Retirement Income Planning Is Like Calculus, Researcher Says

By Linda Koco
AnnuityNews

Insurance researcher Mathew Greenwald has some sobering news for advisors who rely only on financial engineering when they work on retirement planning with clients.

The retirement industry is a rational, mathematical business, but it also must factor in emotions when dealing with clients and helping them make retirement decisions, said Greenwald, who is president of Greenwald and Associates, Washington, D.C. “Some tools don’t get it right, the balance between the two,” he cautioned.

In fact, clients often find retirement decision-making to be more emotional than saving for retirement during their accumulation years, he told a breakout session at the recent Retirement Industry Conference in Arlington, Va. The conference was sponsored by LIMRA-LOMA Secure Retirement Institute (LIMRA-LOMA SRI) and the Society of Actuaries.

Income planning is like calculus

Accumulation is the easy part, he said, because it’s like arithmetic. “But income planning is like calculus.”

During the accumulation years, people can plan to a certain date and they have time to recover from setbacks and volatility, he pointed out. But with retirement income planning, they do not have a certain end date, and time and volatility are enemies. He listed other issues that also become riskier or more uncertain when income planning, such as coping with inflation and health care costs.

Then there is the matter of vulnerability. Older people often have less vitality and strength than they have during their younger years and “they know they will decline” in physical and cognitive abilities as time goes on, Greenwald said. As a result, older people think more about hanging on to their financial independence.

Sometimes, “they feel like a ship without a guiding star,” he added. They feel more vulnerable and also less protected. That makes them more emotional.

They need to deal with this, he said, and so do the financial advisors who work with older people.

He advised against treating retirement income clients as “economic retirees,” which is what he said financial engineers tend to do.

The financial engineering approach tends to assume that retirees will spend consistently, no matter their asset level, that they have a consistent risk tolerance, and that their goal is to have assets above zero when they die (wanting to leave a bequest).

However, research his firm recently conducted with DSG found that the main goal of many retirees is to feel financially secure and independent. If their assets go down, he said, “they start to worry. They wonder, ‘Am I OK?’” They feel the need for reassurance about that.

In addition, only two out of five who have no defined benefit plan said they want to spend consistently in retirement, Greenwald said. And the key reference point for most is their asset level at retirement, not at death.

In sum, “managing money tends to be more emotional (after retirement) than before retirement,” he said.

The problem

The problem that the retirement industry needs to address is that many of its maxims do not fit with retiree emotions, Greenwald said. In addition, the industry's efforts to measure client emotions sometimes "appear flawed" and "contribute to suboptimal solutions."

For more optimal approaches, he said the research shows that people value having an investment strategy. "This is a framing of an approach or set of tactics to achieve something." Sixty-nine percent of those polled named that as being extremely or very important, putting that in first place among desired solutions.

The second-ranked value for this group was having "investments that do well when the stock market is up but have protection against loss when the market declines."

The third-ranked value was having investments that do well in times of high inflation.

Those who use an asset allocation framework "very often do not include guaranteed lifetime income products," leaning instead toward stocks, bonds and cash, Greenwald said. In addition, many investment risk tolerance questionnaires, which advisors use in developing asset allocations, "typically do not map to annuities."

Based on the findings, the researchers concluded that making investment recommendations - especially concerning products with guaranteed lifetime income - within the context of an overall strategy "is more emotionally reassuring" to older people.

Some retirees like and want annuities

Absence of discussion about lifetime income and annuities could pose some challenges for retirees. These would-be retirees value guaranteed retirement income.

According to research just released by LIMRA SRI, such retirees do exist. These are what researchers for LIMRA call "guarantee seekers," Jafor Iqbal said in a presentation during the same breakout session at the conference. Iqbal is assistant vice president at LIMRA SRI.

The study found that this category of affluent Americans — who represent 43 percent of the affluent Americans studied — like to buy annuities, along with certificates of deposit and government bonds, Treasury bills and notes.

Their priority is to have guaranteed retirement income, and they are willing to give up control of some assets in order to get that, Iqbal said.

In fact, the highest ownership rates for this market segment are deferred annuities (37 percent) and immediate annuities (9 percent). Meanwhile, their lowest ownership rates are individual stocks (54 percent), mutual funds (54 percent) and corporate/municipal bonds (14 percent).

The guarantee seekers' annuity ownership is higher than that of the other two affluent segments in the LIMRA SRI study. (These other segments are "estate builders," who are interested in growth, and "asset protectors," who want to preserve their initial investments).

"If the financial institutions are not thinking about this, there will be a big gap, going forward, for the guarantee seekers," Iqbal said.