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## A Q&A about GuidedSpending 2.0

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By Editor Test     *Wed, Feb 16, 2011*

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*In an e-mail, GuidedChoice CEO Sherrie Grabot and CIO Ming Wang answered a few of RIJ's questions about their income planning tool for plan participants.*

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After GuidedChoice announced its GuidedSpending 2.0 retirement income planning model for qualified plan participants, RIJ submitted a few follow-up questions about the new service to GuidedChoice CEO Sherrie Grabot and Chief Investment Officer Ming Wang. Here are RIJ's questions and the executives' responses.

**RIJ:** In the hypothetical client examples offered during your Webex presentation on February 9, the GuidedSpending tool appeared to recommend a \$2,300 a month payout for a plan participant—"Al"—with \$200,000 in savings, and a \$4,610 monthly payout for a couple—"Gene and Eva"—with \$357,000 in savings. Those payout rates sound extremely high, 13.8% and 15.5%, respectively. Did those figures include Social Security and/or pension income?

**GuidedChoice:** An important differentiator of GuidedSpending for the defined contribution market is that it includes ALL retirement accounts that the retiree wants to include. Social Security is automatically calculated and included for them, but they can choose to modify or omit it. In addition, any applicable employee benefits, pension, retiree medical, stock options, etc. are also automatically included. Spousal, prior employer plans, and any non-plan accounts or assets are also included. The retiree can always choose to modify or omit any accounts GuidedSpending has included.

The \$2,300, and \$4,610 are an after-tax, spendable monthly income including all sources of retirement income that the individual chose to include in GuidedSpending. Al only has Social Security and a single 401(k) balance of \$200,000. The couple's amounts included Social Security of \$1,745 monthly, a small pension income of \$350 monthly beginning at Gene's age 65, as well as amounts that would come from Gene's 401(k), the \$200,000 balance, and Eva's 403(b), a \$82,000 balance. Gene also had a previous retirement plan balance of \$70,000 that is included. Together they had nominal IRA balances of \$3,908. We show the amounts in summary and detail to the client in the interface.

**RIJ:** The last slide in your presentation showed payouts of about \$7,000 a year from a \$100,000 account. In answer to my question about that rate of payout, your chief investment officer seemed to say that if you have \$100,000 in savings you can afford to take out 4% of principal plus about 3% worth of growth, to get to seven percent. But that contradicts every sort of model I've ever seen that calculates sustainable payout rates. Or perhaps I misunderstood him.

**Guided Choice:** Sustainability of payout rates will depend on various factors, two key factors being the planning period and whether the payout is adjusted for inflation. For now, we will ignore inflation. Assume the person retires at age 65 and has a planning period of 25 years, until age 90, starting with \$100,000 in his account. If we assume no return from investment, then he can withdraw 4% of his account value. The

next year, he can withdraw 4.17% since there are only 24 years left to fund. Each year, he can withdraw incrementally a greater percentage of the balance because the planning period is reduced by one year. By the 11th year, he can withdraw 6.67%. Over this 11-year period, his average withdrawal rate is 5.13% using a zero rate of return.

In essence, the client would withdraw \$4,000 each and every year for the 25 years. The dollar amount stays the same, but as a percentage of the account balance, the payout ratio increases each year. By the 11th year, this means there are still 15 years left, and he can therefore withdraw 1/15 of his account value which equals 6.67%

If we assume a rate of return, as we do in the case we showed on the slide, then the percentages that could be withdrawn each year will be higher than the zero rate of return example. In the example comparing the Spending Strategies, we use an annual 4% rate of return, the guaranteed return on many annuities. So each year, a higher percentage can be withdrawn, with the average being 7.2%.

During the years 2000 to 2010, because GuidedSpending uses a high and low spending value, the overall average is higher. In other words, during the good years in the market, investment performance would allow for more money to be withdrawn, but the retiree did not choose to withdraw more since the utility value of more money is too low. They preferred to leave the money in the account to provide for a “rainy day” or to leave for heirs. This “consumption smoothing” methodology provided a higher sustainable payout rate during the years between 2000 and 2010. (Note: Other periods could experience different results.)

**RIJ:** In previous conversations with a GuidedChoice executive, I was told that you envisioned a GuidedChoice IRA down the road, but during last week’s presentation, you were more cautious about announcing a proprietary IRA, saying, “Stay tuned.” Do understand correctly that when you’re partnering with an investment firm like Charles Schwab, a participant’s money would rollover to a Schwab IRA, but if you’re partnering with a firm that has no IRA capability of its own, you might offer your own rollover IRA?

**GuidedChoice:** The markets are evolving at an exciting pace, and we are working with our clients and prospects to deliver a variety of integrated solutions. Because of the proprietary nature of the work being done, we’re not currently at liberty to discuss the details of some of our future plans. We are working on integrated solutions with partners designing rollover IRAs, annuity products, guaranteed income mutual funds and low cost ETF solutions. This should prove to be an active year in product launches, so we will keep you abreast as we move along.

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