Special Report

RETIREMENT INCOME PLANNING

Study Suggests Link Between Planner Retirement Advice and Client Lifestyle Changes

by Jonathan Guyton, CFP®

The Financial Planning Association's 2011 retirement income study[1] offers a treasure trove of insights into practitioners' evolving approaches to generating sustainable lifetime income and advising clients both in and near retirement. Study results reveal a strong majority of planners coalescing around a methodology and an assimilation of empirical evidence into practice, as well as a noticeable minority whose thoughts and actions seem very much in flux, at least for now. Digging deeper though, a fascinating set of divergent patterns, depicting both healthy connections and troubling dysfunctions, also come to light and point out directions for future exploration.

Planners Embrace Systematic Withdrawal

Planners utilizing the systematic withdrawal methodology (either "always" or "frequently") to generate retirement income now outnumber all other approaches by 2 to 1 or more—at 74.8 percent. This is actually not surprising to me for two reasons.

Some planners who employ a time-based segmentation, or "bucket," methodology (the second most commonly utilized approach, with 37.6 percent "always" or "frequently" using it) may be realizing that it is no more than a starting point for a systematic withdrawal approach. After all, the matters of funding sources and the triggers for the movement of money within the client's retirement assets inevitably surface. I can easily imagine planners devising some systematic way to make such decisions and recommendations.

Second, as I wrote in my October 2011 *Journal* column ("Mirror, Mirror on the Wall …"), the essential-versus-discretionary approach (third most utilized, with 32.8 percent "always" or "frequently" using it) may inherently encourage a more aggressive portfolio for the funding of "discretionary" expenses, thereby joining at the hip an external event (the economic and market conditions of the moment) and the client's perceived ability to enjoy these parts of his or her life. Any planning strategy that accentuates such a link is rarely healthy for a client. And clients are far from indifferent about their ability to fund the "discretionary" activities in their lives!

More significantly, clients of planners who employ the systematic withdrawal methodology also seem to have more success in sustaining their retirement lifestyle. A systematic withdrawal approach—where a planner utilizes a "normal" adjustment to each year's distribution (for example, increasing for inflation) unless conditions (either negative or positive) have changed enough to make a different adjustment prudent—appears more effective in reducing the likelihood that clients will have to make a significant change in their lifestyle during retirement. Arguably, this is the holy grail of retirement distribution and lifetime income planning. By a ratio of nearly 2 to 1,[2] planners always using this approach for generating sustainable retirement income were more likely to have only a few clients (< 5 percent) making a significant change than to have many clients (> 40 percent) in this situation.

Acknowledgment: As a practitioner specializing in the area of generating sustainable lifetime income, I deeply appreciate the invitation of FPA's research team to offer my observations on this year's study results. Their impressive knowledge and responsiveness could not have made my job easier, and I am grateful for it.

Table 1: Success of Withdrawal Strategies Based on Planners Who "Frequently" or "Always" Use Them

		Percent of Retired Clients Who Made No Significant Changes to Their Employment Status or Lifestyle			
		</= 60%	61%–80%	81%–95%	96%+
Systematic withdrawal: Diversify investments based on client's risk profile and manage the total return of the client's entire portfolio. To provide income, withdraw 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.	Frequently Use	29.0%	29.0%	24.0%	18.0%
	Always Use	**19.0%**	**17.0%**	**31.0%**	**33.0%**
Time-based segmentation: Set up separate pools of investments with lowest-risk investments in the near-term time horizon segment, somewhat higher-risk investments in the next segment, and riskiest portfolio in the longest-term segment. Income is drawn from one segment at a time. Once the first segment is depleted, assets from the second segment are used for income.	Frequently Use	29.0%	31.0%	19.0%	21.0%
	Always Use	*	*	*	*
Essential-versus-discretionary income: Classify client's retirement expenses as essential or discretionary. Low-risk investments or annuity guarantees are selected to fund the essential expenses. A mix of medium- and higher-risk investments is selected to fund the discretionary expenses. Income is drawn from the respective pools to cover essential and discretionary expenses.	Frequently Use	31.0%	33.0%	20.0%	16.0%
	Always Use	*	*	*	*
Less formal strategies: Clients mainly live on their pension and/or Social Security, which may be supplemented periodically.	Frequently Use	22.0%	25.0%	32.0%	21.0%
	Always Use	*	*	*	*

Read as: 33% of advisers who always use systematic withdrawal had 96% or more of their retired clients make no significant changes to their employment status or lifestyle.
* Number of responses too small to prove statistically valid
Source: FPA's 2011 *Financial Adviser Retirement Income Planning Experiences, Strategies, and Recommendations* study (4% margin of error with the industry standard 95% confidence level)

(See Table 1.) Perhaps more importantly, they were the only group where a statistically significant number of more planners reported virtually none of their clients (< 5 percent) making a significant change to their lifestyle, compared to the number of planners with many clients (> 40 percent) experiencing such a change.

Whatever a lifetime income methodology may be labeled, those that allow (or require) the planner to be dynamic and nimble are gaining momentum in the practitioner community relative to those that are more static. Not only does this fit our profession's culture, which values relationships and process, a variety of empirical evidence on this subject demonstrates superior results using such approaches for clients.

Dynamic Policies Trump Set-It-and-Forget-It

Two other insights emerged in the study. A formulaic approach can be helpful, but planners want to direct (or at least continually be involved in) the design and ongoing implementation of their clients' retirement income plans and have the ability to make adjustments to how they practice income planning in the future as further advances occur. To wit, by an overwhelming majority (8 to 1), planners choose a "process-based" approach to retirement income planning rather than one that is "product-based."

Also, by a margin of about 2 to 1, planners utilize some sort of dynamic withdrawal policies to evaluate whether a change from a client's "normal" withdrawal amount is advised, relative to those who use some sort of set-it-and-forget-it approach (e.g., fixed real amount, fixed nominal amount, or fixed percentage) to the annual withdrawal amount. Interestingly, though, for each study respondent employing a dynamic approach that is "systematic," there is one who is not. One can't help but wonder about the basis for these "unsystematic" adjustments. Indeed, other parts of the study suggest that they may not be producing positive outcomes for clients.

This strong preference for a dynamic, process-oriented solution suggests both a growing assimilation of recent research into the way planners actually practice and an active curiosity that employs healthy skepticism and tire-kicking. (Recall that when someone has a strong analytical nature, as many of our colleagues do, one of their most significant needs in many situations is to be right!) It therefore seems that future research in this area will be far more impactful when it explores and compares lifetime income approaches with dynamic components than when it models the distribution amount or asset allocation as unchangeable. Unfortunately, research that holds real withdrawals constant and always

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rebalances to the initial asset allocation may not be sufficiently realistic.

In that light, I propose these topics as particularly juicy for further study: (1) The combined impact of a dynamic approach to both withdrawal policy and asset allocation policy (each has been analyzed separately more than once, but never in combination with the other); (2) A given withdrawal approach's impact on purchasing power over time—in total and year-on-year; (3) The "crying wolf" effect; that is, the connection between a planner's advisory personality (e.g., as measured in standardized psychological, emotional, or behavioral evaluations) and the manner in which that planner materially changes the advice he or she gives clients; and (4) The impact of various rebalancing approaches on a withdrawal rate's sustainability (prior research seeks to maximize expected return, not sustainability or distribution levels; in fact, it does not incorporate ongoing distributions into the modeling whatsoever).

All this said, it's necessary to acknowledge possible less-flattering causes of so much dynamic "non-systematic" decision making. There could also be a lack of confidence or clarity in our body of knowledge or in planners themselves. In fact, planners surveyed were not shy about identifying professional development opportunities for themselves when it comes to retirement income planning. In descending order, more than half of respondents cited these areas for self-improvement:

- Retirement income knowledge (74 percent)
- Managing various economic conditions within a retirement income distribution strategy (73 percent)
- Client communication (64 percent)
- Evaluating a retirement income strategy's likelihood of success (59 percent)
- Non-financial issues relating to distribution planning (56 percent)

Connecting Values with Advice

But enough of these external, left-brain comments. I find myself increasingly curious about the connection between a planner's own values, history, and relationship with money and the advice he or she gives on retirement and distribution planning, not to mention its connection with other aspects of the financial planning process. It's important to note that the study was not designed to test this in any way; nevertheless, some fascinating patterns emerged. Consider the following:

- Overall, planners said that about 30 percent of their retirement-focused clients made a significant change in their lifestyle in the past year. This could include lifestyle expense reductions, a delay of retirement, and/or a return to work. Specifically, this was true for 24 percent of clients in retirement and 34 percent of those near retirement.
- More than a quarter of planners (28 percent) reported that more than 40 percent of their clients in retirement made a significant lifestyle adjustment as described above. At the other end of the spectrum, just over one-fifth (21 percent) of respondents said that no more than 4 percent of their retired clients made such a significant change.
- Among planners with more than 40 percent of retired clients making significant lifestyle changes, 14 percent "always" use the systematic withdrawal method for generating sustainable retirement income. However, this approach is used by 32 percent of planners for whom 4 percent or fewer of their clients made a significant change.[3]

This is a startling proportion of clients undergoing such a momentous change, particularly when, in my experience, so many name "maintaining our lifestyle" as a high-priority goal. So, digging deeper into the wide disparity of client experiences among our colleagues seems highly worthwhile.

According to FPA's research professionals, it is unusual to see such a large difference (about 2.5 to 1) in the approach planners employ from one end of the performance spectrum to the other. Typically, a widely utilized practice is applied with a similar frequency across the board, but not in this case. So it appears—at least among the planners participating in this study—that the systematic withdrawal method for generating sustainable income has been much more effective in helping clients maintain their retirement lifestyles than either the time-based segmentation or essential-versus-discretionary approaches.

However, some other results also appear germane to understanding such a wide range of client experiences over just the past year:

- A strong majority of planners (79 percent) said that their average answer for the safe withdrawal rate most often cited to clients was unchanged in the past year. (See Table 2 for the range of withdrawal rates reported.)

Table 2: Initial Sustainable Withdrawal Rate

25th Percentile	Mean	75th Percentile
4%	4.17%*	4.50%

Source: FPA's *2011 Financial Adviser Retirement Income Planning Experiences, Strategies, and Recommendations study*.
*Standard deviation: 0.81%.

Because the makeup of the responding group changes from year to year, it is difficult to draw conclusions about their specific answers themselves.

- For those describing their changed response, 92 percent said it had decreased.
- For those stating the reason for lowering their current view of safe withdrawal rates, 15 percent cited some type of analysis and 76 percent attributed it to their perception of current and future conditions in financial markets ("current volatility," "uncertainty," or "the future won't be as good as the past" capture virtually all of their perceptions).
- Planners reporting that more than 20 percent of their retired clients had to significantly change their lifestyles were twice as likely to have reduced their sense of the safe withdrawal rate since last year than planners with fewer than 20 percent of clients making such an adjustment.[4]
- A similarly strong correlation exists between a reduced level of safe withdrawal rates and the portion of clients *near* retirement making a significant lifestyle change.[5]

> "It is remarkable how clients' behavior seems to be influenced by changes in the advice they receive."

What stands out is the basis for a planner changing his or her sense of an appropriate safe withdrawal rate and the correlation between that change and client behavior.

Certainly, for a planner to combine perception (art) with analysis (science) seems entirely appropriate in rendering advice to clients. It should be noted that the global economic picture had indeed darkened over the 12 months between the 2010 and 2011 studies. It's also true that the S&P 500 was roughly 18 percent higher this August 31 than at the same time last year (planners completing the survey do so each August), rising 32 percent through this April before falling nearly 10 percent since early May. Ironically, research has shown that extremely large increases in market valuations may in fact necessitate a reduction in the safe withdrawal rate, but this was not the reason the vast majority of respondents cited as the basis of their changing views.

That so many planners made such a change in this aspect of their retirement advice on this basis of market conditions and economic volatility in just one year is remarkable. Depending on the magnitude of the shift they made, it may also suggest a volatility of advice.

What is also remarkable—though not surprising—is how significantly clients' behavior seems to be influenced by such changes in the advice they receive, whatever its basis. And in the past year, based on the 2011 study, many clients in and near retirement were indeed influenced to make significant lifestyle changes.

The disparity in behavior among clients and the differences in the advisory reactions of their planners under identical circumstances seem too great to be fully explained by exterior elements of practice such as retirement income methodology and application of dynamic withdrawal policies. Very likely, we must devote more attention to the interior—to an exploration of the personalities, money scripts, and behavioral influences that affect planners—to more fully understand what causes planners to change their tunes.

For doing so, our clients will certainly thank us.

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Endnotes

1. FPA Research Center. 2011. *2011 Financial Adviser Retirement Income Planning Experiences, Strategies, and Recommendations* study (December). www.FPAnet.org/Journal/CurrentIssue/Supplements/SpecialReport 2011Retirement. Study results are derived from an online survey of 595 complete responses from financial advisers/planners who are members of FPA. The survey was fielded in August 2011 and was sponsored by Thornburg Securities Corporation. It has a 4 percent margin of error with the industry standard 95 percent confidence level.
2. The statistical significance was tested using Pearson Chi-Square analysis and proved significant at the .05 level.
3. Ibid.
4. The statistical significance was tested using Pearson Chi-Square analysis and proved significant at the .05 level. Association was tested with Phi & Cramer's V and proved significant at the .05 level.
5. Ibid.

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