Nationwide®

Nationwide Retirement Institute® | Total Retirement Income Planning

Navigating critical decisions in developing a retirement income plan

By Steve Vernon, FSA, President, Rest-of-Life Communications

Key highlights:

Guide retiring clients with strategies to help their savings last a lifetime. This paper reviews tips to help:

- Better align any unrealistic spending goals to the actual income plan
- Leverage diverse sources of income to fund essential and discretionary expenses
- Ensure that income lasts a lifetime, as many are experiencing greater longevity

Executive summary: Pre-retirees and retirees need and want help with their retirement planning.

Today's pre-retirees and recent retirees face a series of critical decisions that will impact their financial security for the rest of their lives. One of these decisions is building a diversified portfolio of reliable, lifetime retirement income that meets their essential and discretionary living expenses. This decision is the foundation of financial security for most retirees.

However, the reality is that most pre-retirees and retirees do not have the expertise or experience to develop such a portfolio on their own. A recent survey of 2,000 pre-retirees and retirees shows that more than half would like help with determining when to start taking Social Security benefits, deploying savings to generate retirement income and developing an investment strategy in retirement.[1]

Complicating the situation is that there is a significant disconnect between expectations and reality for most current pre-retirees. They typically express a desire to retire before age 65 while maintaining their current standard of living. However, most of today's pre-retirees have not saved enough to do so.[2] They face potentially difficult choices:

- Delay their retirement
- Reduce their spending
- Some combination of the two

[1] "Disconnected: Reality vs. Perception in Retirement Planning," Martha Deevy and Steve Vernon, FSA, longevity.stanford.edu/wp-content/uploads/2022/09/Planning-Ahead-1.pdf (October 2022).

[2] "Seeing Our Way to Financial Security in the Age of Increased Longevity," longevity.stanford.edu/wp-content/uploads/2018/10/Sightlines-Financial-Security-Special-Report-2018.pdf (October 2018).

Some pre-retirees and retirees might have accumulated retirement savings that are inadequate to meet their spending needs. In this case, they might consider redirecting nontraditional retirement assets that have previously served other financial goals in order to boost the savings that are applied to the strategies described in this paper. One example is tapping the cash value of an existing life insurance policy.

This situation presents both a challenge and an opportunity for financial professionals to guide their clients through these tough decisions. To best serve their clients, financial professionals can combine empathy with guidance to help clients build a retirement income portfolio that meets their goals, needs and circumstances. This will help pre-retirees and retirees feel more confident about their financial security and help them enjoy their retirement years.

The shift from accumulating assets *for* retirement to deploying financial resources *in* retirement involves strategies to convert retirement savings and other resources into reliable retirement income and estimating how much income clients can realistically expect.

Most retirees overestimate the value of their retirement savings and the amount of retirement income their savings might generate. They also tend to underestimate how long they could live in retirement and the critical need to develop sources of *lifetime* retirement income.

This paper gives an overview of typical goals that clients may have for retirement, the key decisions they face and a 10-step guide to building a portfolio of retirement income.

Typical client goals and circumstances

Many pre-retirees and retirees have unrealistic expectations regarding their retirement income and they "want it all" — namely, to maintain their current standard of living, protect against inflation and stock market volatility, and preserve flexibility to keep their options open. This is the moment for the financial professional to coax more realistic thinking from the client, including:

- Unpacking their vision for retirement
- Determining the level of income they'll probably need to bring that vision to life
- Determining whether they want to leave a financial legacy

Considerations for constructing a retirement income portfolio

Research underscores the advantages of a diversified portfolio of retirement income consisting of optimized Social Security benefits, pensions, protected lifetime income and systematic withdrawal strategies.[3, 4, 5]

Clients who want more protected income than what is provided by Social Security benefits and pensions can repurpose assets to products that offer it, such as in-plan guarantees, annuities or cash-value life insurance.

It's important to gain alignment with a client about the purpose of an investment. If a client has goals for both a reliable stream of protected income to cover their most essential expenses as well as legacy planning goals for family members or charities, those two goals may require separate investments: one bucket for income and (only after those needs are solved) another bucket to support the client's goals for after they're gone.

---

[3] "Viability of the Spend Safely in Retirement Strategy," Wade Pfau, Ph.D., Joe Tomlinson, FSA, and Steve Vernon, FSA, longevity.stanford.edu/viability-of-the-spend-safely-in-retirement-strategy (May 2019).

[4] "Optimizing Retirement Income by Integrating Retirement Plans, IRAs, and Home Equity: A Framework for Evaluating Retirement Income Decisions," Wade Pfau, Ph.D., Joe Tomlinson, FSA, and Steve Vernon, FSA, longevity.stanford.edu/wp-content/uploads/ 2017/11/Optimizing-Retirement-Income-Solutions-November-2017-SCL-Version.pdf (November 2017).

[5] "Optimizing Retirement Income Solutions in Defined Contribution Retirement Plans," Wade Pfau, Ph.D., Joe Tomlinson, FSA, and Steve Vernon, FSA, longevity.stanford.edu/wp-content/ uploads/2016/07/VIeYvm-Optimizing_SCL_for_web_final.pdf (May 2016).

How much income do clients need in retirement?

The first step is to estimate the clients' monthly living expenses in retirement. They should distinguish between their essential living expenses — those must-haves, such as food, housing, health care, transportation and taxes — and their discretionary expenses or want-to-haves.

Next, determine whether your client wants to dedicate some funds specifically for travel while they are physically able to be more active (the "go-go" years).

Clients should also identify expenses that may increase significantly in retirement, such as medical premiums and related out-of-pocket expenses, and expenses that might decrease significantly, such as expenses relating to child rearing, college expenses, and housing (if the client has paid off the mortgage to their home).

Nationwide® tools can help.

Health care and long-term care costs can escalate significantly during retirement. Clients should learn how these costs could vary based on their personal health and where they're likely to retire. The Nationwide Retirement Institute® offers one of the leading actuarial-based assessments that can help facilitate your discussions.

Key decisions that need time and attention

To build a portfolio of lifetime retirement income, financial professionals and their clients should consider and analyze the following decisions:

Timing

When to retire and whether to work part time for a while

Coverage

How to bridge the gap between retirement and claiming Social Security benefits

Benefits

How to optimize Social Security benefits, which can be complex for two-earner married couples

Income

Using savings to generate retirement income, allocating between sources of protected retirement income* and variable sources that invest for growth, coupled with a withdrawal strategy

Allocation

For variable retirement income sources, decide:

- How to allocate assets between equities, real estate investment trusts (REITs) and fixed income investments
- The method to calculate regular withdrawals

*To determine the amount of protected retirement income that makes a client feel comfortable, you may want to ask which of these goals appeals most:

- Cover all essential living expenses with protected retirement income
- Develop enough protected retirement income to prevent panicking during market downturns

Prepare for spending shocks.

Remember that essential expenses could include occasional large expenses such a new roof or furnace, a major medical event or the need for a new car. Anticipating these spending shocks is important.

A personalized combination of these strategies can help:

- Build a recurring level of surplus retirement income compared with retirement expenses
- Purchase insurance to cover risks that could be challenging to cover from regular monthly income sources, such as long-term care
- Maintain a level of liquid savings for an emergency fund that can be accessed quickly

The appropriate amount for an emergency fund for retirees will typically be different from the conventional advice to workers (setting aside 3 to 6 months of salary), because retirees usually won't have their retirement income suspended due to disability or job loss. Determining an appropriate emergency fund is part of the planning process.

True liquidity vs. technical liquidity

Truly liquid assets aren't being used to generate regular retirement income, and using these assets to meet an emergency won't reduce retirement income.

Technically liquid assets are currently being used to generate regular retirement income, and using these assets for an emergency will reduce regular retirement income.

Client decisions affect income replacement rates.

By making informed decisions about when and how to retire and how to allocate their retirement income portfolio, pre-retirees can significantly influence the total amount of replacement income they will generate.

The article titled "The Power of Informed Decisions" illustrates the impact of these decisions for a representative married couple. The case study assumes both spouses are currently age 60 with $1 million in retirement savings. They devote 30% of their savings at retirement to a protected lifetime income product, and they invest the remainder of their savings with a systematic withdrawal method.

Here are a few results from this example:

- The baseline case assumes that if they both retire at **age 62**, they will replace about **43%** of their pre-retirement pay, well below the 70% to 85% replacement targets commonly advocated by financial planners
- If they both retire at **age 65**, they increase their replacement ratio to **57%**
- If they both retire at **age 70**, they further increase their replacement ratio to **82%**, finally attaining retirement income targets commonly advocated by financial planners

The article contains many more results and insights from this example. The types of analyses shown in this case study can help clients prioritize goals that clients may have.

Read "The Power of Informed Decisions"
www.nationwide.com/financial-professionals/topics/retirement-savings-income/total-retirement-income-planning/pages/informed-decisions.html as a companion piece to this white paper.

A disciplined process can guide clients through retirement income decisions.

Financial professionals can start by encouraging their clients to use a life expectancy calculator, such as livingto100.com, to estimate how long they might live in retirement. This can be an eye-opening and motivating process, because many people underestimate how long they might live in retirement. It's important to tailor the life expectancy calculation to a client's circumstances. For example, recent longevity research shows that people with above-average income or above-average educational attainment often live longer than the population at large.

It's also important for clients to inventory all financial assets. Examples include:

Tax-deferred

- Pension
- Retirement savings; e.g., 401(k), 403(b), 457(b)
- Traditional IRA

Taxable

- Investments
- Cash accounts
- Taxable portion of Social Security benefits
- Equity in a primary or secondary residence

Tax-exempt

- Roth accounts*
- Life insurance cash value
- Health savings accounts (HSAs)**
- Nontaxable portion of Social Security benefits

* Subject to age restriction and Roth distribution rules.

** To be tax-exempt, an HSA withdrawal must be used for qualified medical expenses. Most (but not all) states recognize HSA withdrawals as tax exempt. Please consult a tax advisor.

This information is general in nature and is not intended to be tax, legal, accounting or other professional advice. The information provided is based on current laws, which are subject to change at any time, and has not been endorsed by any government agency.

Clients should consult an attorney or tax advisor for answers to their specific tax questions.

Your 10-step guide to building a retirement income portfolio

The following step-by-step guide can help financial professionals and their clients integrate the various decisions and goals described in this white paper.

☐ **Step 1:** The client begins the process by selecting a target retirement age and deciding whether they will work part time for a period.

☐ **Step 2:** Help them decide how much money to set aside from retirement savings for an emergency fund.

☐ **Step 3:** Determine whether they want to explore using a "travel fun bucket" (a temporary allowance in the early years of retirement, while they are still vital and healthy).

☐ **Step 4:** Estimate the funds remaining at the target retirement age after considering Steps 2 and 3; these funds can be deployed to generate lifetime retirement income.

☐ **Step 5:** Use Nationwide resources to complete a personalized review of various Social Security claiming ages and develop a filing strategy to optimize benefits.

☐ **Step 6:** Bridge the gap between the target retirement age and optimal age for claiming Social Security. Possibilities include:

- Using a portion of savings to replace Social Security benefits that are being delayed
- Working part time

☐ **Step 7:** Estimate the amount of protected lifetime income (from a pension or similar reliable source) that the client might receive at their target retirement age.

☐ **Step 8:** Help the client decide how much additional protected income (beyond Social Security and pensions) would make them feel confident, then help them close the gap with a protected lifetime-income product.

☐ **Step 9:** Invest remaining savings to reach the client's target goal for total retirement income. Decisions include:

- Asset allocation: With protected income in place, it might justify a significant allocation to stocks
- Calculate systematic withdrawals from invested assets: One option is to consider using the IRS required minimum distribution (RMD) methodology as a starting point
- Clients who want to leave a legacy may choose conservative withdrawals; examples could include withdrawing only investment income or withdrawing just 2% to 3% of assets each year

☐ **Step 10:** Review the target retirement age from Step 1. Does the sum of estimated Social Security, pensions, other sources of guaranteed income and systematic withdrawals cover expected essential and target living expenses plus a margin for spending shocks?

- If yes, your client might have a viable retirement income plan
- If no, your client can explore:
  - Ways to reduce living expenses, starting with housing and transportation
  - Alternative strategies to boost levels of guaranteed lifetime income from investments
  - Repurposing home equity, life insurance cash value or other assets
- If the client's total retirement income still falls short, they may need to revisit their target retirement age and whether to work part time for a while, and then go back to Step 2

Clients may need to repeat these steps a few times to balance competing goals and develop enough retirement income to cover their expected living expenses in retirement.

Financial professionals can help clients stay motivated and on track.

The steps described in this article can be hard work. It's understandable that some clients may not want to spend the time it takes to collect the data needed and engage with their financial professional to develop solutions. In such cases, financial professionals can add value by helping to inspire and motivate their clients to do the necessary hard work to help secure their retirement.

One technique to motivate clients is to ask them to envision their hopes for retirement (and express their fears and concerns). Articulating their goals can help motivate clients to spend time working to reach their goals. As the financial professional gets a view of the client's wishes, they will help them build a retirement income portfolio to support those wishes, and develop risk management strategies to protect against their fears and concerns.

The hard work is worth it!

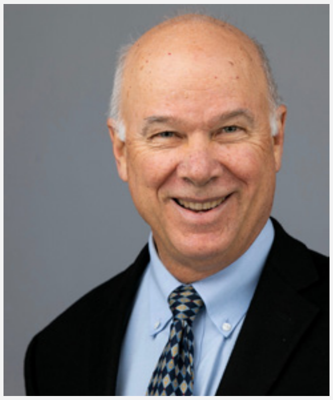
There can be other important retirement planning goals that are beyond the scope of this paper, such as developing a strategy to address the risk of long-term care, planning for a special-needs relative and estate planning. Addressing these goals should be coordinated with developing a client's portfolio of retirement income.

The steps described in this paper represent an idealized way to help develop streams of retirement income that can last a lifetime, no matter how long the retiree lives, and help protect against market disruptions and inflation. These approaches can help add confidence and dignity to a life well lived.

However, not all the steps described here may be necessary or appropriate in all cases; individuals should use their judgment on how to best work with each other. Financial professionals can provide invaluable help to clients with the critical decisions described here and act as an advocate on their behalf. In the process, they will build trust with their clients and will help meet the needs of their clients' extended families.

Help clients build a more personalized and protected retirement income plan with help from the Nationwide Retirement Institute. Visit Nationwide.com/TotalRetirement to get started.

About the author



Steve Vernon, FSA, is an independent actuary, researcher, writer and retirement educator. He bases his insights and strategies on research regarding both the economic and behavioral economics aspects of retirement decision-making.

He consulted for the Stanford Center on Longevity from 2013 through 2022, where he published 19 reports, papers and articles on retirement income strategies and retirement decision-making. Previously, he worked for more than 30 years as a consulting actuary, helping FORTUNE 1000 companies design, manage and communicate their retirement programs.

Steve has published 7 books on retirement planning, and he has published more than 1,000 columns on retirement strategies for CBS MoneyWatch and Forbes.com over a 13-year period.

He is president of Rest-of-Life Communications™, where he delivers in-person and virtual retirement planning webinars for pre-retirees and retirees and publishes his books and columns.

For more information, go to restoflife.com or email steve.vernon@restoflife.com.

Nationwide®