Why R.I.S.K. It: Addressing Six Retirement Risks

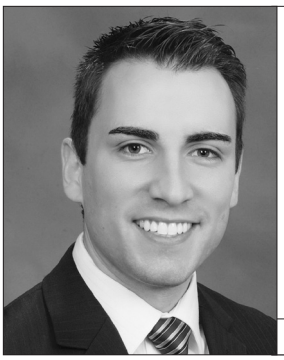
Caleb J. Callahan, CFP

So do you want the good news or the bad news? The bad news is that we've got a problem . . . our clients have a problem! Optimists refer to the problem as "living too long." Pessimists call it "running out of money too soon." You can call it whatever you want, but the statistics tell us that most Americans are going to be broke in retirement. But here's the good news! You can help clients fix this problem. I'd like to talk to you today about creating a process designed to help clients address the various risks they will face in retirement by building their own, well, "R.I.S.K." or "Retirement Income Survival Kit." What I'm talking about is a retirement income blueprint that optimizes the use of clients' retirement resources while minimizing the risk of outliving them—not only an income blueprint that tells them the traditional things about planning for retirement, such as how to diversify their portfolio, but a blueprint that provides specific instructions for how to invest their assets among various income-producing investments and shows how these income streams work together to meet specific income goals while protecting them against the "Six Key Risks" they will face in retirement. I want to talk to you today about building an income plan for clients that they can actually understand and one that motivates them to take action.

But we are not just going to talk about building a Retirement Income Survival Kit for your clients. We are also going to talk about the importance of wrapping this whole thing up inside of a "unique process" offered by your firm, a process that creates a unique and differentiating story for you. It is a story that not only you can tell effectively but your clients can understand and tell others over and over again. I'm talking about bringing a "process" versus "produce" centric approach to planning. This process creates a sense of urgency for your clients to not only take action, but take action and work with you specifically because what you offer will be unlike anything they have seen before. It will be an absolute game changer for your business and completely distinguish what you do from your competitors.

So you're obviously thinking to yourself at this point, "Who is this guy? How does he know that?" Well, I don't know that for sure because I don't know each of your firms. But here is what I do know. I'm fortunate to be able to work with some of the most successful advisors across the country on a daily basis. I can tell you that many of them have adopted a similar story, or process, that we are going to talk about today. Those advisors have seen the sales of investment and insurance products that can be used for retirement planning—such as annuities, life insurance, and asset-based long-term care plus others—absolutely take off. If you ask them, they will tell you that building a story and process around retirement income planning is what made this happen. This stuff works!

One more thing: I'm not sure what each of your business models is, but effective retirement income planning requires the use of solutions that are composed of broker dealer, advisory, and insurance products. So regardless of what your business model is, I think this material is very relevant for you. It is at the heart of the intersection of the different types of products offered in the financial services industry and, more specifically, the kind of products that uniquely intersect the area of investment and insurance products, which is really what the people in this room do better than anyone



Caleb J. Callahan, CFP

Callahan is chief marketing officer of ValMark Securities and responsible for the overall sales, marketing and distribution of the firm's insurance and investment products. Callahan works directly with independent financial professionals—including many current MDRT members and past Presidents—to help them plan their clients' retirement income planning with a holistic approach to insurance, brokerage and investment advisory products, and services. He is a published author and has been quoted in multiple publications.

130 Springside Dr., Akron, OH 44333
phone: +1 800.765.5201 email: caleb.callahan@valmarksecurities.com

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So I mentioned the bad news at the beginning of my talk. Let's circle back quickly and be more specific about this bad news so that we can make the case for why the good news is really . . . well, such good news! So just what are people up against in preparing for retirement? That's exactly what Congress asked the Government Accountability Office (GAO) to try and figure out this past summer. So the GAO asked for help from some of its good friends, including the Treasury Department, Department of Labor, Internal Revenue Service, Securities and Exchange Commission, Social Security Administration, and the National Association of Insurance Commissioners. Through their collective efforts, the GAO published a report, the title of which essentially summarizes its groundbreaking conclusions: *Ensuring Income throughout Retirement Requires Difficult Choices*. Phew, on behalf of all of us, thank you for clearing this up for us! I'm so glad you all got together on this one. In their defense, they did go on to say some meaningful things, such as, "As life expectancy increases, the risk that retirees will outlive their assets is a growing challenge. The shift from defined benefit (DB) pension plans to defined contribution (DC) plans also increases the responsibility for workers and retirees to make difficult decisions and manage their pension and other financial assets so that they have income throughout retirement."[1]

However, by far and away my favorite analysis is contained in the conclusions of their findings, which stated, "Americans can avoid the risk of outliving their assets by saving more money, working longer, investing wisely and delaying social security." Really? Is that the clearest recommendation we can give people about how to build a retirement income plan? Here you go, Mr. and Mrs. Client. The big secret to retirement is the following. Lean a little closer; I have to whisper this because it's a special secret: "Invest wisely!" Really? Invest wisely? What does that even mean?

The bottom-line conclusions of the GAO remind us that the burden of preparing for retirement falls directly on the shoulders of retirees, and not even a report to Congress has the answers. No one is handing out pensions as they used to. You can read article after article about the rate at which some of the biggest companies in the world are taking away defined benefit plans. For example, CBS recently did a story on how the PBGC took control of unfunded pensions from Toyota. The plan was only 55 percent funded and had $160 million of assets and only $300 million of liabilities. California's public pensions are underfunded by $500 billion, according to a study by Stanford University. In early 2011, General Electric closed its traditional pension plan to new hires.

I think the great philosopher Yogi Berra summed it up best when he said, "The future ain't what it used to be." Guaranteed income streams for life are no longer handed to us at retirement. So how do we respond to the fact that the burden of preparing and planning for retirement income falls directly on the shoulders of consumers? Well, we can look at traditional investment and retirement planning. We could say that, well, it's all about saving enough money in our 401(k) plan and then picking a safe withdrawal rate. We could just say that all we need to do is diversify among different asset classes, such as large cap, mid-cap, small cap, and so on, and we will be fine because, after all, roughly 90 percent of portfolio performance can be explained by asset allocation based on Modern Portfolio Theory. So if we diversify, we are all set, right? Well, we could say all that, but we'd really only be telling *half* the story. All this only focuses on accumulation planning.

Now, don't get me wrong; saving money and investing wisely through effective asset allocation is fundamentally important. In fact, without accumulating a nest egg, there is nothing to even talk about when it comes to distribution planning. But effective planning doesn't just focus on saving a retirement nest egg and then stop; it needs to address distribution planning. The truth is, traditional planning and all our textbooks and white papers are *not working*! Consumers want to plan better for retirement, but what they are being told is not helping them, and even if it were, it is not being communicated in a way that they can understand nor do they feel compelled to take action. A recent study sponsored by the Society of Actuaries on retirement income planning summarized its findings by saying that "Despite high levels of concern over retirement, we find little change among Americans in planning for the future."[2]

So what the industry, government, and academics are doing is not working. Now, we can blame the government and academic institutions, but let's just avoid that conversation altogether. We can blame the consumers. But, frankly, that's not all that helpful because even if we do, they will still die broke, and we aren't going to be successful either. So maybe we should acknowledge that we need to do a better job by making the case for why this planning is important, explaining our strategies in simple terms that they can understand, and, most importantly, providing solutions that actually

work. Maybe we need a new process for retirement income planning. Maybe we need . . . a new story!

Yes, exactly, we need a new process and story around retirement income planning. And now that we fully understand the bad news, let's talk about the good news. The good news is that we can offer our clients a process by which they can build a custom income plan, or a Retirement Income Survival Kit. And we need to communicate this in a way that clients actually understand, feel a sense of urgency, and take action.

So let's talk about this process. Let's build this story! We have to begin by answering one very important question: What is the ultimate goal of retirement planning anyway? The answer to this question is not just important for us to understand as agents and advisors; it is even more important for our clients to understand. It's fundamental to our story. Effectively asking and helping clients answer this question is the most important step in creating clarity and urgency around building a retirement income blueprint. And there is one way I recommend you ask this question of clients, and it's with an analogy that they will easily understand and never forget. And since this process is about building a Retirement Income Survival Kit, this analogy fits perfectly. Is anyone here an outdoorsman, backpacker, or climber? For those of you who are, if I asked you what the goal was of someone who set out to climb a mountain, what would you say? Most people would likely say, "To make it to the top." While this certainly is part of the goal, simply reaching the top of the mountain is not the ultimate goal. The ultimate goal of a climber is to reach the top . . . and come back down safely. The *and* is very important. Considering that 80 percent of climbing accidents occur on the descent, it is this second half of the journey that presents the greatest risk and requires a tremendous amount of planning. Climbers who focus only on the ascent and do not consider how personal circumstances and environmental conditions may change during the climb back down, and plan accordingly, contribute to the statistics of all those climbers who never complete their journey.

The same is true for retirement income planning! Many people spend their whole lives working and planning diligently so that they can save a large sum of money for retirement. However, few people give the same amount of attention to planning how their money is going to provide income for the rest of their life. What they fail to realize is that the risks they face saving *for* retirement are different (or at least impact them differently) from the risks they face during retirement. Building a plan to distribute a nest egg in a manner that mitigates the unique risks the client will face during the retirement years is absolutely necessary for effective retirement income planning. So, in short, we need to make sure that both you and your client understand that the ultimate goal of retirement planning is to accumulate a nest egg that will produce enough income to satisfy a client's needs and wants throughout his or her lifetime. In other words, the goal is to reach the top of the mountain and come back down safely.

So now that clients are clear about what the goal is, let's talk about the actual steps you can go through with your clients to build this income blueprint. You tell clients you have a process. This process is for retirees. You spell it a little differently, though. It's "Four Retiree E's." The Four Retire E's are Educate, Explore, Engineer, and Execute. You walk clients through the Four Retire E's process as a way of building them a custom Retirement Income Survival Kit. So let's walk through them.

The Education phase is all about helping clients understand and plan for the Key Risks to their income streams that they will face during the distribution phase (coming back down the mountain). McKinsey & Company did a study, and one question asked, "What causes extreme anxiety to you as a retiree when you think about retirement?" More than half the respondents said that they were worried about things like their pension benefits such as social security going away. They were worried about interest rate changes negatively impacting their retirement income. They were worried about outliving their money. They were worried about the lack of guaranteed income streams to cover basic needs. They were worried about the volatility of the stock market. They were worried about health expenses, and they were worried about inflation. I've broken these down into the Six Key Retirement Income Risks, which we are going to talk about today and which every retirement income blueprint needs to address. These are (a) market risk, (b) longevity risk, (c) inflation risk, (d) liquidity risk, (e) health risk, and (f) legacy risk.

Let's first talk about market risk. Here is the S&P return data for 81 years, from 1929 to 2010. During these 81 years, the average annual rate of return was roughly 9 percent. Now, there is nothing smooth at all about how we got to that nice average trend line, but my hand is shaking, so probably it actually did look little bit like that. What we actually had over those 81 years were 57 positive years and 24 negative years, with the average positive year returning almost 21 percent, and the average negative year returning almost negative

14 percent. If you bought in and held your investment over that time period, you would have earned the equivalent of 9 percent a year. But the market on an actual year-over-year basis almost never returned 9 percent. It gets to this nice smooth 9 percent as the average of the extreme positive and negative returns of the various years. So the question is, in which of these years are we going to retire? I'd like to retire here. I can't predict when I'm going to retire, and the thing about market risk is that it is a necessary evil because equity exposure is generally needed to reach our retirement goals. When you think about equities historically, they are one of, if not the strongest, vehicles for growth. The other thing about equities is that they are a natural inflation hedge. The reason they are a necessary evil is the fact that while they do offer these great features toward retirement planning (growth and inflation hedges), with market risk, how much of what's invested in the market can you lose? Bingo—*all of it*! And that's the reality of market risk; you likely need to be invested in equities in order to hit your savings targets, but at the same time, there's a risk that you could lose all your savings. The reality is that you need to stay invested in equities in order to hit growth bogeys and fight inflation, but as you go into distribution, you have to have some kind of risk management strategy to reduce market risk.

Let me explain a component of market risk in a little more detail and share with you why it's a risk that is so much more potentially devastating during the distribution phase as opposed to while you are saving money during the accumulation phase. Many of you are familiar with sequence of return risk, but I want to walk through a very simple example to really drive home the point of what sequence of return risk means and why it's important for retirees to address. In this example, we are going to assume that a 60-year-old retiree is going to withdraw $50,000 a year (adjusted 3.5 percent for inflation) from his $1 million portfolio. This is of course a 5 percent initial withdrawal rate from the portfolio. Let's say conservatively that the market averages 7 percent annually. If that's the case, it seems like a reasonable assumption that on an inflation-adjusted basis I should be able to withdraw 5 percent a year while the market earns 7 percent and not have my $1 million principal depleted for some time. One more thing—while the market averages 7 percent a year, I am going to go ahead and make my actual year-over-year market return sequence equal exactly 7 percent as well (meaning the market earns exactly 7 percent, 7 percent, 7 percent, and so on), and let's see what happens. Our retiree doesn't run out of money until age 97.

Now, what if we keep everything else exactly the same, but this time we make our year-over-year returns more indicative of a typical market cycle but still keep the average annualized return at 7 percent. Let's assume the market gives us a three-year return sequence of say 7 percent, 27 percent, and negative 13 percent. This three-year return cycle repeats itself every three years (but the average is still 7 percent). We're going to take out the same amount of money that we took out before, but the only difference is the sequence in which these returns are experienced. In this case, we actually run out of money at age 91. We did everything exactly the same, but by the luck of the draw, our money ran out six years sooner.

In the final example, we will keep all things constant but simply swap the return sequence one more time while leaving the average still at 7 percent annually. In this example, let's assume the three-year return sequence cycle has the negative number earlier, so it goes 7 percent, negative 13 percent, and 27 percent in three-year cycles throughout retirement. What happens in this example is that we run out of money at 86. We run out of money 11 years earlier, and we did nothing different. We made the exact same investment decisions we did before, but what we thought was a reasonable distribution plan turned out to be a premature depletion of our portfolio because of luck—because of return sequence.

Here is the bottom line. Average returns mean nothing once we begin withdrawing money. Return sequence is what matters. Negative returns early on in retirement can wipe out a portfolio prematurely. This is why market risk, and specifically market return sequence risk, is so fundamentally important to address during the distribution phase of retirement. If this risk is not addressed, then a successful retirement really depends on being lucky enough to retire in the right year. And I don't know any clients who are going to say, "I appreciate all the work that you've done for me all these years, and you know what? That's okay—I'm okay with just being lucky enough that my income lasts throughout retirement." No way, at least not the clients I know. The point is, we have to come up with a solution that facilitates enough market and equity exposure to drive those growth rates, to drive the natural inflation hedge that is created, but still ensure that we can have a sustainable withdrawal out of these assets regardless of return sequence. We'll talk about how we can address this later in the process.

The second of our Six Key Risks is longevity risk—the risk of outliving the assets I have set aside for retirement. What do we know about longevity as a whole? Well, we know that with advances in technology and medicine, longevity is

increasing. We also know that life expectancy is essentially in the 50th percentile. How is life expectancy defined? For someone of my age and sex, it is the number where 50 percent of the people are going to die before that age and roughly 50 percent of the people are going to the live beyond that age. Again, I don't know any clients who would be okay to hear you say, "Thank you for the planning fees; we've built this distribution strategy, and the good news is, we are 50 percent sure that it is going to last as long as you do." No, absolutely not. The reality is that optimized portfolios—and this is the key—can be accomplished only with some type of lifetime income component, and the reason is that we cannot predict when we are going to die. If we really could predict the date we are going to die, we would not need longevity insurance products. We could truly optimize a portfolio without a lifetime income component, but because we cannot predict when someone is going to die, we have to incorporate a form of guaranteed lifetime income.

One other thing to note about longevity risk: This graph shows the probability of survival, so in this case the probability for a joint couple age 65 is that one of them will live to at least age 90 is 50 percent. [visual] What's interesting is that when you look at the graph with the blue line, which is the joint probability of survival line, you actually see these inflection points at the derivatives. What that means is that if you're 86, your probability of making it to 87 is actually less than the probability of making it from 96 to 97. We have limited experience with the tales of these "probability of survival" graphs, but the point is, as longevity improves this is going to be a more and more substantial risk that needs address.

Let's move on to the third of the Six Key Risks in retirement and talk about health risk. The cost of health care for retirees is one of the fastest growing costs and therefore one of the greatest risks facing retirees. The fact is that health care costs are growing twice as fast as general inflation. When you look at the fact that two out of every three people age 65 and older will need some form of long-term care insurance, combined with the fact of how expensive this care is, you'll see that this is a substantial risk for retirees. Health care without long-term care expenses is the second biggest expense for retirees on average. These costs average about 20 percent of their total monthly expenses. Roughly 75 percent of single people and 50 percent of all couples spend all their savings within one year of entering a nursing home. You can have the greatest distribution strategy in the world out of an asset management portfolio, and, depending on what health care expenses are, it doesn't matter, it won't matter. This is the real deal in terms of serious risks to income!

The fourth Key Risk to income every retiree faces is inflation. I love this quote from Milton Friedman: "Inflation is the one form of taxation that can be imposed without legislation." Inflation has superseded health care risk as the top interest of retirees and pre-retirees. What's inflation been like lately? Really high, right? No, of course not. In fact, some worry about deflation. There are two questions people always ask each other when they have nothing else to talk about: "How's the weather?" and "What do you think about inflation?" The reality is that nobody knows for certain about either one, especially about the weather in Ohio, where I live. Based on the current interest rate environment, it is reasonable to assume long-run inflation will likely increase, but by how much and exactly when we cannot predict. However, the point here in planning for retirement income is not that you need to know exactly what the inflation rate is going to be in the future, but that you understand that retirees spend differently, and therefore you have to look at the inflation levels of their various spending areas. While the CPI-U, the consumer basket of goods for the average urban household, is a handy index, the reality is that retirees spend differently compared to that index, and so we have to be intentional about how we look at adjusting for inflation. For example, look at the inflation rate as it is tied to medical expenses, because this is an area that has seen high inflation and an area where retirees spend a lot of money. This is important to factor in when building an income plan.

The fifth Key Risk to income is liquidity risk. Change is the one constant in life . . . and in retirement. We all have clients that are "poor" millionaires. No access to cash. They cannot escape the unexpected event. At the end of the day, you can build the best income distribution strategy in the world that addresses things like market risk and longevity risk, and if you have no flexibility through liquidity, what's it really worth? If you touch one component of it and the whole thing blows up, how good is the plan? There has to be built into that portfolio the flexibility through liquidity to plan for the unexpected.

Finally, the sixth Key Risk to retirement income is legacy risk. This is the risk in which your resources will be depleted during retirement and you will be unable to leave a financial legacy to the people or organizations you care about most. As we build a retirement income plan for clients, we need to know whether their priority is maximizing their legacy or their lifestyle. We want to know what's most important to

clients because that's going to impact and tell us how much flexibility we have with that nest egg in terms of what type of income distribution strategy we can create. We need to know what their goals are in terms of a financial legacy. Do they want to finish with one dollar left after retirement versus finish with the same amount of money they started with or have even more money at the end? The answer to this question tells us whether we should use all the financial resources to provide lifelong income or try to preserve some of it. It also helps us determine if we can reduce income during lifetime—for example, increase the potential for a financial legacy or do the opposite and increase spending during their lifetime so that they can enjoy things even more, because there are plenty of assets since there is no goal to pass anything on at death. Also, since we are at MDRT, it's worth mentioning that this is also a huge opportunity for us to transition from discussing income plans to things like estate planning and life insurance to help leave a legacy. But it all starts with getting clients educated and excited about building a retirement income blueprint.

So what's the conclusion of this discussion on the Six Key Risks retirees face? Well, I said the purpose of this session was to share with you how you can build a process that starts with a story you can use to get clients focused on planning specifically for the retirement income phase of their life. This story is built on the climbing analogy, which will convey to your clients exactly what you are helping them do (build a plan for coming back down the mountain)—a custom retirement income blueprint. Once clients understand what the main goal and focus is: the four steps (the Four Retire E's) that you can share with your clients and that you walk through as part of this process. We just went through step one, Education. It's important that we educate clients on the key risks they will face coming back down the mountain in retirement. Once we do this, it's time to move on to step two of our process, Exploration.

The Exploration phase is where we do our fact finding with the client in order to begin building their custom retirement income plan. When you think about the fact-finding process for traditional comprehensive financial planning, it typically involves the use of a comprehensive planning questionnaire that is about 1,000 pages long, and virtually nobody's willing to go through that process. However, we want to keep things simple in this process. Again, we are focused only on distribution planning, building an income plan in retirement, not a comprehensive financial plan. You're dealing with someone who is at the top of the mountain and getting ready to make the transition back down. Here is an example of the kind of questionnaire I recommend that you use during the Exploration process. You can use whatever you want. There is no right answer. But I hope sharing some of this will be helpful to you in your own practice. It's only two pages, and the goal is really to gather about 75 percent of the information but have a majority of the people actually use it. We can always go back and get more information. This condensed questionnaire is designed to be used over a cup of coffee. It's a conversational questionnaire. It really looks to get basic client information, such as name, DOB, projected retirement age, and other general assumptions, such as their tax rate, inflation assumptions, and cost-of-living adjustment. It includes other questions such as "What is your current savings?" "How much do you plan to save annually until you retire?" "What dollar amount do you plan to spend each year during retirement?" "Of this amount, how much of this would you define as a *need* versus a *want*?" We then will ask them to list their current retirement resources, such as social security income and pensions, and other sources of income, and if they have any existing risk management strategies in place, such as life insurance policies, long-term care insurance policies, and so on. This is all done on one page!

On page 2 we ask them to place a priority on their retirement objectives: whether they want to maximize their lifestyle or their legacy and, if necessary, if they are willing to reduce their standard of living to reach their legacy goals. We then move to the most important part of the Exploration process, or fact-finding process, which I like to call the "retirement risk assessment." This is where I ask clients, in writing, to rank each of the Six Key Risks (market, longevity, health, inflation, liquidity, and legacy risk) in order of importance. You can then take it a step further and ask them to answer, in writing, *yes* or *no*, and whether their current portfolio adequately addresses each of these risks. If they are not your client and you are just sharing with them how your fact-finding process works for retirement planning, they will be your client after completing this part of the questionnaire. Almost all clients answer that their current portfolio does not adequately prepare them to address the Six Key Risks of retirement. Now, this of course isn't the only way to do a fact-finding questionnaire. My point to you is that regardless of whatever you use, you need to have a simple questionnaire that clients actually understand and that gathers the basic information. I'd rather have a questionnaire that gathers 75 percent of the information, which the majority of people actually use, than a questionnaire that can gather 100 percent

of the information but frankly nobody wants to use because it's too complex and overwhelming. This is really the whole point of the Exploration process—to gather this information and begin to move to the Engineering phase of the process.

The third step of the Four Retire Es process is the Engineering phase. The Engineering phase is one of the most important concepts of this entire process and presentation. This is where we build on the Education phase, in which we educated retirees on the Six Key Risks of retirement planning and incorporate the specific client information gathered during the Exploration phase, including clients' personal risk assessment and attitude toward the Six Key Risks of retirement, and use the information to build their own retirement income allocation model. This model will be the basis for their retirement income blueprint.

So you're probably asking, "What's an income allocation model?" Well, you are familiar with an asset allocation model, right? Sure, everyone has these in their 401(k) plans and IRAs. A typical asset allocation model might look something like this: It includes diversification among different kinds of mutual funds, such as large cap, small cap, emerging markets, debt, real estate, and so on. You even have a range of options from conservative to aggressive, say, 20/80 to 90/10 equity/bond mix based on risk tolerance. This idea of asset allocation is appropriate for climbing up the mountain or for saving money for retirement during the accumulation phase. It does a good job of addressing the type of risks we face during this stage of our investment time horizon. In fact, this is what things like Modern Portfolio Theory are all about. It's all focused on climbing up the mountain.

However, this is not good enough for addressing the kind of risks we face climbing back down the mountain or during the retirement income distribution phase. The climb back down the mountain requires the client to have a custom income allocation model. So what's an income allocation model? Here, take a look at this chart. [visual] An income allocation model includes everything we just reviewed with traditional asset allocation, but that's only a small part of the overall allocation. An income allocation model takes a step back and does a broader allocation at the super category level, among other types of solutions, rather than just traditional asset allocation, in order to more effectively address the Six Key Risks of retirement. For example, an income allocation model not only includes the traditional asset management diversification, it also includes diversification among things such as equity income guarantees, longevity insurance, inflation protection, long-term care coverage, and death benefits.

Professor Moshe Milevsky of the Schulich School of Business at York University, in his book *Are You a Stock or a Bond?*, says it this way: "As we get closer to retirement, I believe that asset allocation takes on a more limited role, compared to the much more important and critical decision of suitable product (income) allocation." He goes on to say:

> I've run thousands of simulations of hypothetical retirements and ranked what can go wrong. Far and away the biggest causes of failure are longevity risk, inflation and a sour market early in retirement. No one kind of investment works against all three. So you need to diversify among investment products, just as you need to diversify among stocks and bonds and so on.

This is what income allocation is all about! Here, look at what Jim Otar says in his book *Unveiling the Retirement Myth*: "Any income allocation strategy that does not export all of the longevity, long-term care, market and inflation risks will likely fail." He's talking about addressing the unique risks of the retirement income phase, the Six Key Risks, with something more than just asset allocation. He's talking about income allocation. He's talking about using different types of specially designed products that can work together to create a holistic portfolio designed to provide lifelong income during retirement while mitigating the Six Key Risks that will try to fight against income along the way.

Now, where can you find these types of solutions to make an income allocation model? What type of financial professionals have access to things such as equity income guarantees, longevity insurance, inflation protection, long-term care coverage, and death benefits? Oh, that's right. We are at the Million Dollar Round Table, a gathering of the industry's top financial professionals, many of whom are multidisciplinary and all of whom have access to unique solutions at the intersection of the insurance and investment business, many of which insurance companies alone can create.

So what kind of products might an income allocation model have? Well, I mentioned earlier that I work for an independent broker-dealer and, like many of you in this room, work with independent financial professionals who are multidisciplinary and sell products that cross over multiple sets, including traditional investments and securities products as well as risk management and life insurance products and fee-based advisory and asset management types of solutions. As you think about each of these different types of products,

you realize that they all have the potential to address the Six Key Risks of retirement we talked about earlier. However, not one product can do everything. Look at this list on the screen. [visual] For example, a traditional asset management portfolio diversified among stocks and bonds might provide upside potential, and while it might address liquidity risk and even inflation risk to some extent, it certainly does not address market risk, longevity risk, health risk, or legacy risk. You look at a product like a single-premium immediate annuity. It addresses longevity risk, but it doesn't address liquidity risk or health risk, for example. Life insurance can address legacy risk, and long-term care insurance can address health risk, but neither addresses liquidity risk all that well. Some products attempt to do multiple things, such as variable annuities with lifetime income riders, as they address longevity risk as well as market and return sequence risk, but they do not necessarily address all the Six Key Risks. The point is that there is no silver bullet product that addresses the Six Key Risks of retirement, but the idea is that you need to diversify among different product sets during the retirement years in order to effectively address the risks you will face coming back down the mountain, just as you, for example, diversified among different asset classes with a traditional 70/30 type of allocation in your 401(k) while you were climbing up the mountain.

As you walk your client through this process, the Four Retire E's, and you Educate them on the Six Key Risks, explore their personal situation, goals, and income risk tolerances, and begin to engineer an income allocation for them. When you show them something like this, they will realize that no one else is doing what you do in this business. The guy down the street who can manage their assets for them for 25 basis points cheaper will be out of the picture. Look at this chart. [visual] I like to call this "Retirement's New Risk Spectrum." Clients are used to seeing a spectrum of, say, five different asset allocations, ranging from a conservative 20/80 to a more aggressive 80/20 mix. But show them this spectrum, which ranges from "Risks Unaddressed" to "Risks Addressed," and everything will click from them. You list the Six Key Retirement Risks down the side and then show the income allocation models at the top. The one on the far left, under the heading "Risks Unaddressed," is just a traditional portfolio of stocks and bonds. It addresses liquidity risk, so you can see that the box is checked, but it does not address market, longevity, health, inflation, liquidity, or legacy risk. You go to the middle of the spectrum and you see an income allocation model that includes asset management, equity income guarantees, longevity insurance, and inflation protection, for example. This kind of income allocation model addresses liquidity, market, longevity, and inflation risk, but not necessarily health or legacy risk. You then go all the way to the right under the "Risks Addressed" heading, and you find an income allocation model fully diversified among asset management, equity income guarantees, longevity insurance, inflation protection, long-term care coverage, and death benefits. You see that every one of the Six Key Risks is checked off as being addressed with this portfolio.

You show clients a one-pager like this, and they will get what the Engineering phase and income allocation is all about. There is no right answer here, just as there is no best asset allocation model, but the point is that clients understand the risk and return tradeoffs. When you explain it this way, they will want you to address the Six Key Risks. And when they realize that only the kind of professionals here at MDRT are the ones who have access to these different types of solutions, they are not going to be as concerned about the stock picker down the street who will manage their money for a few bucks cheaper. They are going to want someone who can engineer a custom income allocation model based on their needs, goals, and attitudes toward income risks so that they can have a detailed income blueprint for coming back down the mountain safely. Speaking of a blueprint, let's move on to the final E in our Four Retiree E's process—the Execution phase.

The Execution phase is about taking the work you have done during the Engineering phase and delivering it to clients in a way that they will actually understand. It has to be simple but very specific about what you are recommending clients do. Every one of you might do this differently, but I want to share with you an example of what I've found successful and see if you think it's valuable. At this stage clients know about the Six Key Risks. They know we've gathered all the information through the Exploration process and have spent time engineering them a custom income allocation model. As we told them in the beginning, they know that the whole purpose of this process is to build an income plan for coming back down the mountain safely and addressing all the risks they will face along the way. In short, they know that the whole purpose is to build them a blueprint, a Retirement Income Survival Kit (R.I.S.K.) to address the Six Key Risks.

That being the case, I deliver the client a R.I.S.K. blueprint. This is the roadmap for coming back down the mountain and addressing all the risks along the way. You can do

whatever works best for your clients, but here are some of the characteristics I've found of building, delivering, and getting clients to take action with a blueprint. It has to be simple and concise. For example, this one is only five pages total. Let me walk you through it real quick. [visual]

The first page is just a summary of the key information they told us during the exploration process. The most important thing about this page is that it lists the priority clients gave us for addressing the Six Key Risks. In this example, the client was most concerned about longevity risk and least concerned about legacy risk. You can see the risks listed in priority from one to six.

Page two is an overview of the client's retirement income allocation model. This page shows the client's current allocation, which is just an asset allocation, next to our income allocation. Essentially, on one page we are comparing the current allocation to our proposed allocation. Our proposed income allocation includes asset allocation but also adds in equity income guarantees, longevity insurance, long-term care protection, and so on. The bottom of page 2 lists the Six Key Risks under each respective portfolio and then has a checkmark beside each risk that the portfolio addresses. With the current portfolio of just asset allocation, you can see that the only risk the client has addressed—if he stays invested as he is—is liquidity risk. This is because the client has an accumulation focused portfolio, not a distribution focused one. With our proposed income allocation model, you can see that we can check all the boxes, indicating we may address these risks. The last thing page 2 does is show the total assets, and you can see that they are the same for each portfolio, current and proposed. We want to do this because we want the client to make sure that he does not feel as though he is spending money. The client is simply reallocating his existing resources differently. He is moving from a strategy that was designed for climbing up the mountain to a strategy that is designed for coming back down. It's just an asset reposition!

Page three then, on one page, gives the specific recommendation for how we propose the client accomplishes shifting from his asset allocation model to our proposed income allocation model. It's a step-by-step road map. You can break down each area of the income allocation into (a) strategy, (b) solution, and (c) source. The strategy is the overall income allocation at the category level, for example, an equity income guarantee. The solution, listed right beneath this, is the product (solution) we recommend to carry out this strategy. Here, we recommend they allocate $500,000 to a variable annuity with income rider from ABC Insurance Company to fulfill the equity income portion of the income allocation model. You can see that we use an SPIA for the longevity insurance. The third and final layer of this flowchart is the source. This is where the money will come from out of the existing portfolio to fund each of the solutions that executes each of the strategies. So on one page you have an income allocation model proposed that lists the specific solutions or products to use, including how much to invest in each of them, plus where the money is going to come from out of the existing portfolio in order to fund these products. Clients love this because it's simple, concise, and specific. So many retirement plans are tens of pages long and have vague recommendations such as to have a 60/40 portfolio and to withdraw 4 percent a year. Here, we are giving them specific recommendations by category, telling them what product and company to use, and where they should move from in order to do this. When clients see this action plan for executing their income allocation model, they don't even think about the things all the other advisors are talking to them about, such as why their money managers are better than the other guys' and why they can do this for less money than someone else.

Page four is a cash flow summary of how these various solutions that make up the income allocation model work together over time. It just shows the various income streams each year, broken down by source, so that they can see their income needs are funded and by what sources (social security, annuities, pensions, and so on).

Finally, page five is a graphical representation of the income streams. Some clients are more visual than others, so breaking down their annual income streams with a bar graph that shows how much is coming from each source is really attractive to many clients. The best part about this graph is that it shows how much of the annual income is from guaranteed sources such as lifetime income annuities. Clients love this because most of them want to know that their core income needs are funded by guaranteed sources while their wants can be funded by projected earnings. Of course, there is no right answer here. Some prefer more or less guaranteed sources of income. The point here is that you show them in a way that is concise and simple, but specific. So that's it. Those five pages make up the R.I.S.K. blueprint, and I can tell you from experience that clients love this concept. How you choose to do it is up to you, of course, but I wanted to at least share some examples with you that I hope you find helpful.

So let's recap everything we discussed today. We talked about the fact that retirees are facing a crisis and that very few Americans are changing how they plan for the future. Our options are to blame them or to take a different approach to retirement income planning. It all starts with a process. The process that we talked about does three things. One, it simplifies things for clients. It communicates with them in a way they will understand and gives them a sense of urgency to address these risks and to understand that there are strategies they can understand that will actually work. Two, it will result in an outcome that is more consistent with evolving regulatory standards. Any products you recommend will be based on a consistent, repeatable, and documented process (which includes a written income plan). The third thing the process does, in addition to benefiting clients and complying with regulatory standards, is to differentiate your practice. It also gives you consistency within your business. Customers and the staff know what to expect. It even helps with succession. At the end of the day, with respect to differentiation, a process is your best friend. Every agent out there has access to virtually the same products, all commoditized, but you offer clients a process that gives them something they've never seen before. Whether or not it's on the front end of helping them focus on the right objective, they need a plan for climbing back down the mountain, and not just a plan like everyone else talks about for climbing up and saving a big pile of money. They need the benefit of going through the four steps of the Four Retiree Es: Educate, Explore, Engineer, and Execute, and the eye-opening importance of shifting to an income allocation versus an asset allocation once they retire. When you deliver your recommendations to clients in a clear, concise, yet specific manner—it all works to together to differentiate and benefit your practice in a way your clients have never seen from anyone else.

So my final word to you is this: Building a process specifically around retirement income planning is a win-win-win—a win for clients, a win for meeting and exceeding regulatory standards, and a win for you and your business. So go out there and build a process for your clients that will help them reach the summit and return safely in retirement! Focus on building a process for helping clients get back down the mountain safely in retirement, and I'm confident I'll see you at the Top of the Table.

Endnotes

[1] U.S. Government Accountability Office, *Retirement Income: Ensuring Income throughout Retirement Requires Difficult Choices*, June 2011.

[2] The Society of Actuaries, *2009 Risks and Process of Retirement Survey Report of Findings*, March 2010.