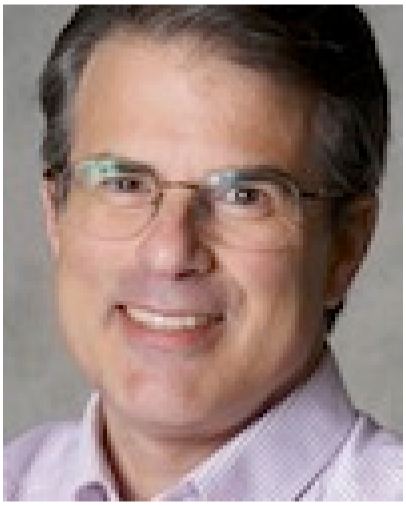
Why Is Income Planning So Hard?

By Kerry Pechter *Tue, Jun 30, 2020*

Everyone says retirement income planning is harder than 'accumulation' planning--for advisers as well as their clients. If so, what makes it that way?



Bill Sharpe, who won a Nobel Prize for co-creating the capital asset pricing model, called retirement income planning the hardest financial problem he has ever tackled. It's clearly different from other types of financial puzzles.

On a personal level, the pre-retirement "accumulation stage" might actually be more stressful. Financially, it involves earning, saving and investing; borrowing and re-paying; buying all kinds of insurance. Plus parenting. That entails a lot of stress. People are least happy at mid-life, **research** shows.

Then comes retirement. It's not all that bad. Medicare and Social Security benefits begin. Mortgages, loans, and credit card debt have melted away, ideally. Paydays end but deferred income or pensions may begin. Many people dread retirement until they dive in. When they do, the water feels surprisingly good.

So what makes retirement *income planning* so difficult—for adviser and client? Well, it's different from the accumulation stage. The risks are different, for one thing. Longevity risk (living too long) replaces mortality risk (dying too soon). "Sequence risk" (selling depressed assets for income) looms larger than market risk (volatility). Those "deferred" income taxes start to come due. Risk *capacity* supersedes risk *tolerance* or risk *appetite*.

For many people, these changes demand a new approach to money management. Your clients probably won't know that the rules of the game have changed. They'll rely on you to guide them through an unfamiliar financial landscape. To maximize your value to them, you may need to make a few mental adjustments yourself. For instance, creating plans that involve investments and insurance can be challenging if you're not used to it.

Blending investments and insurance

At *RIJ*, we believe that a combination of the two can create financial synergies for the client. But most advisers, by personal and professional history, are grounded in either the investment or the insurance world. Investment specialists may find it awkward to “frame” the role of insurance products in their own minds, and when communicating their pros and cons to a client.

The awkwardness is understandable. For retirees, insurance (annuities, life insurance, Medigap or Medicare Advantage policies, long-term care insurance, reverse mortgages) can be looked at as expensive investments, as sunk costs, as income-generating assets, or as tax-deferral or tax-reduction vehicles. The role of deferred annuities with “income riders” can be especially difficult to frame or position in the portfolio, because they contain several of those elements.

There’s a fundamental difference between investments and insurance. When people invest, they buy risk in the form of securities. They also buy asset management services. When they insure, they do the opposite. They sell (or transfer) risk to an insurance company by signing contracts. That is, they buy risk protection or risk management services. When annuities serve as both investments and insurance, their value can be hard to value or communicate.

One important benefit of insurance products often goes unarticulated, I think. Insurance creates opportunities. To transfer one risk, like market risk or longevity risk, to an insurance company is to create “risk budget” for a different kind of investment or expenditure.

Insurance lets people do things that would otherwise be too financially risky. Like spending money today instead of hoarding it for an uncertain or even unlikely calamity in the future. Identifying or measuring those things won’t be easy. Every client’s opportunity will be unique. Only the client can name it. But helping retirees name their own opportunities might produce the most satisfying moments you have with them.

Topics for the future

There are other challenges to retirement income planning. You’re probably familiar with them. There are, of course, the obvious uncertainties related to health and length of life. Then there is the sheer multiplicity of methods for generating income from existing assets. Not least, income planning often involves difficult trade-offs or sacrifices. Spouses may not agree on how to resolve them. Hesitation over an unpalatable trade-off can stall the execution of a plan forever.

Your business model may also present a significant challenge, if not an obstacle. If you earn fees only by charging a percentage of assets-under-management, how can you obtain compensation for providing advice on insurance or home equity? Advisers who are multi-licensed might not have difficulty handling this challenge, but others will.

There’s also the challenge of broaching personal topics with clients. Mortality is an unavoidable presence at the table. Any discussion of annuities, especially for couples, will involve mortality. Many clients will avoid talking about death. Retirement income planning encompasses almost everything that happens within a household. Not all clients or advisers will be equally eager or capable of “going there.” But we believe that the satisfactions make the effort worthwhile.