Retirement Security Smartbrief

A Golden Opportunity

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Financial advisors are on the frontlines of the longevity revolution and should consider a withdrawal strategy recommended by the Stanford Center on Longevity to help clients have enough money for the rest of their lives, says a Stanford consulting research scholar.

“I can state with confidence that the vast majority of older workers today in America are not going to be able to retire at age 65 at their preretirement standard of living. They don’t have enough savings to retire full time,” Vernon told the audience. “They are either going to have to work longer or reduce their standard of living, or some combination. You as financial planners are in the perfect position to help people through these issues. Because what I am saying is this is going to cause some soul searching among these boomer workers as they are approaching their retirement years.”

The boomers he was referring to are those who have saved $2 million in assets or less. “If you’ve got millions of dollars in savings, this isn’t quite as much of an issue, and those could be some of your clients,” he notes. “I’m discussing those with under a million dollars in savings or somewhere between $1 million and $2 million. Those are the folks that are really going to be impacted by the decisions they’ll make.”

People are living longer, and often when they hit their 50s or 60s they are tired of what they are doing and want a change. Integrating financial strategies with lifestyle strategies is part of the solution in planning for financially secure, happy later years.

“The secret is paying attention to motivation and inspiration,” Vernon says. “The strategies are straightforward to understand, but they’ll take discipline and hard work to implement. And that’s where you play a key role. To help inspire, and motivate and persist, and to encourage your clients. A lot of people skip right to the solution before actually motivating people on why they should be doing this.”

Advisors can help by discussing not only facts and figures, but ideas motivating clients’ behavior, ideas that might not be well thought out. One story Vernon has heard from clients is this one: “None of the men in my family live past age 75.” He says clients use that kind of an idea to justify making shortsighted decisions. Research actually shows that what you inherit isn’t necessarily the genes but the habits of your family, he maintained.

In fact, genes only impact longevity by between 25 percent and 50 percent, while lifestyle decisions have at least a 50 percent influence on how long one will live, Vernon says. “We now know that diet, exercise and some medications can delay or completely stop the emergence of some diseases.”

People need to lengthen their planning horizon and recognize there is a second phase now of middle age where they can still be productive. However, Vernon disagrees with observers who say that the word “retirement” should be “retired,” that retirement is an outdated concept. “Because I think no matter how healthy and vital you are in your 60s, and maybe even your 70s, and for the lucky few who can work that long, you are still going to have a period of time when you are too old, or too frail, and you’re not going to be able to work. And we’re still going to call that retirement.”

10 Issues to Discuss

For people with $2 million or less saved, advisors can help them specifically work through 10 questions to understand whether they have financial freedom in later years:

The 10 issues are:
1. When and how will a client retire?

2. When should the client start Social Security?

3. How can the client use savings to build a retirement income portfolio?

4. What Medicare choice should the client make?

5. Does the client need to reduce living expenses, and how?

6. Should the client deploy home equity to generate income?

7. How can the client protect against long-term-care expenses?

8. How can clients protect themselves against financial fraud?

9. How can a spouse be protected when the client is gone?

10. Does the client want to plan for a financial legacy?

Only one of those issues, No. 3, involves investing, Vernon pointed out.

In discussing these issues with clients, an advisor can play a big role in framing how they can achieve retirement security. Vernon says clients tend to fall into two groups: the ones who hoard money and are extremely worried about outliving their savings, and the ones who think their savings are a checking account, spend it too fast and have no plan.

“This is a golden opportunity for planners to help clients assess which camp they fall into and help lead them to a middle ground,” Vernon maintained.

He added that advisors can look to modern portfolio theory for ideas on how to talk with clients about having enough income to exceed their expenses. “I think you can use the same language, concepts and analytical tools for spending money in retirement. When accumulating money, you talk about asset classes, and now we’re going to talk about retirement income classes. When accumulating money, the decision is the asset allocation decision, and now you’re going to talk about the retirement income allocation decision. When you are accumulating, you look at how much you’re accumulating, and now you’re going to look at how much income you are generating. Finally, an investment loss is losing value in your savings, where now you want to focus on losing retirement income.”

A Recommended Withdrawal Strategy

The Stanford Center on Longevity evaluated 292 strategies on generating retirement income, and the “Spend Safely In Retirement” strategy is one that it believes can work well for most clients with $2 million in savings or less, Vernon says.

For clients using this strategy to build a retirement income portfolio, Vernon says, the longevity center suggests three things:

• Retirement paychecks. These are guaranteed to last the rest of your life, no matter how long you live, and they don’t go down in stock market crashes. Use these to cover your basic living expenses, food, a roof over your head, medical premiums, utilities.

• Retirement bonuses. These typically come from invested assets or salaries from working. Use these to cover your discretionary living expenses, like travel, hobbies and gifts for grandchildren.

• Cash stash. This money covers emergencies so you don’t have to dip into your savings.

Vernon noted these concepts are familiar to many advisors, but they also use language that individuals are familiar with from their working days.

The advisor’s goal is to construct a portfolio that safely meets clients’ needs.

Retirement paychecks can come from Social Security, a traditional monthly pension, a low-cost annuity or a reverse mortgage. Retirement bonuses can come from systematic withdrawal plans, including the IRS’s required minimum distributions from retirement accounts; interest and dividends from savings; working or self employment; and rental real estate.

Help clients optimize Social Security through a thoughtful delay strategy, Vernon says; that is going to work for most people. “A lot of people say, ‘But Social Security isn’t enough.’ That may be true, but it doesn’t mean you dismiss Social Security. It’s still pretty good and you get most out of that,” he says.

Step 2, he says, is to invest in a target-date, balanced or stock index fund and use the required minimum distributions to determine the annual withdrawal. “This is a baseline strategy. … [The clients] may want to refine this with different withdrawal strategies. But at least this is a baseline that works fairly well,” he says.

Vernon stresses that enjoying one’s later years goes beyond having a solid retirement income stream. Another key is investing in health by getting good nutrition and exercise, as well as monitoring health metrics to get ahead of whatever chronic condition is exhibiting warning signs.

And don’t forget this, Vernon says: “Build a social portfolio with the same attention you gave to building your financial portfolio.”