Finding Success in Retirement Income Planning

by Rebecca King

Retirement income planning is core to your client service. It's what most clients hire you to do; it's where your passion and expertise lie. So, what is your measurement of success?

Would you consider retirement income planning successful if the mix of investing, saving, and withdrawal strategies you recommend enables a client to live the retirement lifestyle he wishes? Is retirement income planning successful if a retired client returns to work part-time to help make ends meet? What if the client must adjust his desired retirement lifestyle so he doesn't run out of money? We analyzed the latest FPA survey data on retirement income planning in an attempt to frame success and reveal the common practices of planners who appear to be achieving success.

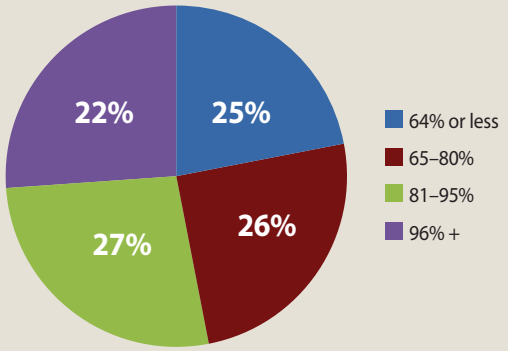
Since 2007, FPA has annually surveyed financial planners on their use of various retirement income planning strategies and the status of their pre-retired and retired clients. The 2012 study[1] was fielded in July among 444 financial advisers who actively provide financial planning services to clients. The study required advisers to anonymously disclose the percent of their clients in retirement who in the past 12 months became re-employed, significantly adjusted their lifestyle due to economic conditions, or made no significant changes to their retirement status or lifestyle.

When analyzing the data, we sought to identify a spectrum of success. Using a histogram analysis, study results were grouped to identify the advisers on both ends of the success spectrum—those who had clients with the *most* success maintaining their retirement plans, and those who had clients with the *least* success maintaining their retirement plans.

- The "most successful" advisers are defined as those for whom 96 percent or more of their clients did *not* need to make significant changes in the last year.
- The "least successful" advisers are those for whom only 64 percent or fewer of their clients did *not* need to make significant changes (see Exhibit 1).

By looking at the differences in how the most successful and least successful advisers approached retirement income planning, we can identify some key tools and techniques that show a statistically valid association in driving client success.

Exhibit 1: Percent of Advisers' Clients Who Are Retired and Did Not Need to Make Significant Changes in the Past 12 Months



Source: FPA's *2012 Financial Adviser Retirement Income Planning Experiences, Strategies, and Recommendations* study.

Do Systematic Withdrawals Lead to More Success?

FPA's 2011 retirement income planning study found that the most successful advisers were more likely to always use systematic withdrawal strategies with their clients[2]. (In the 2011 and 2012 survey questionnaires, systematic withdrawal was defined as withdrawing either a pre-determined or policy-based amount funded by a combination of interest, dividends, and/or portfolio holdings based on the client's income needs and economic conditions.)

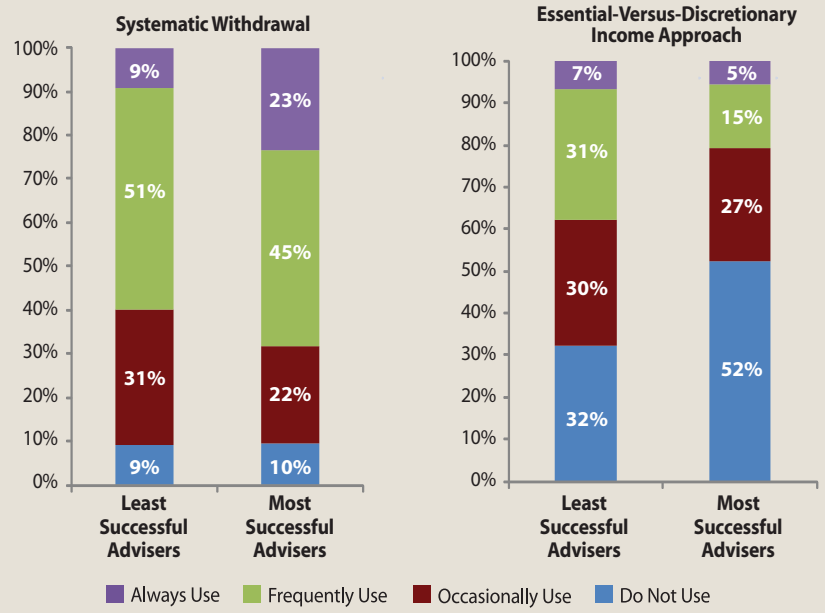
The trend continued this year. 2012 study data showed that 23 percent of the most successful advisers reported always using systematic withdrawal strategies, compared to just 9 percent

of the least successful advisers who reported doing so. Stated another way, 40 percent of the least successful advisers did not use or only occasionally used systematic withdrawal strategies, compared to 32 percent of the most successful advisers who either did not or only occasionally used systematic withdrawals.

If the least successful advisers were not widely embracing systematic withdrawal strategies, what strategies were they using? Advisers who experienced less success were more likely to be using an essential-versus-discretionary income approach. Could it be that this approach was not flexible enough to accommodate the needs of retired clients? These clients were more likely to seek re-employment or make significant lifestyle adjustments (including reducing expenses). These changes could have been spurred by a realization among planners that discretionary income was more important to these clients than originally thought. These changes also could have been spurred by a general tightening of the belt in times of lower-than-expected market returns, or perhaps the study findings indicated that the essential-versus-discretionary income approach was strong in concept but problematic in execution (see Exhibit 2).

Similar to 2011, advisers in the 2012 study who reported frequently or always using a less formal strategy (defined as clients primarily living on a pension or Social Security, which may be supplemented periodically) did not show a significant difference in achieving a higher level of success. This seems counterintuitive. Clients who relied on a guaranteed income stream—the amount of which they were aware of prior to retirement—would seem less prone to market fluctuations or unexpected events. However, the data suggested that these individuals were equally susceptible to having to change their retirement status or lifestyle, and therefore may require additional assistance planning for unexpected events or strategizing for becoming re-employed and reducing expenses.

Exhibit 2: Most and Least Successful Advisers' Use of Systematic Withdrawal and Essential-Versus-Discretionary Income Strategies



"The "most successful" advisers are defined as those for whom 96 percent or more of their clients did not need to make significant changes in the last year to their retirement status or lifestyle. The "least successful" advisers are those for whom only 64 percent or fewer of their clients did not need to make significant changes.

Source: FPA's *2012 Financial Adviser Retirement Income Planning Experiences, Strategies, and Recommendations* study.

Withdrawal Rates Coming in Line

Over the past six years, study participants have been recommending an average initial sustainable withdrawal rate that has decreased from 5.3 percent in 2007 to 4.07 percent in 2012 (see sidebar).

Least successful advisers were more likely to report that in the past 12 months they had decreased the initial sustainable withdrawal rate they recommended. These advisers primarily attributed this decrease to current market valuations, and anticipated substandard market return expectations in the future. Interestingly, these advisers did not show a statistically different initial sustainable withdrawal rate compared to the broader profession.

> "Advisers who experienced less success were more likely to be using an essential-versus-discretionary income approach."

This means that these advisers have adjusted their initial sustainable withdrawal rate to be more in line with the rest of the profession, suggesting

this decrease was overdue and may have negatively impacted the likelihood of a client outliving their assets, resulting in the need to make significant adjustments to retirement status or lifestyle. Advisers who continually evaluate and make adjustments to the initial sustainable withdrawal rate may be better positioning their clients to weather various financial challenges in retirement.

Stress Testing and Emerging Research Make a Difference

Reviewing the study data on retirement income plan implementation, one key area stands out: methods for testing the likelihood of plan success.

The most successful advisers were about twice as likely to use portfolio stress testing/sensitivity analysis and the application of ongoing and emerging research on sustainable withdrawal strategies as the least successful advisers (see Exhibit 3). This data showed that keeping up on emerging research on sustainable withdrawal strategies was not just a good idea, it also had a positive effect on retirement income planning results.

Of course, there is no silver bullet, and your ability to tailor strategies and recommendations to each client situation is perhaps the biggest key to your success as a retirement income planner. However, this data showed that some strategies stood out in delivering more effective retirement income plans for clients. Is it possible that one or more of these strategies may offer the extra insight you need to provide even more effective retirement income plans for your clients?

Rebecca King is a market research consultant specializing in the independent adviser market and

Withdrawal Rates Drop to Lowest Level in 6 Years

by Carly Schulaka

The average initial sustainable withdrawal rate recommended by advisers has dropped 23 percent from 5.30 percent in 2007 to 4.07 percent in 2012, and to some of the best-known names in withdrawal rate research, this ratcheting down is not surprising.

"We're finally beginning to adjust our expectations to the Bill Gross new normal," says Michael E. Kitces, CFP®, CLU, ChFC, RHU, REBC, partner and research director at Pinnacle Advisory Group and practitioner editor of the *Journal of Financial Planning*. "We have just gotten to mean expectations that the research said you were supposed to be doing all along. [Bill] Bengen's original number from almost 20 years ago was just over 4 percent, and we've just now gotten to just over 4 percent." (Later, Bengen's expanded research showed a starting point of 4.5 percent.)

Wade Pfau, Ph.D., CFA, whose paper "Safe Savings Rates: A New Approach to Retirement Planning over the Life Cycle" (published in the May 2011 *Journal*) addressed withdrawal rates for clients further away from retirement, noted the 0.9 percent drop in the average initial sustainable withdrawal rate between 2008 and 2009—the aftermath of the financial crisis.

"I think it does make sense that the numbers are even lower in 2011 and in 2012," says Pfau. "This must reflect that stock markets remain overvalued and, more importantly, that bond yields are at historical lows. Lower bond yields can have a big impact on lowering sustainable withdrawal rates. So for the traditional, constant inflation-adjusted spending approach, I think the downward direction for these estimates makes sense."

Initial Sustainable Withdrawal Rates*

For clients who use the systematic withdrawal approach to creating retirement income, what percentage of their portfolio do you typically recommend as an initial sustainable withdrawal rate?

	Lower	Upper	Mean/Average
2012	3.92	4.23	4.07
2011	4.12	4.22	4.17
2010	4.37	5.13	4.75
2009	4.31	4.51	4.41
2008	5.02	5.60	5.31
2007	5.18	5.43	5.30

*95% confidence interval of the difference

Source: FPA retirement income planning studies, 2007–2012.

Too Low?

Jonathan T. Guyton, CFP®, principal of Cornerstone Wealth Advisors Inc., whose research showed how systematic, dynamic decision rules may generate higher safe withdrawal rates, says a mean initial sustainable withdrawal rate of 4.07 percent in 2012 is nothing to raise an eyebrow at, *if* this is the rate used by planners who only and always adjust for inflation. However, if 4.07 percent is the average initial rate used by planners who employ dynamic withdrawal rules, he wonders if it's too low.

"In 2007, with market valuations signif-

the former director of the FPA Research Center. Contact her at Rebecca@RebeccaKing.com.

Endnotes

1. This research was derived from a comprehensive survey of 444 completed responses from geographically dispersed practices. The *2012 Financial Adviser Retirement Income Planning Experiences, Strategies, and Recommendations* study was fielded in July 2012. Data was cleaned to ensure only valid responses were included in the analysis.
2. FPA Research Center. 2011. *2011 Financial Adviser Retirement Income Planning Experiences, Strategies, and Recommendations* study (December). www.FPAnet.org/Journal/CurrentIssue/Supplements/SpecialReport2011Retirement.

Exhibit 3: Percent of Advisers Using Method to Evaluate Likelihood that the Plan Will Provide Adequate Income and Address Risks

	All Advisers	Least Successful Advisers	Most Successful Advisers
Portfolio stress testing/sensitivity analysis	23%	15%	28%
Application of ongoing and emerging research on sustainable withdrawal strategies	32%	19%	40%

Source: FPA's *2012 Financial Adviser Retirement Income Planning Experiences, Strategies, and Recommendations* study

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icantly higher than today, the 5.3 percent average recommended withdrawal rate matched the empirical evidence for a dynamic, policy-based distribution strategy," says Guyton. "Today, the average recommendation is nearly 25 percent lower—a real volatility in this advice and a significant lifestyle price for retirees to pay. A client could only wonder, 'Why?'"

(Ninety-one percent of planners who participated in the 2012 FPA study used a systematic withdrawal approach to provide retirement income to clients. Among those planners, 71 percent used some kind of dynamic withdrawal policies; 13 percent adjusted only for inflation.)

Although Kitces is relatively upbeat about this downward ratcheting of initial sustainable withdrawal rates—because it seems to indicate that advisers are adjusting expectations to reality—he also has some concern.

"Although it's great to see the number come into what the research shows, I'd hate to see it go too far," he says. "I'll be very curious to see from here: do we level out and get comfortable with this number, or do we ratchet down again and give unusually low [initial sustainable withdrawal] rates?"

Investment manager and financial adviser William P. Bengen, CFP®, whose research laid the groundwork for the "4 percent rule" and the "SAFEMAX" concept, wonders if the average rate has already come down too far.

"Assuming [the FPA] data represents a real trend, they may have come [down] too far," Bengen says. "They may have overreacted a little bit, and they may have been squeezing their clients a little too much."

Bengen noted that on a 30-year, tax-deferred retirement account, 4.5 percent is still the starting point he uses with his clients.

"I do recommend that clients be more careful with their spending, but I have not seen anything in the data yet that would mean that [4.5 percent] standard does not still apply," he says. "It's based on a worst-case scenario, and we have not seen that worst case repeated yet."

Bengen reminds advisers that the 4.5 percent standard is only a starting point.

"I never tell a client coming in that 4.5 is it; 4.5 percent applies when spending and income are both rising with inflation, and not too many clients meet that profile," he says. "Many clients are actually going to have to take out a lower rate earlier in their retirement, and later on take out a higher rate. You just have to be careful how you use that 4.5 percent. It's a rule of thumb."

So, by ratcheting down from an average initial sustainable withdrawal rate of 5.3 percent five years ago to 4.07 percent today, are advisers getting it right?

"It is hard to know whether the numbers recommended to clients represent what the adviser views as 'safe' in the traditional sense, or what the adviser views as the best trade-off for their clients between spending more now and potentially less later," says Pfau. "For these reasons, I don't see any reason to say that the survey estimates are either too high or too low. Hopefully for everyone involved, they are just right."

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