

Retirement Risk Solutions

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This table was built for the Retirement Income Certified Professional® (RICP®) designation program for financial advisors. Building a retirement income plan starts by making sure that the client's income needs and other financial objectives are met. But after that is the tough task of evaluating all the risks that retirees face, and developing a plan to address each one. This table identifies 18 risks in six different categories. With each risk, we define the risk, provide an example, identify facts that describe the magnitude and scope of the risk, and offer a wide range of possible solutions.

The solutions offered here are intended to provide ideas. Building a retirement income plan is a complex process and building solutions to retirement risks is much more than just checking the box. For example, solving longevity risk may include deferring Social Security, purchasing annuities with lifetime payouts, buying life insurance to provide an income stream to a surviving spouse, and carefully choosing a withdrawal strategy from a retirement portfolio. In other words, almost every risk described here requires a carefully crafted, balanced set of solutions that requires thought, knowledge, and experience.

Here are some additional resources:

For consumers looking for an advisor to work with, visit [Designation Check](#). To learn more about retirement income planning, visit the New York Life Center for Retirement Income's [website](#). For advisors interested in learning more about the Retirement Income Certified Professional® designation, visit the [RICP®](#) page.

The Society of Actuaries publication "[Managing Post-Retirement Risks – A Guide to Retirement Planning](#)" offers background information and more discussion about the risks. The Society of Actuaries publication "[Managing Retirement Decisions](#)" series offers eleven decision briefs covering specific areas of decisions. They can be downloaded and used with clients. While this document focuses on solutions, the Managing Retirement Decisions series focuses on questions to ask and considerations in making decisions.

Risks of Outliving Resources

Longevity Risk

Definition	No one can predict how long he will live. This complicates planning since a retiree has to secure an adequate stream of income for an unpredictable length of time.
Example	You build your plan expecting to live to age 82. It turns out that you live to 92. How are you going to make your money last an additional 10 years?
Factors	<ul style="list-style-type: none"> • According to the Social Security Commission, the average life expectancy for those still alive at age 65 is <ul style="list-style-type: none"> – Age 84 for males – Age 86 for females • Maybe more important are the odds of living longer than average <ul style="list-style-type: none"> – 1 in 4 will live past age 90 – 1 in 10 will live past 95
Solutions	<ul style="list-style-type: none"> • Uncertainty cannot be eliminated but good planning starts with a realistic expectation of life expectancy using life expectancy tables as well as considering personal and family health history. One online calculator that takes these factors into consideration in providing an individual estimate is called the living to 100 calculator. • Many will want to plan to age 90 since 1 in 4 are expected to live that long--but fewer may want to plan for living past age 95 as only one in 10 lives that long. Those with a greater concern about outliving their assets will choose a longer planning horizon. It is important to note that unless the risk is transferred, the longer the planning horizon, the more resources will be required to be saved. • Transferring the risk of living too long can be accomplished by increasing sources of income that provide income for life, using the following approaches. <ul style="list-style-type: none"> – Inflation protected, lifetime income can be increased by deferring Social Security payments. – Electing life annuity payments from an employer sponsored retirement plan—most employees with a lump sum option usually make this election. – Purchase a life annuity to create a stream of income for either the life of a single individual or over the joint lives of a couple. Immediate annuities can be purchased at retirement or layered over time in case a person's health status changes as she ages. – Purchase a deferred income annuity which allows for the prepurchase of lifetime income for those that want to build retirement income prior to retirement or want to buy an annuity that begins later in life. This can be a cost effective way to protect against longevity risk. – Deferred annuities can also be used to create income for life as these can be annuitized at a later date, allowing the owner to lock in lifetime income. Deferred annuities can be purchased with riders that provide for a lifetime withdrawal at a rate specified in the contract. <ul style="list-style-type: none"> – Lifetime income is also available with life insurance contracts. When a death benefit becomes due, a spouse can choose a life annuity form of payment. Also, cash value life insurance contracts can be exchanged for a life annuity under Code Sec. 1035 without tax consequences. • Other sources of income payable for an indefinite period will provide some protection from longevity risk. <ul style="list-style-type: none"> – With reverse mortgages under the Home Equity Conversion Mortgage program (HECM), one of the withdrawal options is the tenure option. This is a specified monthly payment for as long as the last borrower remains in the home.

	<ul style="list-style-type: none"> – Rental income on property owned is one of those sources of income. That could be renting out the basement apartment, owning a home or apartment building that is rented out, or owning commercial property. – Dividend paying stock has no time limits on the payment of dividends. – Those with active business interests can also receive ongoing payments. This can be anything from owning part or all of a company to receiving royalties from books, television shows or other property interests. • With a strategy of taking periodic withdrawals from a portfolio, it is important to carefully consider how much can be withdrawn and still ensure that the portfolio lasts a lifetime. What some of the research reveals is: <ul style="list-style-type: none"> – The safe withdrawal rate research shows that a 4 or 4.5 percent inflation adjusted withdrawal rate (based on the initial account value) will be sustainable for 30 years. If planning for a possibility of a longer retirement period the withdrawal rate should be adjusted downward somewhat. – Portfolio sustainability is enhanced by making reductions to the withdrawal rate when the market is down. – With longer time horizons, the portfolio’s sustainability is generally enhanced by increasing the percentage of equities in the portfolio. • A contingency fund can be built that can be used for longevity as well as other risks. <ul style="list-style-type: none"> – A contingency fund for this risk can be a diversified portfolio—with investments that emphasize long-term growth. – A Roth IRA makes a good tax wrapper for this type of account since the value is not diminished by taxes, and if the funds are not needed, the Roth is a very tax efficient vehicle to leave to heirs. – A contingency fund could also be the cash value of a life insurance policy—the goal may be to provide the death benefit for heirs, but if needed the cash value can be withdrawn or borrowed from the policy. – A reverse mortgage with a line of credit payout option is another good contingency plan.
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Inflation Risk

Definition	When working, inflation is often offset by an increased salary. In retirement, inflation reduces the purchasing power of income as goods and services increase in price, impeding the client’s ability to maintain the desired standard of living.
Example	<ul style="list-style-type: none"> • Juan and Maria needed \$5,000 a month to live when they retired at age 62 in 1981. They will need \$12,373 per month in 2011 to maintain the same purchasing power. • The Department of Labor inflation calculator can be used to illustrate the erosive impact of inflation.
Factors	<ul style="list-style-type: none"> • It is possible that some will be exposed to high inflation rates during retirement. • Some economists worry that the federal deficit may lead to high inflation. • Even modest inflation can significantly erode purchasing power over time. For example, a 3% annual inflation will mean that costs double for a client who retired at 62 and is now 86. • Higher inflation rates can apply to the goods and services that retirees purchase—for example, health care expenses.
Solutions	<ul style="list-style-type: none"> • The first part of the plan to address inflation is building in realistic estimates of long-term inflation when calculating how much to be saved for retirement. In this modeling sophisticated retirement software can apply different inflation rates to different expense categories. • An excellent strategy is to build in streams of income that have built in inflation protection. <ul style="list-style-type: none"> – Deferring Social Security benefits means a larger percentage of income that has inflation protection. – If an employer-sponsored retirement plan includes cost of living increases—deferring has the same impact. Cost of living adjustments are

- more likely with a government-sponsored plan—although private company plans may provide ad hoc increases to benefits over time.
- Another option is purchasing a life annuity with a cost of living rider. There are a limited number of products that offer this option, and they may be expensive due to the risk taken on by the carrier.
- Build a ladder of bonds using TIPs. More specifically, purchase just the principal portion of the TIPs to create an inflation-adjusted stream of income for a specified period of time.
- Besides income streams that have direct inflation protection, you can also simply build income streams that increase over time.
 - Build a bond ladder that provides for an increasing income over time.
 - Purchase a term certain or life annuity that increases payments over time. Many annuity products allow this feature—and increases of 1 to 5 percent are often available.
 - Another option with annuities is to buy more annuity income over the retirement period. Payout rates from annuities increase as the owner ages, and purchases can be made in good years when asset values have increased.
- Purchase Inflation adjusted investments such as US government TIPs and Series I Treasuries. TIPs can be used to build an inflation-adjusted stream of income, and TIPs and Series I Treasuries can also simply be part of a portfolio that keeps up with inflation.
- Invest in asset classes that are likely to do well in inflationary times.
 - Investments in real estate are one such category, as unanticipated inflation often positively impacts real estate returns.
 - Investing in equities can also provide a limited hedge on inflation. International equities may provide an even better hedge as inflation is often associated with depreciation of home currency. Next, we will watch a video blog with Wade Pfau discussing the issue of inflation and equity investments.
- Under the safe withdrawal rate research, a 4 or 4.5 percent withdrawal based on the initial portfolio value can have cost of living increases and still be safe for a 30-year retirement period.
- Have a contingency fund that addresses a number of risks in retirement. Note that longevity risk and inflation risk are related, and if a client lives a long time, he or she will have more exposure to inflation risk as well—meaning that having a single fund to address both risks may be problematic.
- Another way to manage inflation risk is to shorten the retirement period—reducing the number of years that the retiree is subject to inflation. This can be done simply by deferring retirement. This is another value to working longer that is not always considered.
- Working part-time in retirement may be another way to offset inflation risk as wage income is likely to reflect the inflationary pressures.
- Lower or eliminate expenses in retirement.
 - If expenses are prepaid at today’s prices, you do not have to be concerned about inflation.
 - One common expense that is handled this way is prepaid funeral expense.
 - Another consideration is paying off or converting adjustable rate mortgages and loans to fixed rate loans to eliminate the risk of increasing debt service.

Excess Withdrawal Risk

Definition

When taking withdrawals from a portfolio during retirement to fund income needs, there is a risk that the rate of withdrawals will deplete the portfolio before the end of retirement.

Example

Since you know that stocks have historically earned an average of 8% a year, you assume that you can afford to withdraw 8% of the initial portfolio value (plus a little more for inflation each year)—while in reality to protect against the uncertainty of the market you may have to limit

	withdrawals to 4% or less.
Factors	<ul style="list-style-type: none"> • Sustainable withdrawal rate research—There is a lot of research on how much can be withdrawn from a portfolio without risking portfolio failure. Unfortunately the answer is complicated, and depends upon the length of retirement, the asset allocation, and whether rates of return will match historical returns. Choosing an appropriate withdrawal rate should be done with the help of a qualified advisor with expertise in this question and with the assistance of computer software. <ul style="list-style-type: none"> • Appropriate adjustments—Another factor that affects how much can be withdrawn is whether the client is willing to make adjustments over time. If the income need is determined —let’s say its \$50,000 and increased for inflation each year and the client cannot tolerate a reduction—the possibility of portfolio failure increases. • Discipline—Another factor is the ability to stay within the discipline of a withdrawal plan. Taking withdrawals from a portfolio allows for flexibility, but that can be a disadvantage as well. When the adult children are buying houses, the grandchildren are going to college or other compelling reasons to spend appear, it’s hard to stay within the discipline of a spending plan. • Under- and-over-spending—To ensure that a portfolio lasts a lifetime, the withdrawal rate needs to be conservative. This has the downside that retirees may not fully enjoy retirement out of a concern of running out of money. So taking withdrawals from a portfolio presents both a risk of spending too much, and a risk of spending less than can be afforded.
Solutions	<ul style="list-style-type: none"> • Building a plan to address excess withdrawal rate risk requires an understanding of the research about rates of withdrawals that can be sustained over a retirement period. • Technically, the safe withdrawal rate means the rate that using historical analysis would be sustainable in the worst case scenario. In many years, a higher rate would work—meaning it’s not that easy to pick an appropriate withdrawal rate. • Choosing a withdrawal rate also means weighing a client's desire for increased spending in relation to willingness to reduce spending. That is in part the client's attitude, but it's also a function of his risk capacity as well. If a retiree has Social Security and a substantial pension that is payable for life, then the client has more capacity for risk in taking withdrawals from the portfolio. • A real and serious consideration is sticking with the withdrawal plan. It should be helpful to have regular client meetings reviewing the plan and making sure that the client has a clear understanding of the consequences of failing to follow the plan. • Whether the plan is realistic is also a function of whether other contingencies have been planned for, or whether the portfolio is being relied upon to meet long-term care needs, unexpected health care expenses and other risks faced in retirement. Sometimes clients simply determine their income needs without considering those big periodic expenditures like replacing a roof or buying a new car.

Risks Associated with Aging

Health Expense Risk

Definition	For those that had employer health care coverage, retirement may mean paying more for medical insurance (Medicare Parts B and D and Medicare Supplement policies). Even with insurance, some expenses will be paid out of pocket. Also, chronic or acute illnesses may mean more significant and unexpected out-of-pocket expenses.
Example	At age 70, a client has some serious problems with her feet and she discovers that Medicare does not cover routine podiatrist visits. Or an even bigger surprise, she has a major surgery and discovers she faces a deductible and a 20 percent copay on many expenses.
Factors	<ul style="list-style-type: none"> • The amount needed to cover health insurance premiums and out-of-pocket expenses is significant—and often underestimated. A Fidelity study indicated that retiree couples thought that they only needed to have \$ 50,000 to cover medical expenses. • According to an EBRI study, the dollars needed at 65 to cover health care costs for couples varies from \$151,000 to \$360,000 depending upon whether the couple has average expenses or medical and drug expenses at the high end.
Solutions	<ul style="list-style-type: none"> • Planning for unexpected health care costs begins by choosing appropriate insurance. For those aged 65 and above who are eligible for Medicare, it means understanding options under Medicare and choosing insurance to supplement Medicare. • Having comprehensive insurance helps to make costs more predictable and avoid any extraordinary expenses. Medicare has no cap on out-of-pocket expenses; to limit costs requires purchasing a Medicare supplement. • A critical part of planning is making sure that sufficient funds are available at retirement to meet expenses. Determining costs is not easy as they vary a lot from individual to individual. When modeling health care expenses, you can build in a lump sum amount to the amount needed at retirement or estimate annual expenses each year. Also, it's important to consider the inflation factor appropriate for medical expenses. • Insurance for those eligible for Medicare <ul style="list-style-type: none"> – Individuals become eligible for Medicare at age 65. Almost everyone is eligible for Medicare Part A which covers hospital expenses at no cost and for Part B upon paying a monthly premium. – Individuals aged 65 can purchase prescription drug coverage under Medicare Part D. Individuals choose from among available private plans. Choosing a plan is an important decision, and changes can be made each year in an open enrollment period. Plans with higher premiums may offer more comprehensive benefits and may result in lower total out-of-pocket costs for a retiree with significant drug expenses. – Medicare Parts A and B are quite comprehensive, but they do have deductibles and copays and some health care needs of older adults are not covered. Some of the gaps can be addressed through Medicare Supplement insurance. Insurance companies must sell plans that provide standard benefits, however premiums can vary from company to company. There are a number of available plans; the more comprehensive have higher premiums but can have the important function of making costs more predictable and putting a cap on out-of-pocket expenses. – An alternative to a Medicare supplement is to join a Medicare Advantage plan. With this approach, instead of Medicare providing reimbursement directly under A and B, the individual is no longer in traditional Medicare, and the insurance company takes over responsibility for all medical reimbursements. These plans require care through a specified network, usually in exchange for lower premiums than Medicare plus a supplement or a wider range of benefits. • Pre-Medicare coverage is required for those that retire prior to 65. Options include <ul style="list-style-type: none"> – Employer-provided post-retiree medical coverage.

	<ul style="list-style-type: none"> – COBRA-continued coverage for 18 months under the employer’s plan – Coverage under a working spouse’s insurance plan. – Purchase private medical insurance to cover the gap between employer-provided insurance ending and Medicare beginning. This can also be coverage purchased through the health care exchanges • Controlling health care costs can also be part of the solution and options include <ul style="list-style-type: none"> – As drug expenses make up a quarter of health care costs in retirement, going to generic brand drugs may result in significant savings. – Preventative care and living a healthy lifestyle can significantly cut down on health care expenditures. – Continue to evaluate insurance, dental, and drug plans to get the best deal. – Consider some medical procedures out of the country. Many other countries have state-of-the-art medical care but at a fraction of the U.S. cost. – Relocate to lower the costs associated with medical care. Both medical costs and costs of insurance vary significantly across the country. • Other solutions <ul style="list-style-type: none"> – Those with high deductible health care plans can use health care savings accounts to set aside money for medical costs in retirement. – Limit end of life costs by maintaining advanced health care directives. – Defer retirement to stay on the employer’s subsidized health care insurance or go back to work to get employer-provided coverage.
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Long-Term Care Risk

Definition	Chronic diseases, orthopedic problems, and Alzheimer’s can restrict a person from performing the activities of daily living, which will require financial resources for custodial and medical care.
Example	Because of physical or mental infirmities, you need help with basic activities such as dressing, taking a shower, or even eating. To get help, you may need to move to assisted living, a nursing home, or go to adult day care. Even if a family member can provide care, it might be a real financial burden for them, especially if they have to cut back on work.
Factors	<ul style="list-style-type: none"> • 70% of all people age 65 and older will need long-term care at some point • 70% of long-term care services are provided by family members and family provided care has been shown to negatively impact the family caregiver’s career and health. • Less than 10% of those aged 65 have long-term care insurance. • Average length of long-term care: <ul style="list-style-type: none"> – 2.2 years for male – 3.7 years for female • \$85,000 – U.S. average for one year in a semi-private U.S. nursing home room • Alzheimer’s is the number one cause of need for long-term care.
Solutions	<ul style="list-style-type: none"> • Planning for long-term care <ul style="list-style-type: none"> – The first step when planning for long-term care is to understand the risks and costs associated with long-term care. – The client needs to determine how he wants to pay for long-term care and how care will be delivered. – It is important to take inventory of funding sources available such as long-term care insurance, family members willing to provide care, the option of using a reverse mortgage to fund long-term care costs, and whether government programs are available to pay for services.

- Buying insurance as a solution. When looking to purchase long-term care insurance, there are a variety of decisions that need to be made.
 - An important question is when to buy it. Purchasing in a client’s fifties keeps the cost down and provides a better chance that the client will be healthy enough to purchase the product.
 - Other decisions regarding long-term care insurance include the amount of the benefit, how care can be provided, whether to include inflation protection, the length of the elimination period and the length of time that benefits will be provided.
 - A well-developed and planned out long-term care insurance policy can help alleviate the stress of financing long-term care costs and can help protect other aspects of the retirement plan.
- Government solutions as an option
 - The government is actually the largest funding source for long-term care needs. Medicare only covers a very limited amount of long-term care services, but not for an extended period of time.
 - Medicaid, however, is the number one financing source in the U.S. for long-term care expenditures. However, in order to receive Medicaid long-term care funding you must essentially be impoverished and out of money. While there are some Medicaid spend down techniques designed to protect an individual’s assets from complete exhaustion this type of planning needs special attention from a knowledgeable professional.
 - State partnership long-term care insurance programs can help protect assets from Medicaid spend down while at the same time providing a higher level of long-term care than normally available under Medicaid.
 - Veterans programs also offer long-term care services to veterans when available.
 - Additionally, other government programs run through the Administration on Aging can also help with long-term care needs.
- Other solutions for long-term care costs
 - Self-funding is another option for long-term care financing. This is the option that most people rely upon, with a backup plan of relying on Medicaid when out of money. Setting aside funds specifically earmarked for long-term care expenditures can be a good plan if you can appropriately identify the amount you will need for services.
 - Some states have set up single purpose reverse mortgage programs designed specifically for funding long-term care expenditures.
 - Purchase a hybrid or linked benefit product such as a long-term care insurance and annuity product or a long-term care insurance and life insurance product. These products can help fund the costs of long-term care and serve another function such as providing income for a life or a death benefit. In some cases an individual can 1035 exchange an existing policy into a hybrid policy to create an additional long-term care funding option.
 - Some continuing care communities offer contracts that provide for long-term care services at below current market price. These usually have a significant up-front fee as an offset against the lower-cost care later.
- Managing costs as a solution
 - Having good health insurance and maintaining healthy habits can help reduce the risk of long-term care disabilities such as a stroke or diabetes.
 - Putting in ramps or disability-outfitted bathrooms might allow an individual to live in his or her home for a longer period of time and reduce overall long-term care expenditures.
- Because long-term care can be extremely expensive, in most cases there will not be a one shot solution for long-term care risk, but rather a mix of self-funding, housing decisions, family decisions, long-term care insurance, and other product purchases will be needed to deal with long-term care risk.

Frailty Risk	
Definition	<i>Frailty risk</i> is the risk that as a result of deteriorating mental or physical health, a retiree may not be able to execute sound judgment in managing her financial affairs and/or may become unable to care for her home.
Example	<ul style="list-style-type: none"> • At some point later in life, you might have trouble remembering to pay bills or have difficulty balancing your checkbook. Filing complex medical insurance claims or making sound investment decisions might become more difficult. Also, making complex medical decisions can become more difficult. • You own a big home and you begin to find cutting the grass or shoveling the snow more difficult and you can't find someone to do these chores without paying an exorbitant amount. You lose the ability to drive, and since you live in the country it becomes difficult (and expensive) to get around.
Factors	<ul style="list-style-type: none"> • A <u>University of Michigan Study</u> shows 1/3 of those aged 65+ suffer from frailty. As such, frailty in retirement is a real risk and impacts people early on in retirement. Additionally, the majority of retirees will suffer from frailty at some point during their retirement. • A <u>UK Study</u> shows the longer you are retired, the more your mental health decreases; working longer can help hold off frailty. As such, the risk of frailty can exacerbate other retirement risks such as retiring earlier than expected and increased costs as the individual will need help to care for him or herself.
Solutions	<ul style="list-style-type: none"> • Having others step in to make decisions may mean involving a family member, hiring a daily money manager, or even selecting a corporate trustee to make investment decisions. • Giving someone control is generally done with a power of attorney, which is either currently in force (durable power) or becomes effective only when the individual is no longer able to make decisions (springing power). • Having assets in a living trust is another option, and the retiree can remain the trustee until he or she decides to step down in favor of a prechosen successor trustee. • Preplanning with the documents described here is critical to avoid having to go through a court incompetency hearing in which a court-appointed guardian is chosen • Simplifying finances can also be helpful by using direct deposit for income payments and automatic withdrawals for regular bills. Some retirement products are simpler to manage as well, such as an immediate life annuity. • Household management solutions for addressing frailty can include <ul style="list-style-type: none"> – Family members chipping in with chores. – Hiring others to handle household chores such as mowing the lawn or cleaning. Seniors hiring contractors and others for home maintenance need to be careful—this is an area of significant financial abuse. – Choose alternative housing with lower maintenance such as townhouses and condominiums. – Senior housing developments may offer robust services, and continuing care retirement communities offer an aging-in-place solution as needs change with age. – House sharing may be another way to share expenses and chores.
Financial Elder Abuse Risk	

Definition	The possibility that an advisor, family member, or stranger might prey on the frailty of the client, might recommend unwise strategies or investments, or might embezzle assets
Example	James, under the guise of taking care of his elderly father, abuses his power of attorney to acquire assets for his drinking and gambling problem.
Factors	<ul style="list-style-type: none"> • The annual loss due to elder financial abuse is \$2.6 billion. • Many victims are never the same emotionally after being taken advantage of by someone they trust. • The typical victim is a woman aged 70 to 89. However, victims represent a diverse profile, including older men. The problem also exists across all ethnic and socioeconomic groups. • Families, friends, neighbors, and caregivers were the most frequent perpetrators (55%) of elder financial abuse. • Sixty percent of family perpetrators are adult children. Crimes often involve misuse of powers of attorney, stealing money, using credit cards, and borrowing against the elder person's home. • Elder financial abuse perpetrated by businesses can involve large sums of money, and one perpetrator can have hundreds of victims. • Abuse may be brought about because the person is too polite to push back when necessary or because the person is lonely. • Acquaintances and strangers that commit elder financial abuse often have excellent persuasion skills. • Elder financial abuse goes unreported because people are embarrassed, they do not want to send a family member to jail, they fear losing their care, or that perpetrator may harm them more.
Solutions	<ul style="list-style-type: none"> • Retirees can protect themselves from financial elder abuse in a number of ways. <ul style="list-style-type: none"> – Stay organized—keep close track of all possessions, money, and assets. – Open and send own mail – Complete and sign own checks – Set up direct deposit for regular checks – Use voicemail to screen calls – Make sure that wills, advanced directives, and powers of attorney are executed to ensure that trusted individuals will step in to make decisions when needed – Learn about where to go if abuse is expected and be willing to ask for help from the police and adult protective services • Steps that Financial Advisors can take to help protect their clients against financial elder abuse. <ul style="list-style-type: none"> – Educate clients about their risks and the risks of financial elder abuse. The client can be better prepared to identify and avoid fraud, abuse, and scams. – Help the client set up a plan for when he cannot continue to manage his financial and other affairs. – Pay attentions to changes that might indicate signs of elder abuse. – Stay appraised of current trends in abuse and how to prevent them. – Seek assistance from social workers, government agencies, others when appropriate. – Report cases of abuse.

Investment Risks

Market Risk

Definition	The risk of financial loss resulting from movements in market prices.
Factors	<ul style="list-style-type: none"> • In a research study, Wade Pfau showed the impact of market risk on retirement income planning. Looking at 151 hypothetical portfolios, each earning market returns, with the only difference being the 30 years measured, the amount accumulated at retirement varied a lot-- the average accumulation was 10 times salary, but outcomes ranged from 3 to 27 times salary depending upon the 30-year period tested. • The impact of the specific rates of return in the final years of accumulation when the value was the highest had the most impact on the ending value at retirement. • Taking the same portfolios forward (into retirement) another 30 years, using a constant inflation-adjusted withdrawal strategy, he also found that the actual maximum sustainable withdrawal rates over 30 years ranged anywhere from 1.9% to 10.9%. Sustainable withdrawal rates are disproportionately explained by the returns in the early part of retirement. • So you can say that market risk and the risk of bad timing of returns is most acute in the final years prior to retirement and the first few years of retirement. • Even though market risk creates some uncertainty, other research shows that retirees may not be able to afford not to take some market risk—as research shows that increasing equity exposure generally improves portfolio sustainability and ending wealth and is a key to address the risk of inflation
Solutions	<ul style="list-style-type: none"> • One approach to address this challenge in retirement income planning is to choose a bifurcated investment strategy, with investments and products with little or no market risk chosen to meet basic needs and more market risk taken to address discretionary and unexpected expenses and legacy goals. With this approach, basic expenses can be met with Treasury or other low risk government bonds, buying annuity income, or even deferring Social Security benefits. • Other ways to reduce market risk include <ul style="list-style-type: none"> – Have the lowest exposure to equities in the years nearest retirement age—where a bad order of negative returns can have the most negative impact. – Consider market conditions when choosing how much to withdraw, lowering withdrawals in bad years reduces the risk of failure. – Purchase downside protection for the portfolio with derivatives and income riders in deferred annuities.

Interest Rate Risk

Definition	Technically, this is the risk that arises for bond owners from fluctuating interest rates. How much interest rate risk a bond has depends on how sensitive its price is to interest rate changes in the market.
Factors	<ul style="list-style-type: none"> • When interest rates are low (as they are today), if interest rates rise, values of individual bonds and bond mutual funds will decrease. • If fixed income investments are reinvested, a related risk— referred to as reinvestment risk—arises. This is the risk that when it comes time to reinvest fixed income investments, interest rates may be lower.

	<ul style="list-style-type: none"> • In retirement income planning, interest rate risk is also considered the risk that the returns on fixed income investments vary and at times can be quite low.
Solutions	<ul style="list-style-type: none"> • Interest rate risk in the technical sense can be eliminated by holding bonds to maturity and liquidating the bonds to meet income needs. Bonds are used this way in a strategy referred to as asset dedication. • When bond investments are going to be reinvested, there is some ability to offset interest rate and reinvestment risks—using a strategy called immunization. • In the long-term low interest rate environment of today, current retirees probably think of interest rate risk as the risk that they can't earn enough to meet their needs with fixed income investments. Today's retirement income strategies that focus on a total returns approach are in some ways a reaction to today's low interest environment.
Liquidity Risk	
Definition	Liquidity risk is the inability to have assets available to financially support unanticipated cash flow needs.
Factors	<ul style="list-style-type: none"> • Liquidity may be considered a risk or just a characteristic of an investment—the ability to sell the investment at a reasonable value quickly. • With regard to specific investments, the issue of liquidity comes up in several contexts. First there are definitely assets that may not be able to be sold quickly at a fair market value. Real estate and business interests come to mind. The other context is with annuities. Life annuities have traditionally offered no liquidity, although that is now changing with some products offering a limited ability to liquidate. Deferred annuities offer liquidity, but surrender charges can reduce the value.
Solutions	<ul style="list-style-type: none"> • Planning for having sufficient liquidity is an important part of a retirement income plan, as we know that retirement comes with unexpected expenses and the need to be able to sell investments. • Planning should definitely consider what assets are available if liquidity is needed. Besides having a cash reserve or liquidating investments, other alternatives for a short-term need can be borrowing from a life insurance contract, a home equity line of credit or reverse mortgage line of credit or borrowing from a margin account. • One of the often touted advantages to taking systematic withdrawals from a diversified portfolio is that the strategy offers liquidity. Some would argue that if you are taking withdrawals from a portfolio that you don't really have liquidity as you need the assets to meet the withdrawal requirements. • When talking about liquidity, most are also thinking about flexibility as well—that is, in the ability to change strategies in the face of new law changes, investment conditions or other reasons. Clearly a systematic withdrawal strategy offers flexibility. • There are some planners that would say that having too much liquidity is a liability. It gives the retiree the opportunity to spend too much on themselves and their families, and gives those that would harm seniors the opportunity to take their money.
Sequence of Returns Risk	
Definition	Investment returns are variable and unpredictable. The order of returns has an impact on the how long a portfolio will last if the portfolio is in the distribution stage and if a fixed amount is being withdrawn from the portfolio. Negative returns in the first few years of retirement can significantly add to the possibility of portfolio ruin.

Example	<ul style="list-style-type: none"> • Peggy’s portfolio is worth \$10,000. She draws \$1,100 at the end of each period. Peggy earns returns in years 1 through 5: 40%, 20%, 0%, –20%, –40%. Peggy has a 0% average rate of return. • Gregg starts with the same amount, makes the same withdrawals, and earns the same returns, except in reverse order.
Solutions	<ul style="list-style-type: none"> • Sequence of returns risk is tied in part to portfolio volatility. Reducing volatility in the retirement portfolio reduces sequence of return risk. This can be done by purchasing life annuities or buying bonds to build a specified income stream over a specified number of years in retirement. • Choose a withdrawal strategy from the portfolio that allows for adjustments for market volatility. <ul style="list-style-type: none"> – A common way to define the withdrawal rate is an inflation-adjusted withdrawal each year based on the initial portfolio value. This approach provides for steady income that keeps up with inflation, but is inefficient when withdrawals are from a volatile portfolio and creates more risk. – Sequence of return risk can be eliminated entirely by choosing a withdrawal rate that is a specified percentage of the current portfolio value (so, for example, each year you withdraw 5 percent of the current portfolio value). The problem with this approach is that the amount withdrawn each year may vary significantly and it may not meet the client's income needs. – So a compromise is to start with the standard withdrawal definition—and then make some minor adjustments based on market conditions. • Provide for downside protection in a portfolio. This can include using derivatives and purchasing deferred variable annuities with living benefit riders that provide minimum income benefits on deferred variable annuities or indexed annuities.

Work

Forced Retirement Risk

Definition	There is always the possibility that work will end prematurely because of poor health, disability, job loss, or to care for a spouse or family member. This event can quickly derail a retirement plan.
Example	Peggy plans to work until age 65, but her long time employer suddenly closes her office when she is 61. There are very few employers needing her skills in the area, and she is unable to find suitable employment. Not only are her plans to accumulate more funds for retirement ambushed, but she may not be able to receive or afford health care coverage until she is eligible for Medicare.
Factors	<ul style="list-style-type: none">• MMI study—54% of oldest boomers retired earlier than planned<ul style="list-style-type: none">– Fewer than 10% had adequate resources– 32% cited health reasons– 25% cited loss of job• EBRI—47% retire earlier than planned<ul style="list-style-type: none">– 55% due to health or disabilities– 20% due to downsizing or closures– 23% for caregiving responsibilities
Solutions	<ul style="list-style-type: none">• Given the statistics, it's worth discussing with clients how many people retire earlier than planned—and come up with a plan for the unexpected.• One way to do this is to show retirement readiness at different stages—with the goal of building resources to provide a reduced but adequate standard of living—let's say 10 years from retirement, a more comfortable standard of living 5 years prior to retirement and the desired standard of living at the planned retirement age. By setting the savings program up to meet graded goals, you may encourage the client to save earlier and to assess what the final years of work will mean to his/her retirement.• Some job losses are inevitable, and for that contingency employees should pay attention to severance programs—and the possibility of negotiating for a better deal if there is a layoff.• As workers age, it remains critical to stay current with skills and to learn new ones to make sure that they remain a valuable part of their organization.• In case looking for new work becomes necessary, it's also important for older workers to stay ready for this contingency by taking steps to maintain professional networks and keep a resume polished.• Many health concerns that shorten a career are unavoidable—but not in all cases. If work is so critical to retirement security, maintaining healthy eating, weight management, getting enough sleep and exercising regularly becomes an important part of retirement security.• To maintain health, older workers may want to consider making changes that allow them to work longer. This can mean taking more time off, reducing responsibilities, or cutting back on clients.

Reemployment Risk	
Definition	Many retirees plan on working in retirement. Reemployment risk is the inability to supplement retirement income with employment due to tight job markets, poor health, and/or caregiving responsibilities.
Example	Robert is an avid wood worker who had intended to make furniture and sell it on eBay throughout his retirement. However, poor physical health impeded his ability to practice his craft.
Factors	<ul style="list-style-type: none"> • EBRI work in retirement • 2013 expecting to work 69% • 2013 retirees actually working 25% • Reasons for work in retirement (2010 RCS) • Almost all gave a positive reason for working <ul style="list-style-type: none"> – stay active and involved (92 percent) – enjoyed working (86 percent) • Those working solely for nonfinancial reasons is small • Ninety percent identified at least one financial reason <ul style="list-style-type: none"> – wanting to buy extras (72%) – a decrease in the value of savings or investments (62%) – needing money to make ends meet (59%) – keeping health insurance or other benefits (40%) • Many retirees have an informal phased retirement by taking consulting positions, part-time jobs, or turning hobbies into profit-making activities. • Employment prospects among retirees vary. • Most employers do not offer phased retirement. • Working part-time may result in a reduction in pay but with increased job satisfaction.
Solutions	<ul style="list-style-type: none"> • Based on the statistics, planning on significant employment income in retirement may be unrealistic for some. Jobs may be unavailable or the client maybe unable to work. • If the client really needs income to meet retirement objectives, it may be best to postpone retirement from a career job that pays better and offers health insurance and other benefits. • For those looking to work in retirement, be sure to use available resources to find employment opportunities that are meaningful and meet income requirements. Books like “What Color Is my Parachute in Retirement,” and websites like AARP can be quite helpful. • It’s also important to be open to learning new skills to be successful in the job market. • It’s important to recognize that work in retirement can have important rewards other than money. The retiree may use a job to add some purpose, fill time, or build a social network.
Employer Insolvency Risk	
Definition	Employer-provided retirement benefits are an important part of retirement security for many. If the employer has financial problems, employees

	may lose their jobs and in some cases their benefits.
Example	Larry is a retired schoolteacher in Illinois. The teacher’s plan has serious funding problems. Larry wakes up every morning and looks for news about what is going to happen with his pension.
Factors	<ul style="list-style-type: none"> • Private employers • Defined-benefit plans of private employers • Must meet minimum funding requirements and contributions are made to an irrevocable trust • Most plans covered by the PBGC • Noncovered plans of private employers • Defined-contribution plans • Contributions to an irrevocable trust • Investments in employer stock • Executive benefits • Employees are general creditors • Assets remain available to claims of creditors • Public employers • Defined-benefit plans of municipalities • Municipalities can file for bankruptcy • Determine priority of pension claims • Benefits may be reduced • Defined-benefit plans of states • States cannot file for bankruptcy • Earned benefits generally have high standing
Solutions	<ul style="list-style-type: none"> • There are limited steps to take to protect pension benefits—but in many cases pensions are quite safe. • For those who work for a private employer and are covered by a defined-contribution plan, maybe the best advice is avoid or at least minimize exposure to company stock. As economists will point out, having your human capital (earnings from employment) and your financial capital tied up with the employer is taking on too much risk. • When an employee retires, she may feel like she wants to elect a lump sum benefit because she doesn’t trust that the plan and employer will pay her pension. But with privately sponsored plans covered by the PBGC, the employee is better served to choose the distribution option that best fits her needs. • Executives that participate in nonqualified plans do have to pay attention to company finances. If the plan calls for employee salary deferral contributions—the executive needs to think carefully before participating. If the benefit is a supplemental benefit provided by the employer, the executive does not have much control—but will want to pay attention to options regarding the timing of payout. • Government entities can sponsor 457 plans. Government sponsored 457 plans have to hold assets in an irrevocable trust, and benefits can be rolled into an IRA in retirement. Note that this is not true for a 457 plan sponsored by a nonprofit entity. With nonprofits, these plans operate more like nonqualified deferred-compensation plans. • With publicly-sponsored plans, there is somewhat less security than with defined-benefit plans. Here, especially with municipality plans, if the

	entity is in financial distress now a lump sum option versus taking an annuity may be an appropriate consideration.
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Family

Loss of Spouse Risk

Definition	The loss of a spouse is a major personal loss, but without planning can also result in a decline in economic security.
Example	Eric retired at age 65 and began to receive a company pension. To increase monthly benefits, he chose the single life annuity, which ceased upon his death, cutting his spouse's income drastically as she no longer had any pension income and Social Security benefits were reduced as well.
Factors	<ul style="list-style-type: none"> • In addition to emotional consequences, there are planning and financial hardships. • Society of Actuaries surveys find that people do not comprehend the financial magnitude • Reduction in Social Security benefits • The surviving spouse may not have the ability to manage finances • Loss of a caregiver • Women from the baby boom generation could be widows for as long as 15 to 20 years • Health costs increase when assets have been depleted due to providing care in the final years of her spouse's life • Financial concerns for widows <ul style="list-style-type: none"> – Within 5 years of the death, 40% of widows fall into poverty – 15% of elderly widows in poverty—only 4% of couples.
Solutions	<ul style="list-style-type: none"> • Clearly planning for a solution involves ensuring that income needs are satisfied for the surviving spouse. There are a number of ways to accomplish this, but one fact is sure: both spouses need to be involved in the process of building the retirement income plan. If one of the spouses is not comfortable with making financial decisions, the plan needs to address this issue as well. • Another part of the plan involves proper estate planning to make sure that wills, trusts and beneficiary designations have been properly completed to protect the spouse. • In terms of the financial plan, there are number of ways to protect the spouse. One is to make sure that Social Security decisions maximize the survivor benefit. As Social Security continues to pay the larger of the two benefits, a key planning strategy is to defer the larger benefit to maximize the survivor benefit. • Another way to increase income to the survivor is to choose joint-and-survivor options when electing pension benefits. Unfortunately many elect single life to increase the benefit. Also income annuities can be purchased with a joint lifetime payout. • Life insurance can provide benefits for a survivor. If permanent life insurance is purchased on both lives, the death benefit at the first death can provide income to the survivor, and if more income is needed the cash value on the other policy can be used to meet income needs. There are also some companies selling first-to-die policies to meet this type of survivor income need. • Continuing to take systematic withdrawals from the retirement portfolio is another strategy. It's important when setting up and monitoring this plan that the joint lifetime horizon is considered. • A contingency fund, set aside to meet the uncertainty of longevity, may also be available to meet this need. Another contingency plan is to use home equity to support the surviving spouse through a reverse mortgage or simply by selling the home to support alternative housing or care needs.

	<ul style="list-style-type: none"> • Long-term care planning for the surviving spouse is more critical, as she will not have her spouse to care for her. Some long-term care policies allow couples to pool benefits, so if benefits haven't been used up for the first spouse to die, they can be used by the second spouse.
Unexpected Financial Responsibility Risk	
Definition	Many retirees have additional unanticipated expenses during the course of retirement, in many cases due to family relationships and obligations.
Example	Lisa's adult child, a single mother, loses her job and needs assistance. Lisa decides to pay her daughter's mortgage until she gets back on her feet. Lisa wants to validate that she can afford this expense. She does not want to be in the position to help her children early in retirement only to become a financial burden to her children later in retirement.
Factors	<ul style="list-style-type: none"> • Six in ten (62%) aged 50+ today provide financial support to family members • Older adults are concerned about running out of money and being a burden on their families • 5.8 million children live in grandparents' homes
Solutions	<ul style="list-style-type: none"> • The planning for these two contingencies is different. Figuring out how much retirees want to help their families financially is an issue that should be explored with clients—and here is an area that it is critical to involve both spouses. How much to give, what to give, when to give it and who should get it are all questions that need to be answered. • This needs to be done in the context of balancing family needs with financial security in retirement. Building a sustainable retirement income plan helps to make it clearer how much money is available. Also, framing the issue in terms of “giving too much can lead to financial dependence on children later” helps to make the boundaries clearer, too. • Once these decisions have been made, clients should in many cases have conversations with family members—and an advisor can help to facilitate these conversations. • The Merrill Lynch report that I talked about could be a good tool to help a family begin to tackle these tough issues. • Addressing those truly unexpected family circumstances is not as easy. But here the value of having built a clear retirement income plan that the couple buys into may really pay off when having to make quick decisions when the unexpected arises. • Second, clients should be encouraged beforehand to reach out to their advisors when such events arise. Just taking the time to meet with a more dispassionate third party can help provide some emotional distance when important financial decisions have to be made. • The advisor can also help identify both the short-term and long-term consequences of decisions. What is so different about retirement is that unless going back to work is an option, resources are finite and cannot be replenished. • Finally, when things happen to families not everyone is good at looking for available resources to help. Advisors can help with this process—and so can retirees—when something has happened to their adult children who are caught up in the current crisis—retirees may have the time and the distance from the situation to look for outside resources that may be available to help. Sometimes you will be surprised what resources may be available. When building this material, for example, I became aware that AARP has helped to create a community for grandparents raising grandchildren to share their experiences and to provide support.

Other

Timing Risk

Definition	Also known as point-in-time risk, <i>timing risk</i> considers the variations in sequences of actual events that can have a significant impact on retirement security. There are just some factors outside of your control. Depending upon when you retire, you may, for example, face high inflation or low interest rates.
Example	<ul style="list-style-type: none"> • Patty retired in 1974. For every \$1,000 per month of income she needed required \$3,379 25 years later (1999) • Mary Lou retired in 1986. For every \$1,000 per month she needed required \$2,064 25 years later (2011) • For Mary Lou, prices increased 206%. For Patty, prices over the same number of years increased 337%!
Solutions	<ul style="list-style-type: none"> • In many cases, clients are not in a position to exert control over point-in-time risk. The impact of high inflation and black swan market events is a “luck of the draw” problem. • Adapting to current conditions is a primary reason to work with a planner who has the skills to navigate changing conditions. • You can argue that timing risk weighs in favor of addressing retirement needs when you can afford it. For example, if market conditions are good 5 years prior to retirement, maybe it’s time to lock into a deferred income annuity to eliminate some timing risk. • It’s also important to monitor a plan regularly so that you can adapt to changing conditions--quickly. • As with the discussion of public policy risk, there are a number of strategies for building in planning for uncertainty. One is building diversification in a retirement income plan, which includes diversifying investments, diversifying income solutions, and diversifying types of accounts. It is also important to retain enough flexibility and liquidity in the plan to react to changes as well. Having a cash reserve provides a cushion and so does a contingency fund—using some of the same strategies that we discussed before.

Public Policy Risk

Definition	An unanticipated change in government policy with regard to tax law and government programs such as Medicare and/or Social Security can have a negative impact on retirement security.
Example	<ul style="list-style-type: none"> • Walt has saved diligently for retirement only to find the government has adopted “means testing” and he is no longer eligible for certain programs because his income is too high. • Kathy, who has decided to age in place, may be affected by significant increases in property taxes.
Solutions	<ul style="list-style-type: none"> • It may not be any easier to predict changes in public policy than it is to predict other risks. However, in some cases there are political or economic realities that do foretell possible changes. In this case taking these into consideration in the planning process can be the responsible course of action. When projecting Social Security benefits for a 30-year-old, for example, it makes perfect sense to discount current benefits somewhat. • At the same time, it’s important to consider whether changes will have any grandfathering provisions. Again going back to Social Security, in the past when changes were made to the system, they did not affect those in or near retirement. However, other provisions, like tax rate changes under the federal income tax system typically do not have grandfathering provisions. Also, there may be prospective effective dates providing

some planning opportunities.

- The role of the advisor here—and a clear advantage for a client working with an advisor—is to stay current on policy changes, planning opportunities and effective dates, and the impact that the change will have on the plan.
- It's hard to plan for future law changes, but there are several options in the tax area. One is to use tax-free investments such as municipal bonds so that if marginal tax rates increase that income will not be affected. Even better is to use Roth IRAs and Roth Accounts to get tax-free growth—which allows the taxpayer to prepay taxes—locking into current rates, in case future tax rates increase. The one caveat here is that if the tax system changes with new taxes added such as a consumption tax—then the Roth tax vehicle does not protect against additional taxes.
- Adding Roth IRAs also creates some tax diversification—providing for a hedge if tax laws change. With uncertainty, having a combination of taxable, tax-deferred and tax-exempt accounts allows for better planning in times of change. You can argue that having diversification in other ways in a retirement income plan may provide some of that same protection—for example, having annuities, life insurance, cash and a diversified portfolio from which systematic withdrawals are taken can provide against policy changes that affect any of these resources separately.
- At the same time, it is important to retain enough flexibility and liquidity in the plan to react to changes as well. Having a cash reserve provides a cushion and so does a contingency fund—using some of the same strategies that we discussed before.