Retirement Planning Software, Inc

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The Greatest (and Unrecognized) Financial Risk for Retirees

Longevity risk. Investment risk. Morbidity risk. Inflation risk. Social Security solvency. Pension solvency. Housing market risk. Those are just the beginning. The Society of Actuaries a few years ago identified fifteen financial risks to retirees.[*] But even so, they left out the biggest, most dangerous one of all: Planning Risk.

What is "Planning Risk"?

Planning risk, by our definition, is the risk that arises from poor financial decision-making, which turns a potentially sustainable financial situation unsustainable.

We consider this to be the pre-eminent retirement risk, trumping all others, because:

- Poor planning magnifies exposure to other risks.
- Lack of planning, or the use of faulty planning methods and procedures, can generate a financial disaster even when other risks do not materialize.

We also believe that this subject merits our focus because we in the financial industry are actively, if unintentionally, spreading such risk.

Components of Planning Risk

Like most other retirement risks, Planning Risk is not entirely avoidable. Among the elements that are not realistically escapable:

- Our inability to reliably predict the future, even in the simplest matters.
- Some significant degree of imperfection in our knowledge, skills, and tools.
- Limited financial resources (for most people), so that trade-offs must be accepted and some gambles taken.
- Absence of a reliable governmental/social safety net – some people *can* end up without resources, despite our best planning efforts.

Other elements of Planning Risk, however, *can* be avoided, or minimized:

- Lack of knowledge (about retirement financial issues, and about the specific per-

[*] Their report can be found at: http://www.soa.org/research/files/pdf/post-retirement-charts.pdf

sonal situation to be addressed).
- Lack of planning skills and tools.
- Lack of will (to face problems, to do the hard work needed to plan well, and to take the necessary steps called for in a good plan).

This latter group of solvable problems applies both to individuals and to the financial professionals and corporations serving them.

How the financial industry increases Planning Risk

Although the financial industry, as a whole, has begun to address the financial needs of retirees, this has mostly been done in ways that actually increase Planning Risk.

Planning knowledge

A little knowledge is a dangerous thing. The financial industry so far has acquired very little knowledge indeed about the financial needs of retirees. Companies acting on this slight deposit of expertise create large Planning Risks for themselves and their clients.

- Most financial companies (and advisors) have had to deal with retirement issues for nearly as long as they have been in business. The effort, though, has usually gone into the few areas where money might be made (IRA rollovers, long-term care insurance, immediate annuities, reverse mortgages – depending on your business), or into areas made necessary by law (e.g., required minimum distributions). But in-depth and wide-ranging understanding of the financial realities most retirees face, the decisions they need to make, and the planning and financial resources they require to truly establish a secure retirement, have fallen outside of most providers' expertise. Most companies offering to help retirees are still unschooled in retirement issues except those related to the company's products and services.

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- Yet there is something like an excess of knowledge in some areas. To recall another old saw: when all you have is a hammer, everything looks like a nail. Most financial firms, and a large portion of individual advisors, are asset managers. They know a lot about asset management but not much about, say, Social Security benefits for surviving spouses or Medicare HMOs or durable powers of attorney. So they see planning for retirees as fundamentally an asset management problem.

  Asset management is important, but an excessive (sometimes nearly exclusive) emphasis on it distorts the overall picture. It reminds one of the illustrations seen in psychology texts that show how the prevalence or scarcity of nerve pathways to (or within) the brain translates to the human body. If you draw the human body in those proportions you get a very bizarre image, like the illustration at the right:*

This illustration (called a "somatosensory homunculus") shows that there are a lot more sensory and motor neurons in our face and hands than in other parts of our bodies. But the drawing itself is a gross distortion of how we really look.

It seems that financial professionals often see retiree clients very much this same way – with asset allocation, or maybe insurance needs, being the overblown features, and with everything else underplayed or ignored.**

If our knowledge of retirees' finances is too limited and over-weighted in one direction or another, our view of them is inevitably cock-eyed. Our planning advice will be wildly inappropriate far too often, which means the exposure to Planning Risk that both we and our clients experience is far greater than it needs to be.

Skills and Tools

When our knowledge of retiree finances is incomplete and out of balance, our planning skills are, too. The tools we use could make up for a good deal of this deficiency, but they don't. If anything, they aggravate it, and increase the Planning Risk. Why?

- ***The tools are too simplistic.*** In the financial industry, we tend to live by the mantra, "Keep It Simple, Stupid." And this does make sense in many circumstances, but not when planning for retirees. For people in or very near retirement, the important financial details are mostly known and therefore should be part of the analysis. Failure to account for when a home mortgage will be paid off, whether a pension plan has a COLA or pays a survivor benefit, which spouse's Social Security benefit is higher, and many other issues of the same sort, insures that advice will almost always be wrong. Some people actually *brag* that their tools are simple and can be used in a few minutes. They might as well advertise, "We send your Planning Risk through the roof!"
- ***The tools are too narrowly focused.*** Most financial companies, and the advisors who represent them, have only one, or maybe a few, planning tools for retirees. Each tool focuses on a single need: usually asset allocation, but sometimes something geared to a product sale. Meanwhile, most retirees – and even more so, people who are quickly approaching retirement – typically have numerous other financial issues to confront. These needs get ignored, so the planning is full of gaps, and Planning Risk remains high.
- ***The tools are not integrated.*** Even if we had a tool for each financial issue retirees face, that wouldn't be good enough. Most such issues interconnect, and if you

* This version is from "Neurevolution: Chronicling the Cognitive Revolution in Neuroscience," available at http://www.neurevolution.net/category/neurophysiology/.

** Ironically, many clients seem to see their advisors very much the same way, though perhaps more literally: all mouth and hands. That's a whole different subject, though.

can't generate an *integrated* plan that deals with all of them simultaneously, your advice is almost always going to be seriously flawed, and often dead wrong.

The Will to Do It Right

On the corporate level, we in the financial community have displayed more uncertainty than resolve and more "followership" than leadership. We have been content to do it wrong, as long as everyone else does it wrong, too. Our failures include:

- Failure to find and disseminate the kind of deep and wide-ranging knowledge and skills financial professionals need when serving retirees.
- Failure to look outside of our own product lines and comfort zones.
- Failure to train/persuade advisors in the right way to serve this market, and to keep them out of it if they insist on using old methods that increase Planning Risk.
- Failure (with very few exceptions) to think creatively, imaginatively, and *from the retiree's point of view*.

First, Do No Harm

Some say that the medical profession didn't start saving more people than it killed until sometime in the nineteenth century. When it comes to planning for retirees, we have not yet reached the turning point where we are lessening rather than increasing Planning Risk. But we need to find the will to get there, and get there fast, for the sake of retirees, and for our own sake.

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