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RETIREMENT POLICY STATEMENTS

A Concrete Plan for Retirement

By Dorothy E. Bossung, CFP®, CIMA®, CPWA®, RMA®

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As a client heads into retirement, a variety of factors are at play. Dreams and personal goals may still be taking shape, contingent upon income from a variety of sources, possibly including "re-careering" or part-time employment. The location where a client chooses to retire drives a big part of the cost of living in retirement. Longevity, however, is the greatest unknown, regardless of the length of parents' or grandparents' lives, because average life expectancy has continued to increase. Figure 1 shows the Social Security Administration's probabilities for life expectancy in the United States. How can advisors help clients prepare for life in retirement amid so much uncertainty?

A retirement policy statement (RPS) is an actionable document that provides a client with the comfort of a concrete plan for retirement. An advisor and client create it together; it summarizes their discussions and provides documentation of their retirement-income planning and a scheduled decumulation process. An RPS has similarities to an investment policy statement; it includes discussions of goals, objectives, target returns, and spending needs. If a client has been with you for a while and you created an investment policy statement years ago, this is a great opportunity to revisit that document and build upon prior discussions. An advisor can take that data and document to another level, displaying expertise by helping a client think in concrete terms about how to approach retirement.

It's important to note that the RPS has not been widely adopted yet. The Retirement Management Analyst® (RMA®) designation is the only designation to advocate for its use at this time.[1] But you will find that the act of creating a written document solidifies the retirement plan and alleviates worries. This is particularly true with couples, because then each can see that they are on the same page and that each individual's goals and fears are addressed. It is very helpful for advisors to remember that even though clients may not express fears or concerns, they have them. It is up to you as the advisor to get to the root of those fears and help clients find a way to discuss and manage the related financial issues. Sometimes, particularly for clients who are good savers, it is in the form of reassurance that they can afford to do what they have been longing to do. In other circumstances it can be breaking the tough news that work may need to continue, either full- or part-time, for longer than initially thought.

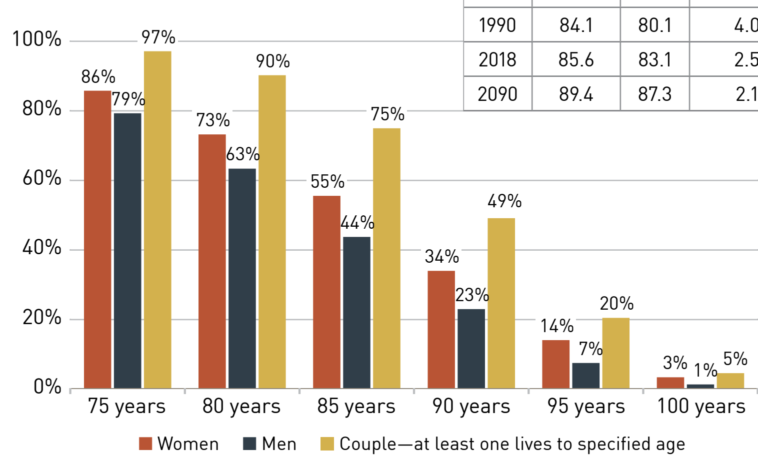
With ultra-high-net-worth clients, planning may focus on when to start Social Security benefits and timing Roth conversions before required minimum distributions begin. You will want to discuss the effects of these strategies on tax planning and the cost of Medicare Part B and Part D. Asset location and withdrawal order can be documented in the RPS.

An RPS begins with complete and comprehensive knowledge of a client's entire household, because the combination of benefits within the household may allow additional flexibility. Is the client single or married? What savings are in place? What Social Security benefits are available at various claiming ages? Is there a pension benefit for one or both if the household contains a couple? How much longer will one or both of them continue to work?

Figure 1

LIFE EXPECTANCY PROBABILITIES

Average life expectancy at age 65			
Year	Women	Men	Difference
1990	84.1	80.1	4.0
2018	85.6	83.1	2.5
2090	89.4	87.3	2.1



Source: JPM

The fundamentals of creating an RPS are outlined below. The best way for an advisor to learn these fundamentals is to enroll in the RMA designation program, which provides a 10-step process for creating an RPS. These 10 steps, listed in the curriculum book for RMA candidates, are sequential questions or statements, and they are presented and discussed below.

SEQUENCE OF CONSUMPTION RISK

Much has been written about sequence of returns risk, or the additional risk to portfolio longevity created when portfolio losses occur early in retirement. Typically, these analyses assume some sustainable annual portfolio withdrawal rate. Unfortunately, life sometimes hands us large expenses early in retirement that can exceed that sustainable portfolio withdrawal amount. Because portfolio longevity depends on the amount spent from the portfolio, the amount needed to cover expenses dominates the sustainable withdrawal amount and creates "sequence of consumption" risk, or additional risk created by large expenses early in retirement.

PRACTICE MANAGEMENT

1. Be sure that your clients know that you will work together to build the plan that will be documented in the RPS.

Advisors need to be sure that clients understand that you can help them plan for retirement but that they personally have control over the success or failure of the RPS. You will want to document these individual responsibilities in the RPS.

CLIENT DIAGNOSTIC KIT

2. Document the initial needs and goals of the client's entire household (using the relevant measures of fundedness to explain overfunded, constrained, or underfunded status) and present the relevant capital market expectations, inflation rates, discount rates, expected nominal interest rates, and risk premiums.

Four percent is quoted often in the press and by industry pundits as the safe amount to withdraw annually from savings in retirement. To apply this to a client's situation, take the amount the client expects to spend or consume (C) and divide it by the client's financial capital (FC). This is the C/FC ratio. In practice, we find that this simple process can lead to classifying clients as overfunded, constrained, or underfunded as follows:

Overfunded. The client has sufficient assets to fund retirement lifestyle and consumption expectations if the client household's ratio is equal to or less than 3.5 percent. Often this means that the resulting investment planning will be much more similar to the discussions you had before retirement with the potential exception of setting up a monthly income stream to supplement Social Security or pension income.

Constrained. The client may not have sufficient assets to fund retirement lifestyle and consumption expectations. The client household's C/FC ratio is between 3.5 percent and 7 percent. An advisor's discussions with the client should include "flooring" and coverage of essential non-discretionary expenses, then move on to the portion of the portfolio that can provide potential growth and inflation protection for the future. "Flooring" is the income that must come from financial capital when the rest of the client's total spending has been covered by human and social sources of capital. It is described as C'/FC where C' is equal to C minus the funds received from sources such as Social Security, pensions, and additional employment. Depending upon the nature of the planning process, flooring can go by the following equivalent names:

- The adjusted consumption floor funded from financial capital
- The amount of income floor that comes from financial capital
- The expense floor funded from financial capital
- The expense floor not funded by human and social capital[2]

Underfunded. The client does not have sufficient assets to fund retirement lifestyle and consumption expectations. The client's C/FC ratio would be equal to or greater than 7 percent. The flooring discussion is essential for this client, who is asset constrained and does not have enough funds for all retirement portfolio allocations. You also must discuss working longer and rethinking spending.

PLANNING STRATEGY

3. Set the initial client-matched, fundamental policy decisions and most importantly the selected planning strategy (investment-based, goals-based, product-based).

An investment-based planning strategy best applies to the high-net-worth or overfunded client because it relates retirement allocation to traditional asset allocation, with which they are familiar. In the RMA curriculum, it is based on the idea of "investment-based flooring," a gradual approach that builds upon our traditional understanding of investment management. Investment-based flooring starts with the traditional approach to upside investing with equities. It is a process for developing a smooth migration from an optimized investment portfolio to a combined retirement-consumption and an upside portfolio. Investment-based flooring analysis provides recommendations for allocations among upside, floor, longevity, and reserves portfolios.

Thus, investment-based flooring starts with the traditional 60/30/10 (equity/fixed-income/cash) portfolio and may shift to 90/0/0/10 (upside/floor/longevity/reserves) for the overfunded client.

A goals-based planning strategy applies to constrained high-net-worth and affluent client households as well as overfunded affluent client households. Product-based planning strategies apply to the mass-market and might focus on a client's lifestyle.

With goals-based planning, the key questions to answer include the following: Are the clients homebodies who simply look forward to domestic pleasures and long visits with children and grandchildren? Or do their retirement plans include travel to Europe or an around-the-world cruise? Do they have plans to live outside the United States and, if so, how does that impact the planning you are undertaking? Is there a risk that one or more of their children or grandchildren will require financial assistance? Are there known health issues that will require specialized care?

Can the client's needs be met by the income from financial and social capital or will additional human capital (working full- or part-time) be needed? Have you looked at using flooring in the planning process? Flooring is essential with an underfunded client and a valuable tool when working with constrained clients. The flooring portfolio relates to risk management allocation and makes use of implementation process approaches; it also may incorporate categories of financial products that may help manage the chance of meeting expected income levels and avoiding asset depletion.

DOCUMENT NEEDS AND GOALS

4. Document the life-cycle needs and goals of the client's entire household. Explain how the cash flows change over time and how the household can effectively manage its human, financial, and social capital to meet its needs for the rest of the household members' lives.
It often helps to match the funds that clients have available to the expenses they will encounter in retirement. Your conversations and planning undoubtedly will cover client needs for the "go-go years," "go-slow years," and "no-go years." The funds that clients may use for travel initially in the go-go years gradually transition to annual spending for health care and assistance with daily living in the no-go years.

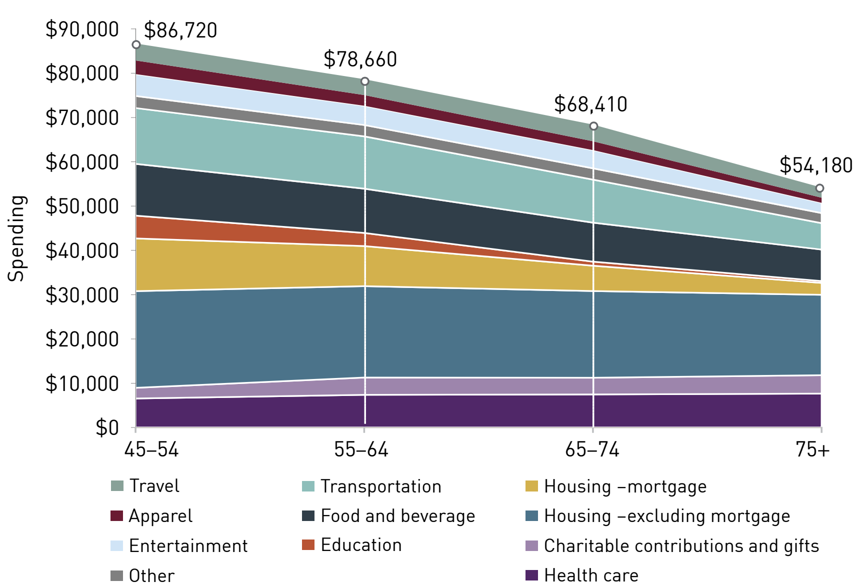
For those that have longevity concerns or who are without a pension, it may be appropriate to discuss annuities or a qualifying longevity annuity contract (QLAC). The QLAC can be purchased using funds in an individual retirement account (IRA). The law allows using 25 percent or up to $135,000 from an IRA, whichever is less (as of 2020), to purchase the QLAC. These funds are excluded from the required minimum distribution calculations, effectively extending the period before they must be distributed and are taxed from age 72 up to age 85, when the client is required to begin distributions from the contract. This is an interesting way to provide a cushion of pension-like income for later years for those concerned about longevity.

A reverse mortgage or a QLAC eases concerns about longevity, but spending risk remains a threat to retirement income (see figure 2). Most people don't want to think about budget, but budgeting is necessary in retirement and advisors must discuss it with their clients. Even your wealthiest clients may, surprisingly, need some help in this area. You want to examine spending carefully early on in the relationship, so you don't have to have these discussions after the client has overspent.

Figure 2

CHANGES IN SPENDING

Average household spending patterns by various age groups—for those with a bachelor's degree or higher



Source: JPM

FINANCIAL, SOCIAL, AND HUMAN CAPITAL

5. Plan for and explain to your clients that they have financial, social, and human capital available for retirement. Document the needs and goals of the client's entire household (using the Household Balance Sheet [HHBS] views [table 1] and the HHBS benchmarks [table 2] to analyze all assets and liabilities).
How does the value of a client's financial capital (investment accounts) and social capital (Social Security benefits, pension income, and potential inheritances) line up with consumption plans? Although clients assume they will be spending a portion of savings in each year of retirement, they often overestimate the

Table 1

BEST PRACTICE TOOLBOX: DRIVING SUCCESS WITH THE HOUSEHOLD BALANCE SHEET VIEW

Assets

Description	Value
Present Value (PV) of Human Capital (HC): *(i.e., work in retirement)*	
Employer Contributions	$ ___________
W2/1099 Income	$ ___________
Subtotal of Human Capital	**$ ___________**
PV of Social Capital (SC):	
Social Security Analysis	$ ___________
Pensions Analysis	$ ___________
Income from Trust Analysis	$ ___________
Expected Inheritance Analysis	$ ___________
Subtotal of Social Capital	**$ ___________**
Financial Capital (FC): *(i.e., work in retirement)*	
Tax-advantaged accounts	
401(k)s or other defined contribution plans	$ ___________
All individual retirement accounts	$ ___________
Health Savings Accounts	$ ___________
Keoghs	$ ___________
Annuities	$ ___________
Subtotal Tax-advantaged Accounts	$ ___________
Tax-free Accounts *(e.g., Roths)*	$ ___________
Taxable Accounts	
Checking, Savings, Money Market	$ ___________
Certificates of Deposit	$ ___________
Stock & Bond Mutual Funds	$ ___________
Other investments	$ ___________
Cash Value Life Insurance	$ ___________
Trusts (beneficial owner)	$ ___________
Educational Accounts	$ ___________
Subtotal Taxable Accounts	$ ___________
Subtotal of Financial Capital	$ ___________
Value of Other Assets:	
Primary Home	$ ___________
Other Real Estate	$ ___________
Business Ownership Interests	$ ___________
Vehicles (planes, boats, autos, etc.)	$ ___________
Tangible Property	$ ___________
Subtotal of Other Assets	$ ___________
Contractual Protection:	
Life Insurance	$ ___________
Disability Insurance	$ ___________
Long-term Care Insurance	$ ___________
Property & Casualty Insurance	$ ___________
Liability/Umbrella Insurance	$ ___________
Professional Insurance	$ ___________
Subtotal of Contractual Protection	$ ___________
Total Assets	$ ___________

Liabilities & Household Net Worth

Description	Value
PV of Expected Consumption in Retirement:	
Fixed/Non-discretionary/Essential	$ ___________
Rising/Non-discretionary/Essential	$ ___________
Healthcare/Medicare Decision Analysis	$ ___________
Variable/Discretionary/Non-essential	$ ___________
Subtotal PV of Consumption	**$ ___________**
Debt:	
Primary Mortgage	$ ___________
Primary Home Equity Loan(s)	$ ___________
Reverse Mortgage	$ ___________
Other Real Estate Loans	$ ___________
Education Loans	$ ___________
Vehicle Loans (planes, boats, autos, etc.)	$ ___________
Credit Card Debt	$ ___________
Other Debt	$ ___________
Subtotal of Debt	**$ ___________**
Desired Amount to Earmark for Bequest, If Any	$ ___________
Total Liabilities	**$ ___________**
Household Net Worth *(Assets – Liabilities)*	$ ___________
Total Liabilities + Net Worth	**$ ___________**

Special Circumstances Checklist:

Check all that apply:

- ☐ Last Will & Testament and/or Revocable Trust
- ☐ Living Will
- ☐ Estate Executor
- ☐ Durable Power of Attorney
- ☐ Married/Cohabit/LGBT
- ☐ Single/Divorced/Widowed
- ☐ Dependent Children
- ☐ Dependent Adults
- ☐ Special Needs Children/Adults
- ☐ Other Special Circumstances

Table 2

HOUSEHOLD BALANCE SHEET BENCHMARKS

Per Household Data ($) for Selected Segments	HNW Constrained Pre-Retired	Affluent Constrained Pre-Retired	HNW Constrained At/Retired	Affluent Constrained At/Retired
Human capital assets				
Social capital assets: Social Security				
Social capital assets: Medicare/Medicaid				
Social capital assets: Defined benefit pension plans				
Tax advantaged accounts: 401(k)s, 403(b)s, 457s	$439,900	$219,000	$472,600	$293,100
Tax-advantaged accounts: all IRAs and SEPs	$549,100	$201,500	$900,900	$332,300
Tax-advantaged accounts: Health Savings Accounts	$5,300	$2,000	$2,000	$3,500
Tax-advantaged accounts: Keoghs	$864,000	$112,300	$231,100	$29,600
Tax-advantaged accounts: Annuities	$367,100	$132,800	$506,000	$267,700
Annual contribution to tax-advantaged accounts				
Taxable investments: Checking, savings, MMs	$190,500	$67,600	$183,600	$82,700
Taxable investments: Certificates of Deposit	$140,600	$82,300	$229,200	$106,800
Taxable investments: Stocks & bond mutual funds	$474,700	$144,300	$845,900	$221,400
Taxable investments: Other investments	$607,800	$75,000	$1,000,100	$209,500
Taxable investments: Cash value of life insurance	$84,000	$46,100	$92,700	$54,200
Taxable investments: Trusts	$1,000,000	$409,000	$270,000	$328,000
Taxable investments: Educational accounts	$97,600	$28,000	$119,500	$26,300
Annual contribution to taxable accounts				
Other assets: Primary residence	$562,200	$399,500	$624,600	$411,100
Other assets: Other real estate	$836,300	$243,100	$1,271,500	$422,600
Other assets: Direct rental income real estate				
Other assets: Business ownership interests	$1,100,000	$144,700	$2,100,000	$107,700
Other assets: Vehicles	$32,800	$30,400	$33,700	$25,300
Other assets: Tangible property	$139,400	$63,700	$94,500	$52,800
Liabilities: Present Value of expected consumption				
Liabilities: Primary mortgage	$209,500	$176,400	$253,100	$148,100
Liabilities: Home equity on primary home	$63,100	$67,500	$50,600	$80,100
Liabilities: Other real estate debt	$393,000	$164,700	$431,300	$479,000
Liabilities: Education loans	$27,500	$32,300	$25,000	$18,300
Liabilities: Auto loans	$16,500	$19,500	$15,700	$14,500
Liabilities: Credit card debt	$9,000	$8,900	$4,100	$2,900
Liabilities: Other debt	$210,100	$62,500	$25,800	$44,200
Liabilities: Desired bequest				
Unique circumstances				

income they will receive from Social Security and underestimate the cost of Medicare Part B, Part D, Supplemental, vision, and dental, etc. While working, clients likely thought only of medical expenses in terms of deductibles and co-pays. The task of setting up Medicare coverage is daunting for most as a result. Clients often are surprised by the costs and, even more so, that the income they generate from various sources may drive up medical costs. They also may be surprised to find that up to 85 percent of their Social Security benefits may be taxed at the federal level. They begin to appreciate the planning you have done with regard to asset location.

Human capital is the client's ability to work by continuing in current employment, re-careering, or taking on part-time work. There are both financial and social aspects to the decision to work. Although there's obviously a financial benefit to working, you also may find that work may be a significant part of a client's identity. This client is the "head of a department" or the "owner" of the business. When these clients retire, they often struggle to find a new identity. Shifting to part-time work to serve as a mentor or a teacher may allow these clients to continue to work and maintain that identity.

Figure 3

CLIENT DIAGNOSTIC KIT: SHARED EXPECTATIONS

ASSETS

NPV of Human Capital (HC):
- Employer contributions
- W2/1099 income

NPV of Social Capital (SC):
- Social Security analysis
- Pension decision analysis
- Income from trust analysis
- Expected inheritance analysis

NPV or Market Value of Financial Capital (FC):
- Tax-advantaged accounts
- Tax-free accounts
- Taxable accounts

Value of Other Assets:
- Primary home
- Other real estate
- Business ownership
- Vehicles (planes, boats, autos, etc.)
- Tangible property

LIABILITIES

Consumption:
- 59.5: Penalty-free withdrawals
- 62: Early Social Security
- 65: Medicare enrollment
- NPV of Consumption 65–75: ___
- 65–67: Full Retirement Age
- 70: Maximum Social Security age
- 70.5: Required minimum distributions
- NPV of Consumption 75–85: ___
- NPV of Consumption 85+: ___

Debt:
- Primary mortgage/home equity loan(s)
- Reverse mortgage, other real-estate loans
- Education loans
- Vehicle loans (planes, boats, autos, etc.)
- Credit card debt, other debt

NPV of Bequest: ___

Household Net-Worth (Risk Capacity Analysis): ___

Contractual Protection:
- Life insurance
- Disability insurance
- Long-term care insurance
- Property & Casualty insurance
- Liability/Umbrella insurance
- Professional insurance

Special Circumstances Checklist:
- Last will & testament and/or revocable trust
- Living will
- Estate executor
- Durable power of attorney (financial & healthcare)
- Married/Cohabit/LGBT/Single/Divorced/Widowed
- Dependent children/adults
- Special needs children/adults
- Other special circumstances

USING THE RETIREMENT ALLOCATIONS

6. Document risk profiles and risk exposures of the client's entire household.

Creating an RPS requires advisors and clients to plan with respect to familiar risks (i.e., issuer risk, market risk, inflation risk, and public policy risk) as well as risks that accompany retirement (i.e., spending risk and longevity risk) (see figure 3). Managing spending and longevity risks calls for striking a delicate balance. You don't want clients to sacrifice unnecessarily by being excessively frugal or working far longer than necessary, but you know that they may need to manage spending to address the risk of living longer. No one wants to outlive their income and become a burden on their families. For a client who has remained in the family home, owns it free and clear, and wishes to stay there until death, it may be necessary to discuss the concept of a reverse mortgage. This can be done formally with a financial institution or, in some families, the children step up when they know their parents need funds and have too much pride to accept financial assistance from "the kids."

When addressing spending risk with a client, advisors need to discuss inflation and its impact on the client's future cost of living. Will clients just assume that they will give themselves a cost-of-living raise annually from their financial assets? Will that decision be impacted positively or negatively by market performance? These are things you want to talk about before they occur. Documenting the decisions made during these discussions within the RPS will help when the situation arises. You can point to the fact that together you had anticipated the issue and had decided, for example, not to take a cost-of-living raise in a year where the portfolio declined in value.[3]

In this portion of the RPS, you will want to reference discussions and decisions about the following topics (see figure 4):

Risk retention: managed with a diversified asset allocation among risky assets forming the upside or growth portion of the portfolio.

Risk management: controlled with preventative, hedging techniques, forming the floor portion of the portfolio.

Risk pooling: implemented with insurance products including annuities forming the longevity portion of the portfolio.

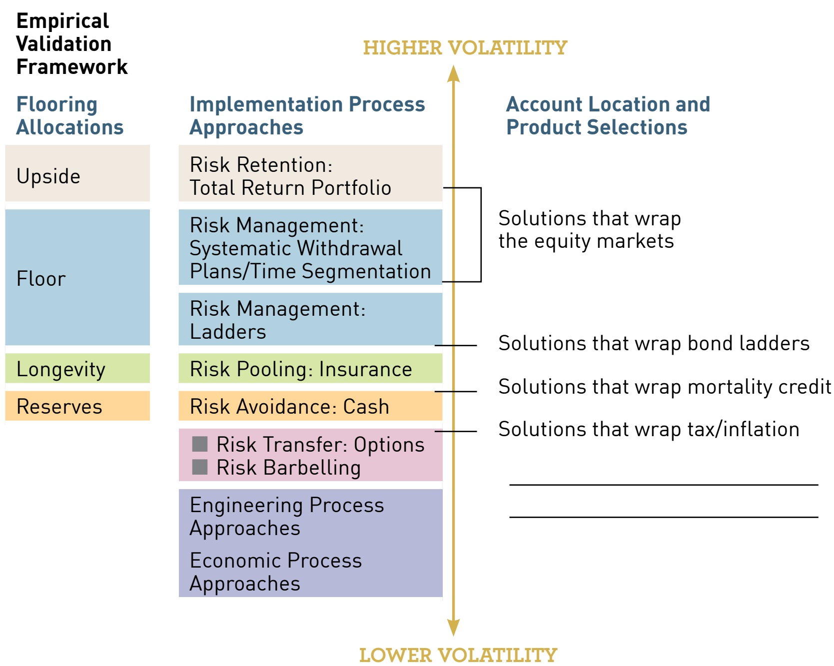
Risk avoidance: managed with risk-free assets including cash, essentially as a reserve portion of the portfolio.

SUMMARIZE THE INVESTMENT OBJECTIVES

7. Summarize the realistic investment objectives that match the client's entire household needs, goals, and risk exposures as well as the capital market expectations that support the retirement-allocation recommendations. Determine the plan's threshold rate of return including the minimum annualized real return necessary for the plan to work.

You will find, upon completion, that the RPS will be a document that reflects risks the client has elected to retain, risks the client seeks to manage (for example through laddering bonds or a bucket approach to income), risks the client will pool through insurance, and

Figure 4 **BEST PRACTICE TOOL BOX: RETIREMENT MANAGEMENT POLICY STATEMENT AND THE PROCESS/PRODUCT TREE**



risks the client will avoid or transfer. The format of the document will vary from practice to practice. Your firm may have rules in place that won't allow you to use outside software to create the RPS and its various components, so you may find it best to set up the document in Microsoft Word, possibly as something that builds on an investment policy statement format or PowerPoint. Regardless, the RPS you create helps the client feel prepared for situations that inevitably will arise in retirement. It will serve as a touchstone during future times of uncertainty and emotional stress. In the future you and your client will all be glad you have it in place.

IMPLEMENTATION AND DOCUMENTATION

8. Document the choice of implementation process approaches.

The approaches map into the retirement allocations in the following manner:

- Upside portfolio: total return portfolios
- Floor portfolio: systematic withdrawal portfolios, buckets, ladders, bar belling, annuities
- Longevity portfolio: insurance
- Reserves: cash

PRODUCT SELECTION

9. Confirm the choice of account locations and make the product selections.

Account location is about tax management through the placement of assets and investments. Client household statements will show that wealth is held in a variety of financial accounts, including taxable accounts, tax-deferred accounts, and tax-free accounts.

It's important to note that many variables should be considered when thinking about investment location choices, including the following:

- Financial holdings' taxation
- Non-financial holdings' taxation
- Life-cycle profile interaction of cash flows and assets
- Life-cycle horizon and longevity (flooring allocations)
- Optimized asset allocations (and product selections)

MONITOR

10. Present, implement, and monitor the RPS plan.

Establish a process for revisiting the RPS in the future. If the RPS is constructed well before a client's retirement, e.g., five years in advance, many things may change before retirement actually begins. Even if the RPS is constructed closer to the retirement date, clients often find that retirement doesn't take place as anticipated. For example:

- A client is offered a buyout four years before the planned date of retirement.
- A client may have retired but may be traveling more, or less, than expected.
- An aging parent suddenly may need more care, attention, financial support, and time than anticipated.
- A child who appeared to be doing well suddenly needs financial assistance.

Retirement is like any other time in the life of a client—surprises occur. Advisors and their clients can make many of these surprises more manageable by planning for them in advance and documenting these plans in an RPS.

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ENDNOTES

1. Learn more about the RMA program at https://investmentsandwealth.org/rma.
2. *RMA® Retirement Management Advisor® Curriculum Book for RMA Candidates*, 6th ed. Greenwood Village, CO: Investments & Wealth Institute (2018), p. 39.
3. See "The Guyton-Klinger Rule of Retirement Investing," thefinancialghost.com (May 20, 2019), https://thefinancialghost.com/category/thefinancialghost-com-retirement/.

CONTINUING EDUCATION

To take the CE quiz online, go to www.investmentsandwealth.org/IWMquiz

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