Still River

Retirement Planning Software, Inc

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Retirement Income Planning, Part 7[*]: Toward Truly "Holistic" Planning

A new buzzword has been appearing in discussions of retirement income planning lately: "holistic." The term represents an increasing recognition that companies serving the retiree market need more than product-specific approaches, more than particularistic sales concepts (such as "inherited" or "stretch" IRAs), and more than the ability to give quick answers to one or two financial questions.

But no one is defining just how far this "holistic" doctrine should extend. This paper is an attempt to fill that gap.

We will explain in general terms why a truly holistic approach is necessary, and specify in detail the range of issues it needs to cover. Finally, we will address the practicality of taking such an approach.

Why Holistic?

"Holistic" suggests "complete," and therefore desirable. But it also suggests "voluminous" and "difficult," so before we embrace a holistic strategy, we ought to have a sound rationale for it. The rationale is two-fold:

1. The marketplace wants a holistic approach.

This is particularly true of people who are actually going through the retirement process and are therefore making big life changes and big financial decisions. Persons confronting this transition (and to a lesser extent, those on either side of it) realize that they are facing issues they have never had to deal with before.

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[*] An earlier version of this paper was presented on April 21 to the Retirement Management Executive Forum, sponsored by the Diversified Services Group, Inc., of Wayne, Pennsylvania.

Part 1 of this series discussed in general form the urgent and wide-ranging planning needs of people facing retirement. In Part 2 we further explored the follow-up question: can a comprehensive financial planning approach really work for retirees and, if so, how? Part 3 examined investment risks and strategies, and argued that most retirees should be investing conservatively rather than for asset growth. Part 4 identified serious problems with the use of Monte Carlo models in retirement income planning, and suggested an alternative approach. Part 5 discussed the optimal time to annuitize. Part 6 dealt with the question of what retirees need from the planning process, suggesting inadequacies in current approaches.

They realize that many of their decisions will have major consequences, and that some of the most urgent decisions are irrevocable, either legally (e.g., which pension option to take, or when to begin receiving Social Security), or practically (once you leave your job, you are unlikely ever to get it back, or get another that pays as well).

Unfortunately for financial product providers, many of the biggest decisions retirees make do not involve the purchase of a new product. Those that do involve a purchase are usually relatively low in perceived importance to retirees. And yet there is often a lot of money moving around when people retire: homes and businesses get sold, qualified plan monies become available for withdrawal or rollover, non-qualified savings and investments are ripe for re-allocation.

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Whoever takes the time to answer the retiree's urgent questions that *don't* lead to a product sale will be the advisor or company that gets to help answer the less urgent questions that *do* lead to a product sale.

Right now, only a handful of individual planners are even attempting to do holistic planning for retirees. But that will change, perhaps soon. In the near future, only the companies that take this approach will be able to establish or retain relationships with retirees, and so only they will be well positioned to retain and acquire assets to manage.

2. Only a holistic approach has any hope of preventing damage to the consumer and to the company sponsoring the plan.

Planning for retirees is fundamentally different from planning for younger persons and families, in two important ways.

First, most planning for families in the "accumulation" phase is primarily motivational: get them to save more money. This is good for them and good for the financial services people. If the analysis that provides this motivation is incomplete or otherwise faulty, little harm is done. Any money saved is a good thing.

Second, even in the rare cases where the numbers actually matter, younger people have time to adjust if the analysis proves wrong. The choices may be a little unpleasant at times, but they are survivable.

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With retirees, these safety valves don't exist. If you endorse certain financial decisions and those decisions turn out to be inappropriate, the damage you have done may not just be unfortunate, it may be disastrous. Decisions at this stage are no longer "motivational" – if you overestimate how much money a retiree can spend, or if you recommend other steps that turn out badly, there are probably not going to be any good options left to correct the situation. Few elderly people have ways of generating new income. You may be consigning them to a life of hardship or even flat-out poverty.

This is obviously bad for them, but it is bad for you, too, if you are the provider or sponsor of such advice. We will not know until 2010 or 2015, when the first big class action lawsuits are filed, what the legal and financial liability is. But it would be naïve to assume that it will be zero.

Using any method other than a holistic planning approach is simply asking for trouble. Even the most ambitious planning methodology is bound to fail at times, because life is simply too complicated and random to be modeled accurately. Yet using shortcut methods to help retirees make important financial decisions means virtually guaranteeing that the advice will be inappropriate in a higher percentage of cases.

One has an adequate moral and legal defense when one has used the best available practices and still failed. It is hard to see a viable defense when one has just taken the easy road.

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The issues that retirees face

Retirement "income" planning (or retirement "distribution" planning, if you prefer) is not just about income or just about distributions from savings.

In technical terms, what retirees face is an "asset/liability matching" problem. Or in more ordinary terms, we can say it's a cash flow management problem. The assets and income need to cover the expenses and liabilities, whatever they may turn out to be, and however long they may last. Issues could arise in any of these areas. In order to "solve" this problem, therefore, all aspects of a retiree's finances have to be taken into account – not just investments, but all assets, plus debts, expenses, income sources, and insurance.

And as far as we can tell, this "holistic" help is what retirees are really looking for. They are often confused and uncertain, sometimes desperate. They want someone to look at the whole picture, and tell them what they need to do to make it hang together properly.

Specifically, the following issues need to be addressed. Not all of them, of course, apply to all families. But all individuals or families will have several – typically a dozen or more – that they need to take into account as they enter retirement.

Issues Concerning Property Ownership:

- Should the principal residence be sold?
- Should home equity be tapped in some other fashion?
- If the retiree is considering relocating, is this a good idea in terms of expenses, taxes, etc.?
- Should any other residences be sold (or, conversely, moved into, rented out, etc.)?
- What should happen to a family-owned business or farm?

Issues Concerning Other Assets:

- How should invested assets be allocated?
- What should be done with stock (or stock options) in a former employer?
- What should be done with investment real estate or other special assets?

- Which specific assets should be liquidated over the next 12 months if cash needs to be raised?

Issues Concerning Insuring Wealth / Income:
- Should part of the nest-egg be annuitized?
- What should be done with existing life insurance policies?
- Is new life insurance needed to cover the survivor's needs if the wrong person dies first?
- Are trusts, life insurance, or other special provisions needed for estate planning purposes?

Issues Concerning Retirement Plans:
- Which pension option should a retiree take on a defined benefit plan?
- Should employer-sponsored defined contribution accounts be rolled over?
- What is the proper beneficiary designation on existing accounts?

Issues Concerning Other Benefit Plans:
- When should each eligible party start taking Social Security?
- What kind of medical insurance should the retiree (and family) have?
- Should anyone in the family have long-term care coverage?

Issues Concerning Expense and Debt Management:
- If he/she cannot afford to retire now, how much longer does he/she need to work?
- Do household expenses need to be reduced, and if so, how?
- Should mortgages be paid off or refinanced?
- Should other debts be paid off or restructured?
- Can the retiree afford to leave legacies to children, church, college, or others?

Other Miscellaneous Issues:
- What financial provisions need to be made to help support parents or other elders?
- What financial provisions need to be made to provide for disabled or other special needs children, siblings, etc.?
- What can/should be set aside for the education or other needs of grandchildren?
- What financial and legal arrangements need to be made to cover pre-death medical contingencies and/or post-death distributions?

A quick read through this list reveals (a) that a majority of these issues do not involve a financial product sale, and (b) that only a few of them are being covered by current approaches to planning for retirees. We're a long way from "holistic" today.

Understanding the household cash flow

Besides failing to cover most of the questions that retirees have, we are also doing a poor job answering even the questions we do try to address.

A number of sophisticated models – some proprietary, some available for licensing – already exist. These generally tend to be investment models (usually asset allocation models) that have been extended to deal with some of the vagaries of the last stages of life.

But in essence, they all try to answer to same question: what can the retiree afford to withdraw from savings every year?

Unfortunately, this is not a question that should even be asked. Few if any retirees need a level (or level-with-inflation) cash flow. There are dozens of common reasons why not. A "holistic" analysis would look at all of these potential issues, find out which ones apply to a given household, and then see if the resulting (and usually far from level) cash flow is reasonably attainable.

Sources of cash flow irregularity – many of them highly predictable – include:

<u>Income changes</u>:

- Phased retirement (or other ongoing part-time work) occurs
- New temporary job is taken later
- Pension/annuity changes at first death
- Deferred comp or other non-qualified retirement benefits end
- Term annuity ends
- Social Security starts in the future
- Social Security changes at the first death
- Inheritance is received
- Royalties, copyrights, patents expire
- Alimony being received comes to an end

<u>Expense changes</u>:

- Inflation
- Death of a family member: one-time expenses
- Death of a family member: on-going expenses drop (depending on who and when)
- New responsibilities (costs) created by the death of a parent or other relative
- Grandchildren living at home
- Support of a parent or other elder
- Special needs child (dealing with medical and life changes, eventual institutionalization)
- Education funding for grandchildren, etc.
- Hobby expenses that decrease and eventually terminate
- New hobbies, travel, or other ventures
- Other future changes (e.g., home improvements)
- Medical emergencies
- Household and personal expenses decrease due to old age
- Family moves to different home and/or state
- Someone joins the household (parent, child, relative, friend)
- Alimony paid out comes to an end
- Casualty losses
- Change in taxes as income (or laws) change

<u>Assets & Debts</u>:

- Sale of a home
- Sale of an existing business or farm

- Payments on a previous installment sale of a business come to an end
- Sale of investment real estate
- Loan to a family member is paid off
- Loan from a family member is paid off
- Mortgage payments end
- Amortization of bank or other institutional loan is complete

Benefits & Insurance:

- Life insurance policy is paid-up
- Life insurance policy is surrendered for cash
- Death benefit is paid on life insurance
- Survivor, charitable or estate needs change: new insurance is required
- Employer payment of medical or LTC coverage ends
- Long-term care insurance benefits run out

Is a truly holistic approach feasible?

Is it really possible to take all of this into account? We think so.

Obstacles exist, of course. First, we need analytical tools that are much more sophisticated than those currently in use. Second, we need professional advisors who have the training and patience to deliver holistic advice. Third, we need a process that will not be too grueling for the retirees to participate in. Let's address each of these in turn.

First, we can build better tools. Here at Still River, we believe that it is possible to create an analytical tool that will take into account all of the issues and concerns listed in this paper. In fact, we have already created a working version of such a model.

Second, we need something practical for financial advisors to use. There is something of a Catch-22 in retirement income planning, in that the kinds of clients who have enough assets to pay top dollar for a holistic plan are often the kinds of clients who don't need retirement income planning at all, because they have plenty of wealth. Conversely, the middle market retiree who desperately needs sound advice cannot or will not pay a big fee, and even if commissionable sales occur, they may not be enough to support days of labor by a staff of experts.

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Retirement income planning is feasible in the field only if it is not too time-consuming for the advisor. There are two solutions: (a) find a quick-and-dirty method, or (b) find a holistic approach where the burden on the advisor is minimized. As we explained at the beginning of this paper, the first solution serves both the client and provider badly. The second solution is the only acceptable one. We see two ways in which it can be made to work:

1. Take the advisor out of the data input business. Do this by making the input process simple enough so that the retiree can enter the data directly into the analytical tool. More on this below.

2. Take the drudgery out of the analytical and report-writing process. With a tool that can turn the client-entered data automatically into a set of recommendations and a printed report, the advisor can spend time doing the things s/he does best: adjusting the system-generated recommendations to fit the client, reviewing the plan in person with the retiree or couple, and working out specific product recommendations or other steps that will be just right for the household in question.

In principle, the process can be so "hands-off" that the advisor is not involved at all. The client could enter all the necessary information via a website, could request an automatic analysis and report, and take the results to a human advisor only for implementation. This is not, perhaps, the ideal scenario, but a tool this flexible allows the advisor and his or her sponsoring firm to determine what level of advisor involvement is desired, rather than having these decisions driven by the process or by the tool itself.

Third, the process needs to be friendly to the retiree. We have already mentioned that the retiree (or whoever manages money in the household) should be able to enter data directly into the analytical tool. This is actually easier for the client than filling out a questionnaire, because a questionnaire must inevitably provide for a lot of questions that will not be applicable to a given household. But an online input process can be "smart," finding out up front what areas need to be dealt with, and skipping whatever is irrelevant. Furthermore, since the client does not get handed a massive, intimidating questionnaire, there is less pain in getting started – and once started, it is more likely to be completed.

To make this work, you need a flexible and user-friendly input design, and you need to make it convenient for the user to do the input, giving them access to a web site, or giving them software they can take home. Either option is feasible.

Finally, the plan itself (the output from the tool, if you will) must also be friendly. It should state clearly what is being recommended and why. Back-up detail should be available for those who want to see it.

Most retirees, whether soon-to-be retirees or those already retired, are different from their younger brethren. They have both the time and the motivation to get answers to their questions and solutions to their problems. They will meet you at least halfway.

Inevitably, of course, some will want quick and dirty answers – but this is a trap we should all avoid. People too lazy to provide the information needed to create a valid holistic plan will disappear when it comes to implementation anyway. In the end, they will have wasted your time. Conversely, retirees who are serious enough to provide all the necessary data pre-qualify themselves as people likely to follow through if you give them a plan they understand, and if you help them with implementation where they need it.

To discuss these issues further, contact us any time.

Still River Retirement Planning Software, Inc., provides both web-based and desktop software offering specialized calculations related to retirement plans and retirement planning.

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