Still River

Retirement Planning Software, Inc

January, 2005

Retirement Income Planning, Part 6[*]: Providing the Information That People Need

To be successful at retirement income planning, we must give people the help they need and want. Unfortunately, we in the financial services industry have focused instead largely on what we want to show or sell them. This is a recipe for failure.

So far, product development has been the one area in which insurance companies, securities firms, and banks are showing some consistent appreciation for the attitudes and problems of retirees.

It is in our interest to give help and advice first so that we can sell the products later.

Yet people approaching retirement, going through the retirement process, or already settled into retirement are not necessarily looking mainly for products. They are looking for advice, comfort, and help. Only when we provide this help and advice are we well positioned to follow with the sale of applicable products and/or retain existing accounts.

This paper discusses a critical component of this process: the report that is delivered to the client. As the physical product of all our analysis, the content of the report is central to our effectiveness in serving clients in this market.

Sound familiar?

Our friends, Joshua and Ellen Taylor, are visiting their financial professional to review the results of an analysis he's performed for them. Here's how it goes:

Financial Professional (FP): So, here's the report we produced for you. As you can see, there are a lot of pages with a lot of numbers and charts, but here's the page that gives you the bottom line: you need to make some adjustments in your finances.

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[*] Part 1 of this series discussed the urgent and wide-ranging planning needs of people facing retirement, and concluded that if financial companies and employers want to serve this demographic group, they need to address *all* these planning needs. 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.

Joshua: What kind of adjustments?

FP: We're recommending that you invest your savings a little more aggressively so that you earn a higher return and are better able to deal with inflation, and at the same time we suggest that you put 20% of your savings into an annuity that will pay you a guaranteed income for the rest of your life.

Ellen: What does this mean, where it says that we have an 83% chance of meeting our goals?

FP: The 83% figure is your likelihood of completely meeting your financial goals. The annuity eliminates your risk of entirely running out of money, and the more aggressive investment makes it more likely you will be able to cover your expenses, but it also involves some risk. As the detailed analysis shows, if you do fall short, you do not necessarily fall *way* short. Your odds of a financially catastrophic scenario are less than 10%.

Joshua: Whoa, we have a one-in-ten chance of financial catastrophe?

FP: But if you think of it as a 90% chance of complete or near success…

Ellen: It does sound better when you put it that way. Still…

Joshua: To be frank, I'm wondering how valid these numbers are. I realized after we filled out your questionnaire that you never asked us what the terms of our mortgage are, or about the loans we made to our children, or about how long we expect to keep our beach house going, or how long my wife is likely to keep getting royalties on the book she wrote, or about the money we are saving toward our grandchildren's college education and how long we'll have to be doing that, and a whole bunch of other things. If you don't know about all those items, how can you know we have an 83% chance of meeting our goals?

FP: Of course, certain simplifying assumptions are being made here.

Joshua: But these things are important to us, and they're a big part of our financial picture. How far could this 83% number be off?

> **"Of course, certain simplifying assumptions are being made..."**
> **"So how far could this number be off?"**
> **"There's no way to tell, really."**

FP: There's no way to tell, really.

Ellen: So our chance of catastrophe could actually be a lot higher than 10%?

FP: Well, yes, possibly, or maybe lower…

Joshua: But you can't tell us by how much. So the 83% doesn't really mean 83%, does it? It really doesn't seem to mean much of anything.

FP: It's imperfect, granted, but not meaningless. It roughly indicates that this is a viable plan.

Joshua: But does this really answer the questions that we originally asked you? We did want to know what to do with our savings, and your advice on that makes some sense. But we also wanted to know what we should be doing about our pension plan – I've got all these options and I don't know which one I should be taking. And Social Security –

I'm eligible now, I guess, and Ellen is, too. Do we sign up right away? Some people are telling me it's better to wait. And my group health insurance isn't going to last much longer – what do I do about that? Will Medicare cover us? What about nursing home costs? Do we need to save money for that?

FP: The model takes medical risks into account.

Joshua: But what is it recommending we *do* about it? Are we supposed to cross our fingers and hope for the best, or do we buy insurance, or do we set up a separate savings plan in case we go into a nursing home, or what?

FP: These are all excellent questions, Joshua, and —

Joshua: That's only the beginning. I have a pretty long list here: should we pay off our mortgage early, should we be selling that beach house right away, should we —

FP: We'll discuss all those questions separately.

Joshua: They're not in this model? I don't get what this model is doing if it's not answering our questions.

FP: Granted, it's not answering a number of your questions, but it's answering some of the most difficult ones.

Ellen: But how can it be doing that, especially if it doesn't know about all these other things? Don't they all affect our finances?

FP: Yes, of course. Once we have decided some of these other things, we can go back and run the model again.

Ellen: And will it still come out saying 83%?

FP: Probably not.

Joshua: Then what does that 83% really mean, again?

Ellen: It seems to me that we've kind of wasted our time here…

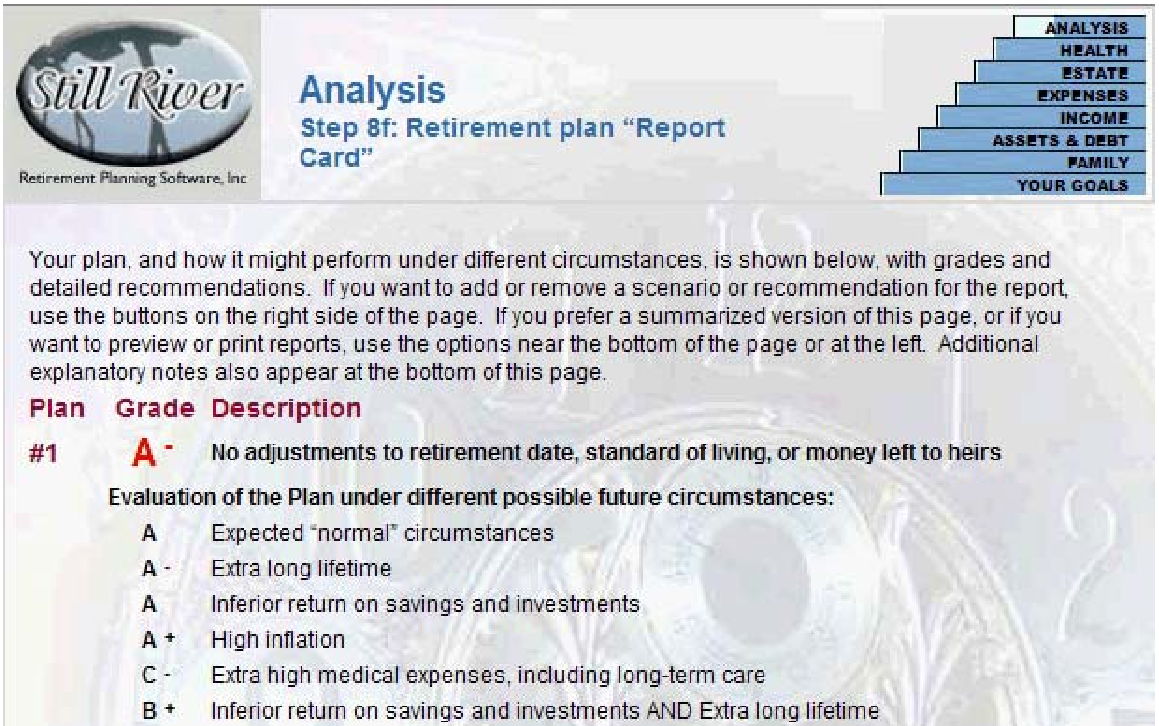
It seems to me that we've kind of wasted our time here.

What people want

We believe that people want four main results from the retirement income planning process:

1. an understanding of their current financial situation, including an evaluation of whether they are on track for probable success or probable failure.
2. advice about what they should do to improve their financial situation, particularly about issues that require quick or irrevocable decisions – such as those they face when they first enter retirement.
3. an understanding of what could go wrong, and an idea of what they can do to prevent, or at least cope with, the contingencies that they fear the most.
4. products and services that will efficiently and reliably implement the advice that they are being given.

As we are focusing here on the planning rather than the implementation phase, we won't address #4 now. The first three, however, are critical to the process that leads up to #4, and only if we do those properly will we even get to #4.



The above screen-shot shows one way of delivering what people want. Although summarized (much more detail is available in the printed version of the report), it provides a lot of information, including the most important information. It tells Joshua and Ellen that they can have a satisfactory retirement under "expected" circumstances, and that they are within passable range even under certain adverse circumstances that they themselves have indicated are of concern.

Furthermore, the plan (continued on the following page) tells them what they need to do to achieve this level of security. The recommendations are quite specific, although we leave it to the financial advisor to help identify the actual financial products used to implement the plan, including which specific investment and savings instruments should be selected.

Again, the printed version of the report provides more detail and explanation, but the following illustration shows the essence of it.

This kind of presentation goes a long way toward giving Joshua and Ellen what they are looking for. It tells them specifically what they should do, and tells them how well it is likely to work out. If they want to tweak the plan, they can. But when they are done tweaking, the plan is complete – and the product sales are essentially made.

Specifics of this plan:

1 Joshua will retire according to current plans. Ellen does not currently work for pay, and will not do so in the future.

2 Joshua should begin taking Social Security at age 67. Ellen should start at age 69.

3 Joshua should elect the option that pays a full benefit to himself or Ellen for as long as either is alive, under the Company pension plan.

4 Expenses are assumed to remain at a level in line with your current standard of living.

5 This plan does not assume that you sell your home.

6 You should pay off high-interest debt.

7 The plan assumes that the amounts you wish to leave to your heirs will be provided for.

8 Joshua and Ellen should sign up for Medicare Part B as soon as possible after age 65.

9 Joshua and Ellen should continue on a full health insurance plan up to age 65, and use Medigap coverage after that.

10 Joshua is not advised to seek new long-term care insurance, because living arrangements may go a long way toward reducing the need for outside help, because home equity can help pay for care, and because other assets are also likely to be available, if needed.

11 Ellen should purchase new long-term care insurance because expected future living arrangements do not provide for adequate care needs.

12 This plan assumes that all current insurance on Joshua's life is kept in force indefinitely. It is also assumed that Joshua will purchase new life insurance in the amount of $46,000.

13 This plan assumes that you will purchase a series of 4 immediate annuities, with purchases spaced 4 years apart, each in the amount of $5,000, starting in about 2 years.

14 A review of your current assets suggests that the following types of assets probably should be sold in the order given as you raise cash for your retirement needs: your personal investments/savings, your tax-advantaged retirement plan savings, your saleable personal property, your home.

15 This plan assumes a relatively conservative investment strategy, targeting an average annual rate of return 3% above inflation.

16 Ellen should draw up a last will and testament.

17 Joshua and Ellen should each create a living will.

18 Joshua and Ellen should each sign a health care proxy.

19 Joshua and Ellen should each set up a durable power of attorney.

One size does not fit all

We have emphasized before (especially in Part 2 of this series) that dealing with a problem of this complexity requires taking into account people's differences in style and comprehension. We previously discussed this in terms of input: how data is gathered, and in what degree of detail. Similar considerations are at least as important on the output side.

Assuming we have already determined whether people like a lot of detail or not, or whether they are comfortable with numbers or not, we can produce analyses that suit their style.

Although providing this kind of variability is a lot more work when developing a planning model, we believe that it is vitally important because, as experienced planners know, as hard as it is to produce a good plan for people, it is even harder to get them to actually read and implement the plan. Adjusting the style of the plan for different kinds of people will help overcome this hurdle.

It's almost ready…

We appreciate the patience of those of you who have been reading these papers and the interest of those of you who have responded. But it is one thing to talk about all that it would be nice to do, and another to see whether everything hangs together and really works. That's why it is important, finally, to have a prototype system that includes most of what we have been discussing that you can actually try out. We expect to have one in March 2005.

Let us know if you have any thoughts on these subjects, or if you would like to know more about the prototype. Retirement income planning is a relatively new field, and no one has all the answers yet. We're willing to share our own insights, and we would love to hear yours – perhaps by doing so we will all have the answers before too long.

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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