIES OF UNEXPECTED HEALTH-CARE COSTS AND LONG-TERM CARE NEEDS?**

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tified a Hispanic and a Chinese agent that he believed were potential management candidates. He recalls having a candid conversation with the Chinese agent. He went to her and said, “Can you help me? I need someone who is willing to go into management and help me recruit more Chinese agents inside this community.”

His agent accepted the challenge and Farina opened a location inside the Chinese community with three people. “They saw it as a sign of pride that we were going inside the community and becoming a part of that community by participating in cultural events and programs,” he said.

LEARN TO NOMINATE
You must get involved in the community you are trying to reach and take the time to identify local candidates to grow your business. “Let people know that you are there to serve,” Farina said. And this must be a long-term goal. To make a lasting impression, you must become a fixture, a familiar face, and only through repeatedly talking to people will you learn who would be a valuable addition to the company. “Nominating takes months, not one day,” he said. “It took me three years to build relationships in the Chinese community through nominating and word of mouth. If you have a short-term plan, it is not going to work because people will forget you.”

With representatives in the community on a regular basis, you can take advantage of the opportunities when they present themselves. For example, one individual with whom Farina had fostered a relationship lost his job when his employer was downsized. Farina was able to remind him of the potential job with New York Life and the relationship truly became a win-win for both parties.

“How we have 100 Chinese agents because we became a visible presence,” he said. “We spent hundreds of thousands of dollars on rent, advertising and community affairs. People saw us as part of the community, and we kept growing from it. Now, instead of having one Chinese manager, I have eight.”

Successfully building a culturally diverse financial services firm is about tolerance and understanding. It’s about active, ongoing communication. It’s about embracing differences and keeping your eyes open to the possibilities. “You build the relationships,” Farina said, “and then you get serendipity.”

Continued from page 15

Retirement Key Competencies for Proper Retirement Income Planning

insurance choices. Those eligible for Medicare can choose between the original program and a managed care program. They also can choose from a number of Medicare Part D drug plan options. Most choose to supplement Medicare through a supplemental policy, a managed care plan or through an employer-provided retiree health-care plan. Clients also should plan for the possibility of needing extended long-term care at some point in their lives. This planning requires consideration of long-term care insurance and other ways of funding long-term care. Counseling clients also can include discussing risk-avoidance techniques to help avoid health problems from falls and other physical infirmities.

WHAT IS THE BEST STRATEGY FOR TAX HARVESTING?
An important part of retirement income planning involves tax planning. Today clients have accumulated assets in taxable (brokerage) accounts, tax deferred accounts (IRAs and qualified plans) and tax-exempt accounts (Roth IRAs). Choosing which account to withdraw first and which to defer depends on the client’s current tax situation as well as an expectation of tax rates in the future. There are some rules of thumb. For example, in most cases, withdrawing taxable accounts first, saving tax-deferred and tax-exempt accounts until later is most tax efficient. These choices are important because they have an impact on how long retirement assets will last.

As co-directors of the New York Life Center for Retirement Income at The American College, we want to thank all the participants of the Retirement Income Summit for their valuable time and expertise. As we hope you have found, this group took tremendous strides in helping to define the field of retirement income planning.

We hope meetings like this continue to inform this interesting and evolving field. As knowledge in this area grows, company training, The American College courses and the New York Life Center for Retirement Income can incorporate these valuable new insights into their programs—which will help us all better serve clients’ needs.