Reaching the Summit and Returning Safely in Retirement

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Abstract: *The purpose of this paper is to address specific strategies and supporting tactics for successfully navigating the spending phase of retirement by making sure that a client's income lasts as long as the individual does. The period of time just prior to the client making the decision to retire and moving from saving for retirement to drawing down the nest egg is the time to examine the sources of retirement income and expected expenses. A case study illustrates a process for developing and implementing a retirement income plan that includes detailed and custom distribution strategies designed to provide lifetime income and reduce the risks.*

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Introduction

As the first baby boomers turn 65 in 2011, perhaps the most important question for many is: "Which will last longer, me or my money?" On the heels of one of the most volatile decades of equity performance in history, the significance and uncertainty surrounding this essential question have grown immensely.

While financial industry professionals and academic researchers alike have spent years studying the most effective investment and retirement planning strategies, their energies have focused primarily on accumulating a nest egg, while far less thought and research have been given to the best strategies for distributing it. The purpose of this article is to address specific strategies and supporting tactics for successfully navigating the spending phase of retirement by helping a client form a plan for retirement income that will hopefully last at least as long as the individual does.

What Is the Ultimate Goal of Retirement Planning Anyway?

Accumulating savings is fundamentally important to successful retirement planning, and without focusing on key tactics for effective asset accumulation like diversification, minimizing fees and taxes, as well as other key investing principles, there would likely not even be a nest egg. If saving the appropriately sized nest egg is not the end goal of retirement planning, then what is?

The following illustration provides an answer. When a mountain climber sets out to climb a mountain, what is his/her goal? Most people would likely say "to reach the summit "or "to make it to the top." While this certainly is part of the goal, simply reaching the top of the moun-

tain alone is not the ultimate goal. The ultimate goal of a climber is to reach the top…and come back down safely. Considering that most climbing accidents historically 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 (i.e. risks) may change during the climb back down—and plan accordingly—contribute to the statistics of all those climbers who never complete their journey.

Many people spend their whole lives working and planning diligently so that they can save a large sum of money for retirement. Few people give the same amount of attention to planning how their money is going to provide income for the rest of their lives. Making sure the nest egg will provide income throughout retirement is the part of the journey that is often overlooked.

TABLE 1

Risks to Retirement Income

RISK	CONCERN	IMPACT ON RETIREMENT INCOME
MARKET	The risk of losing all or a significant portion of my money invested in the market. Specifically, the risk that the order or sequence of investment returns in retirement will negatively impact my portfolio and its sustainability (e.g., retiring just before a major market crisis).	Equities are typically needed to reach certain retirement objectives and to help keep pace with inflation. However, market risk, if not addressed, can cause volatility in portfolio values and may result in depletion of the entire portfolio. Once we retire and begin withdrawing income from our investments, average returns no longer matter. What matters in retirement is the sequence of returns. For example, experiencing negative returns early in retirement may cause premature depletion of the entire portfolio. Retirees need to avoid being in the position of having to sell assets to facilitate an income withdrawal during down markets.
LONGEVITY	The risk of outliving the assets I have set aside for retirement.	Advances in medicine, technology, and health awareness have increased the chances by more than 50% that you and/or your spouse will live beyond the standard "life expectancy." To successfully manage longevity risk, your retirement plan should include a component that provides for lifetime income, not just income for life expectancy.
INFLATION	The risk that costs of goods and services will increase over time.	Inflation has superseded health care risk as the top concern of retirees, with the majority expressing concern that the value of their savings and investments might not keep pace with inflation.[a]
LIQUIDITY	The risk that my current portfolio will provide me with limited or no flexibility when unexpected needs arise.	Since change is the one constant we can count on, even the most well-thought-out retirement plans must possess flexibility through liquidity.
HEALTH	The risk of being forced to deplete a significant portion of my assets to pay for long term care.	Two-thirds of retirees age 65 and older will need some form of long-term care in their lifetimes.[b] About 75% of single people and 50% of all couples spend all of their savings within one year of entering a nursing home.[c] Leaving such a risk unaddressed can have a devastating impact on a spouse and family, both financially and emotionally.
LEGACY	The risk of not being able to leave a financial legacy to the people or organizations I care about most.	By prioritizing a legacy as one of our financial goals, we can balance funding for retirement income with provisions for those we care about most.

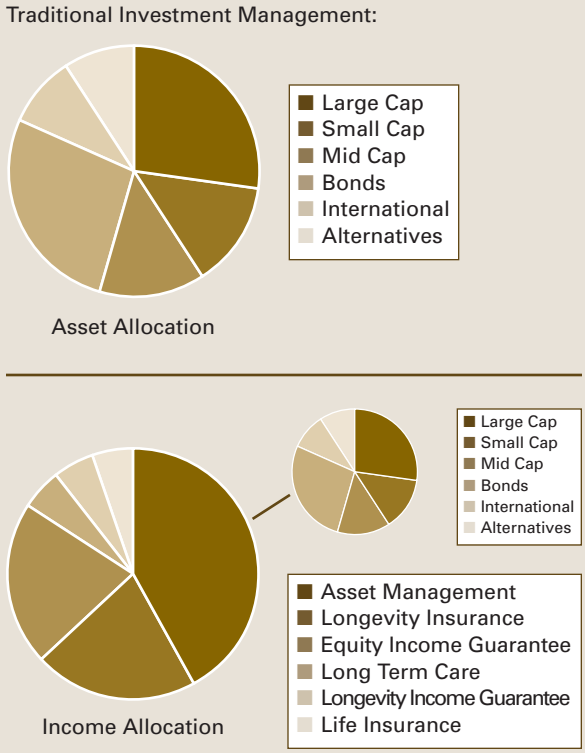
[a] M.G. Associates, "2009 Risk and Process of Retirement Survey Report and Findings," *Society of Actuaries* (2009).
[b] AARP, *AARP Public Policy Institute Fact Sheet* (2007).
[c] 2009 Kaiser Commission on Medicaid and the Uninsured, www.kff.org/kcmu.

Financial planners have historically taken two approaches to addressing the risks confronting retirement income: (1) changing the asset allocation of the portfolio as the client nears retirement, and (2) using an initial level of withdrawals once the client is retired and then modifying it for inflation. This withdrawal rate concept is based on a 1994 study[1] that initially recommends that the highest sustainable withdrawal rate is 4% if the portfolio is to last 30 years and that clients should reduce their withdrawals if the returns are less than expected.

Cooley, Hubbard, and Walz[2] provide an excellent review of the extensive literature on withdrawal rates and sustainability. They discuss changes in the withdrawal rate based on alterations of the portfolio asset allocations and Monte Carlo simulations with various time period returns. Bernard[3] tests for the depletion risk of a portfolio when it is used for retirement income and examines five aspects of the withdrawal concept that include: (1) initial amount of the withdrawal rate, (2) inflation adjustment to the withdrawal rate in subsequent years, (3) allocation of the portfolio for bonds and stocks, (4) assumed time period spent in retirement, and (5) fees incurred to manage the portfolio. Results indicate that the traditional withdrawal of retirement income from the portfolio has unacceptable depletion risk and legacy risk; therefore, he suggests four possible solutions. These studies offer evidence that a retirement income that is based on an initial withdrawal rate adjusted in subsequent years for inflation has a significant chance of the individual lasting longer than his/her money.

FIGURE 1

**Sample Nest Egg Allocations:
Accumulation Phase versus Distribution Phase**



The risks clients face saving for retirement are different than the risks they face during retirement, and these risks will be discussed shortly. 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.

What is the ultimate purpose of retirement planning? To accumulate a nest egg that will produce enough income to satisfy a client's needs and wants throughout a lifetime. These retirement plans must be based on detailed conversations with clients to determine their goals and objectives as well as the willingness to make trade-offs as suggested by Harlow and Milevsky.[4]

The Great Transition

How does a financial planner build a successful retirement income distribution strategy? Many risks are not necessarily unique to the distribution phase but often become more intense and are magnified once the client enters this phase and begins living on his/her savings. Some of the risks fighting against a retiree's income streams are summarized in Table 1 (on previous page).

These risks can pose significant threats to the sustainability of a client's retirement income streams. It is during the transition from saving money for retirement to spending money throughout retirement that individuals may find themselves running out of money as their income streams are depleted by one or more of these retirement income risks. To protect against this happening, as the client shifts into retirement he/she needs to start reallocating savings from traditional asset allocations to income allocations. The nest egg needs to be diversified and allocated among a variety of complementary income solutions that are uniquely designed to work

together to provide specialized retirement benefits to suit a client's specific needs. Figure 1 shows the change in investment philosophy from the accumulation phase to the distribution phase.

The income allocation has traditional asset allocations for part of the savings but also provides solutions that are designed to eliminate or reduce key risks. What a retiree's actual income-focused portfolio looks like will largely depend on individual facts and circumstances that create various degrees of exposure to different retirement risks, as well as the retiree's specific attitude toward these risks. The shifting of assets from accumulation-focused holdings to income distribution-focused holdings as the client gets set to retire is what we refer to as "The Great Transition" (Figure 2).

Shifting from asset allocation (climbing up the mountain) to income allocation (coming back down the mountain) is nothing more than a "role change" for the nest egg. The goal for the client is to make sure that the assets are used or spent in the most efficient manner possible during retirement, given the purposes they are trying to accomplish.

The Risk Management Process

As clients get ready to retire, it is important for them to realize the magnitude of risk. Individuals must decide how they plan to address each of the income risks they will face during retirement. There are four ways to address risk: avoid, reduce, retain, or transfer (AART) as shown in Figure 3.

When it comes to managing retirement income risk, there are really only three risk management tactics available, because the option to "avoid" a risk such as poor health (incurring a long-term care event) does not really exist for a client. The remaining options are to retain the risks and either prepare for or deal with the consequences, reduce exposure as much as possible and hope that an out-of-the-ordinary event does not happen, or truly transfer the risk to a third party who can provide protection. When a client evaluates the feasibility of these three risk management options, it becomes clear that retaining 100% of income risk is not an attractive option. For example, if a client lives longer than expected and has no other strategy in place, the reality is that he/she is likely to run out of money. Such a scenario makes it unattractive for a client to want to retain all of this risk.

Reducing income risk as much as possible is certainly an option and should be part of the comprehensive plan. For example, a client can reduce health risk by attempting to maintain a healthy lifestyle, but that can only reduce the health risk to a certain level. Family history and unexpected events can trigger a long-term care event at any time. Attempting to reduce risks such as market and liquidity risk by taking savings out of equity investments and placing them in cash equivalents will

FIGURE 2

**The Great Transition:
Shifting from Asset Allocation to Income Allocation**

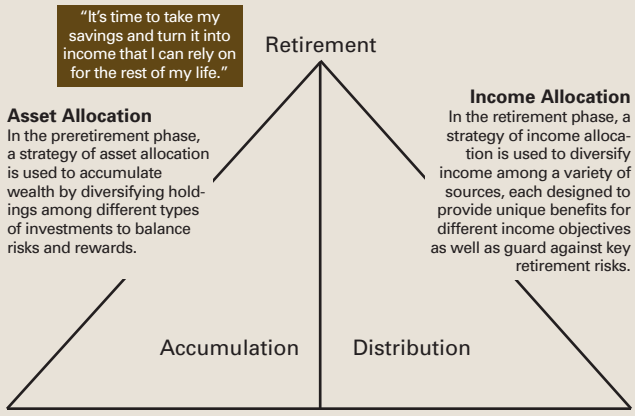
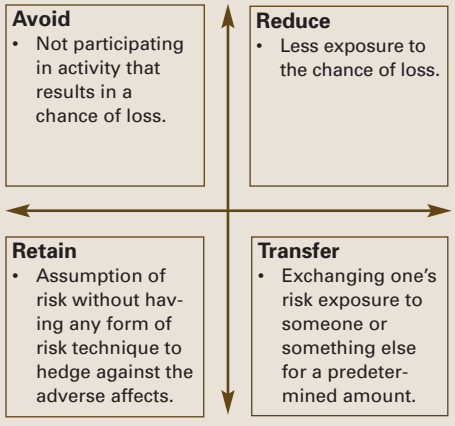


FIGURE 3

The "ARRT" of Managing Retirement Income Risk



likely reduce these two risks, but such a strategy can actually be harmful because the reduced equity exposure may mean that the portfolio is unable to keep pace with inflation or produce returns large enough to either provide income throughout retirement or leave a legacy.

The remaining risk management strategy is to transfer all or part of the various risks to a third-party financial institution that, due to the law of large numbers and the ability to pool capital, is able to offer specific, tactical risk management solutions to a client for an affordable price.

Several studies emphasize adding different insurance products that can sustain retirement income. Ameriks, Veres, and Warshawsky[5] recognize the concept of harmful effects of reducing equity exposure and suggest that adding an immediate annuity to the portfolio mix will increase sustainability. In contrast, Lemoine, Cordell, and Gustafson[6] try five different approaches to sustainable retirement withdrawals and find that the highest probability of success results from a portfolio with 100% equity combined with a fixed annuity. Milevsky[7] provides mathematical justification for suggesting that both fixed and variable annuities with guaranteed riders offer protection against longevity risk and market risk. Warshawsky[8] points out the advantages and disadvantages of different types of annuities designed for sustainable retirement income as a solution to the problem of a lump-sum distribution from a pension plan.

Ultimately, the decisions a client will make during the risk management process will largely depend on individual facts and circumstances and overall attitudes toward the various risks. During the distribution phase a risk-based income allocation portfolio will be based on the risk tolerances of the client, and these portfolios need to be custom built and designed around decisions the client makes to retain, reduce or transfer the various retirement income risks.

For example, Figure 4 shows the hypothetical portfolios retirees may use to allocate their savings across different income solutions in the distribution phase. The hypothetical portfolio to the far left of the spectrum ("UNADDRESSED") shows savings invested 100% in asset management. This is because while a pure asset management portfolio, regardless of what the equity/bond mix is, may offer some protections against risks to retirement income, there is no certainty that the portfolio will produce retirement income. This type of portfolio to the far left of the spectrum is often what a traditional retirement portfolio looks like in the market. The equity/bond mix may range from 0 to 100%, but the overall holdings are focused entirely in traditional asset management strategies built around asset allocations instead of income allocations designed to address key retirement income risks. Such a portfolio design would be the result of a client who, after performing the ARRT of managing retirement income risk, decides to retain the various risks to income.

To the far right of the spectrum ("ADDRESSED") is a sample portfolio that is designed as the result of a client who wants to transfer as much income risk as possible to third-party financial institutions. Through incorporating solutions such as longevity insurance, lifetime income guarantees, and asset-based long-term care coverage in addition to traditional asset management, targeted amounts of retirement income can be produced. The portfolio also targets an ending residual value that

FIGURE 4

Retirement's New Risk Spectrum: Risk-Based Income Allocations

KEY RETIREMENT RISKS	UNADDRESSED ←				→ ADDRESSED
LIQUIDITY	✓	✓	✓	✓	✓
LONGEVITY		✓	✓	✓	✓
MARKET		✓	✓	✓	✓
SEQUENCE OF RETURN		✓	✓	✓	✓
INFLATION			✓	✓	✓
HEALTH				✓	✓
LEGACY					✓

- Asset Management
- Equity Income Guarantees
- Longevity Insurance
- Long Term Care
- Inflation Protection
- Life Insurance

would be consistent with the client's overall legacy goals.

The three hypothetical portfolios in the middle of the spectrum represent hybrid solutions lying somewhere between the two portfolios just described. These hybrid portfolios are the types of income allocation that would transfer some income risk to a third party while still retaining a portion of the risk. For example, a client may not feel the need to address legacy or health risk and may decide to retain these risks.

Oftentimes it is not economically feasible for clients to address all of the risks of the income distribution phase. There is a trade-off between risk and return when transferring risk to a third party. Risk is reduced but it has a cost and therefore may reduce returns. If a client does not really consider a certain retirement income risk (such as legacy risk) a meaningful threat, then transferring this risk to a life insurance company that will provide a death benefit to the client's beneficiary is a low value strategy to the client.

The goal is for a client to decide, based on his/her personal circumstances and overall tolerance to the various risks, how much risk he/she is comfortable retaining. The financial planner builds a robust transfer strategy around the remaining risks that maximizes the client's personal risk-adjusted rate of return. None of the hypothetical portfolios shown on the spectrum in Figure 4 is better than the other; it simply is a matter of allocating retirement resources based on the client's risk profile in retirement.

In the case of a couple where individual goals, objectives, and risk tolerances may vary greatly, the financial planner must engage both parties to ensure the portfolio design and income allocation is appropriate. Customizing a retirement income allocation around these unique retirement attributes is both an art and a science, requiring a great deal of communication between the financial advisor and the client in order that all goals are adequately addressed and planned for in retirement.

Putting It All Together—A Case Study

The following case study is designed to illustrate how a client, after performing the ARRT of retirement income risk management, can build a distribution-focused income allocation model to meet the retirement goals and minimize the income risks throughout retirement.

Let's assume Jack and Jane Smith, who are both 64 years old and healthy, are getting ready to retire in one year and want to begin to allocate their assets according to an investment strategy that will produce income starting at age 65. They are risk averse and have already started to transfer their nest egg into a conservative investment allocation to alleviate volatility in their portfolio. Overall, they are apprehensive about their retirement outlook because they worry that an adverse market cycle could hinder their probability of having a successful retirement. Moreover, with advances in modern medicine and long life expectancy in their family, they are worried about outliving their retirement savings. Their goal in retirement is to be able to maintain their lifestyle without having excessive risk exposure. After completing the ARRT of retirement income risk management, they have decided to pay for and transfer as much market, longevity, and health risk as possible to a third party. The Smiths are looking to turn their nest egg into an investment allocation that falls toward the right half of the spectrum shown in Figure 4, indicating that they are looking to transfer much of their retirement income risks.

The Smiths have a $1 million nest egg to draw from in retirement. They will need a starting gross income of $50,000 dollars over and above their Social Security in order to maintain their current standard of living (5% of their total nest egg). Traditional thinking about retirement planning is that, as clients near the distribution phase, they should begin to shift savings into fixed-income vehicles to hedge against volatility and safeguard their retirement nest eggs. However, while shifting assets into more conservative investments may reduce their equity risk in retirement, it may actually create more risk in other areas such as the risk of running out of money.

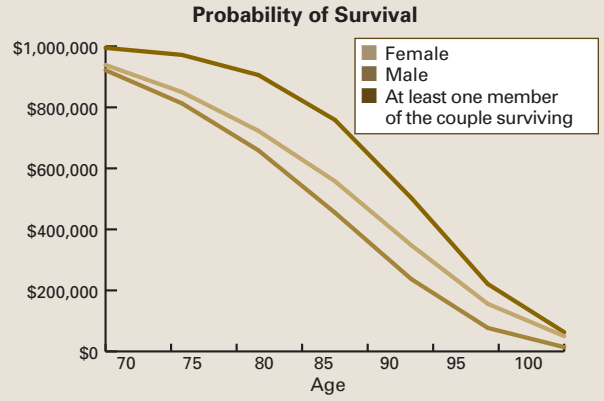
This concept is illustrated in a study done by T. Rowe Price[9] in which they calculate the probability of various investment portfolios to sustain stated income withdrawal amounts over a 30-year retirement period. In the study, five different types of investment portfolios are used with allocations ranging from 80%/20% to 20%/80% equity/fixed income. An assumed withdrawal rate is taken from each portfolio annually ranging from 3% to 8% (adjusted for inflation). If after the end of the 30-year period of taking inflation adjusted-annual withdrawals there is at least $1 left

in a portfolio, the study considers the portfolio to be a success and therefore a sustainable investment strategy. The results of this study indicate that the Smiths would have a 63% chance that their portfolio will produce a 5% inflation-adjusted annual withdrawal rate and leave them with at least $1 in their account at the end of the 30 years (assuming a 40/60 allocation). A 20/80 allocation has only a 49% probability of sustainability.

Given the Smiths' attitude to risk, they are not comfortable with a 63% chance that their $1 million nest egg will last for 30 years. If they reduce their equity exposure, the probability of success goes down. If they increase their equity exposure, the probability of success goes up, but only by a few percentage points, and the risk of principal loss increases greatly with a larger allocation to equities. If they try to increase their odds of success by planning for a retirement period shorter than 30 years, they discover an equally large problem. Since there is roughly a 50% chance that at least one spouse of a couple age 65 will be alive at age 92,[10] planning for a shorter than 30-year retirement period is unwise and may result in personal financial ruin (Figure 5). The Smiths realize that they are faced with a serious problem.

They decide to reduce and transfer most of their retirement risk while retaining a small proportion in order to have some flexibility for life's unknowns. The following are steps the Smiths could take to build a customized income allocation in order to manage the income risk they will face during retirement. (Note: For the purpose of this case study we will only deal with gross numbers before taxes to more easily convey the concepts.)

FIGURE 5



Source: RP2000 Mortality Table, IFID Centre calculations, from *Are You a Stock or a Bond?* by Moshe Milevsky (Upper Saddle River, NJ: FT Press, 2008).

The first step in building a custom retirement income-focused allocation for the Smiths is to lower the planned withdrawal rate from the traditional portfolio. If they make no changes to their traditional investment portfolio in retirement, the initial $50,000 they need in retirement will require a beginning annual withdrawal rate of 5% from their $1 million investment portfolio. If they reposition 25% ($250,000) of the investment portfolio into a lifetime income annuity, they can reduce the annual withdrawal rate needed from the investment portfolio. Based on the their ages, a $250,000 allocation to a lifetime income annuity produces an annual income stream of $16,388 (based on income annuity rates at the time of the case study) that is contractually guaranteed by the issuer to last for both their lifetimes. This means that they only need to withdraw $33,612 ($50,000 – $16,388) or 4.5% from the $750,000 allocated in the traditional portfolio.

By reducing the initial annual withdrawal rate from the traditional portfolio from 5% to 4.5%, it increases the probability of the portfolio's sustainability from 63% to nearly 80% based on the study done by T. Rowe Price & Associates[11] for a 40/60 portfolio over a 30-year time horizon. The income generated from the lifetime annuity provides protection against both market and longevity risk.

The second step is to address market volatility for the 75% of assets that remain in a traditional investment management portfolio. Ideally, the Smiths would like to create more certainty around the $33,612 lifetime income stream being generated from the traditional portfolio without annuitizing the assets as with the income annuity and, thereby, maintaining control over them. They would like these assets to have a chance to grow in the equity markets but want to ensure that they can at least produce enough annual income to cover the $33,612 gap that exists no matter how badly the equity markets perform.

This can be done by utilizing an equity income guarantee, which can be a variable annuity with a lifetime

income rider attached to it and offered by an insurance company. Unlike a traditional annuity, this variable annuity solution does not involve the "annuitization" of the client's invested dollars. The funds are invested tax deferred in underlying subaccounts such as mutual funds or exchange traded funds (ETFs) similarly found in traditional asset management portfolios. The value of the annuity is based on the performance of the underlying investments less costs and fees associated with the product. However, for a fee, a client can add a lifetime income rider onto an annuity that allows the client to withdraw a certain percentage of income from the annuity for the rest of his/her life no matter how long or regardless of what happens with the equity markets.

The annual lifetime withdrawal rate offered by these products varies but is generally between 4% and 7% depending on the age of the client when withdrawals are started. The withdrawal rate is calculated from a separate income base value that exists separate from the account value. Generally, the income base grows each year by the greater of the real account value (based on the underlying investments) or a stated guaranteed growth rate typically ranging from 5% to 8%. This means that during positive equity market cycles the income base grows with the account value of the annuity. During negative equity market cycles the income base grows by the minimum growth rate, regardless of the market performance of the income bucket (the base on which the withdrawal rate is calculated for purposes of taking annual income), and is guaranteed to grow.

Using a variable annuity with a living benefit rider allows the client to have the upside potential of investing in equities, with the opportunity for real account value growth, while offering downside protection for purposes of taking income. No matter what happens in the market, a phantom income bucket is guaranteed to grow each year from which a client is contractually guaranteed to withdraw income for his/her entire lifetime.

The variable annuity with living benefit rider offers a guaranteed income stream to manage market and longevity risk and does not require the clients to annuitize their assets. It allows them to be invested in the market (arguably providing more freedom to invest in equities because of the underlying lifetime income guarantees) without the same degree of market risk. A variable annuity with living benefit rider does cost more than a traditional asset management portfolio; on average, the increased cost is between 1% and 1.5% annually. However, the total weighted average cost of the entire retirement portfolio may only increase by a marginal amount. The key is to look at the portfolio holistically to see if a variable annuity with living benefit rider can add any value to the retirement income allocation.

In our sample case for the Smiths, we assume the following features about the variable annuity with a living benefit rider based on current availability from a highly rated insurance company at the time this sample case was developed.

- The annuity with the lifetime income rider costs roughly 2.3% per year (plus the cost of the underlying funds, which generally averages about a 1% expense ratio).
- The annuity with the lifetime income rider allows for up to an 80/20 equity-bond asset mix.
- The lifetime income rider applies a 6% annual deferral credit to the income base (the bucket from which the lifetime withdrawal percentage is calculated). If the market performs well and the real account value grows by greater than 6%, the income base will grow by actual market return.
- The withdrawal rate from the income base is also equal to 6%.

The Smiths decide to allocate 30% of their portfolio to this solution. They stay invested in equities with the 75% of the portfolio that was not allocated to the lifetime income annuity but reduce market and longevity risk because the $300,000 of assets allocated to the variable annuity with living benefit rider has contractual income guarantees built into the equity investments. This helps them protect a substantial income stream that makes up a large percentage of their income gap of $33,612 ($50,000–$16,388). Specifically, when they retire next year, they will be guaranteed to withdraw at least $19,080 each year from their annuity (the income base made up of the $300,000 invested today is guaranteed to grow by at least 6% regardless of equity performance), which equals $318,000 next year when they retire. At that time, the Smiths will be able to take lifetime income of 6% of the $318,000 or $19,080. If the markets

perform better than 6%, the guaranteed annual withdrawal amount can increase, but it can never decrease.

Of the $50,000 annual income needed, $16,388 is guaranteed by the lifetime income annuity and $19,080 is guaranteed by the variable annuity with living benefit rider. The difference of $14,532, which must be withdrawn from the remaining assets, is equal to only about a 3.2% withdrawal rate and, therefore, has almost a 99% probability of sustainability based on the T. Rowe Price study.[12] The lifetime income annuity, coupled with the variable annuity with living benefit rider, has brought the withdrawal sustainability of the Smiths' portfolio up from 63% to almost 99% while simultaneously helping them to hedge against market, longevity, and inflation risk and still granting them control over 75% of their assets to be invested in the market.

The third step in building the Smiths' retirement income allocation portfolio is to address their health risk in retirement. A long-term care (LTC) event could have a devastating impact on their retirement income and overall investment portfolio. The average LTC stay is over three years in length and an average nursing home can cost around $70,000 annually.[13] When evaluating various LTC protection strategies, clients have a variety of options to choose from, such as traditional LTC insurance, life insurance policies that offer accelerated death benefit riders, annuities that offer enhanced income withdrawal rates, or even newer, asset-based or hybrid LTC contracts that offer a combination of these features. There is no "right" answer or single "best" solution. It all depends on the client's needs, circumstances, and preferences.

With traditional LTC, insurance policyholders generally pay ongoing premiums for a period of time or throughout their entire lifetimes depending on the product design. If an LTC event occurs during their lifetime, coverage is provided. If an LTC event does not occur, the premiums are not returned. In addition, the premiums for traditional LTC insurance can be expensive, and the rates can increase during the life of the contract. Recently, a number of traditional LTC contracts with insurance companies have raised their premiums on existing policies by up to 40%.[14] So while traditional LTC coverage does make sense for retirees looking to maximize their protection, given the Smiths' financial situation and personal preferences, they decide not to purchase traditional LTC coverage.

Instead, the Smiths decide to allocate 5% ($50,000) of their portfolio to asset-based LTC. This particular solution has the following features:

1. Requires a single lump-sum deposit (no ongoing premiums required).
2. Offers 100% return of premium allowing policyholders to surrender the contract at any time and receive back what they invested (no "use it" or "lose it" feature).
3. Provides leverage of roughly 4–5 times the single deposit amount that can be used to pay for LTC expenses when they occur. In the Smiths' case, their $50,000 deposit creates a $237,156 LTC bucket that the Smiths can use to pay for home health care, assisted living, or nursing home expenses should an LTC event occur.
4. Provides a small death benefit if they do not incur an LTC event or have not yet withdrawn the funds and used them for other eligible expenses before their deaths.

The fourth and final step in building the Smiths' retirement portfolio is to compare the equity-bond mix of the entire portfolio after the reallocations take place to what the equity/bond mix was before the reallocations to "income focused" investments are made.

In the end, the Smiths are able to maintain a 40/60 equity-bond mix. They reduce their annual withdrawal percentage from nonguaranteed sources from 5% to 3.63%, thereby increasing the sustainability of the portfolio from 63% to over 90% as well as addressing market, inflation, longevity, and health care risk and maintaining liquidity. The overall results are shown in Table 2.

What do the Smiths accomplish with their custom retirement income allocation model?

1. Market, inflation, longevity, health care, and liquidity risks are reduced and some legacy benefits are provided.
2. The withdrawal percentage of the nonguaranteed investments is lowered to better insure that they have a more sustainable retirement allocation.
3. A significant portion of their core annual income need is contractually guaranteed to be there no mat-

ter how long they live or regardless of what market cycles they encounter.

4. Their portfolio maintains appropriate equity exposure to combat inflation while not having to face the income risks that such equity exposure typically creates.

The overall asset allocation of the portfolio remains the same as does the value.

Conclusions

By shifting assets from traditional investment-focused asset allocation and building a distribution-focused income allocation, the Smiths are able to reduce the risk associated with their retirement income streams. This strategy required no new assets but rather an efficient allocation of existing resources to meet the objectives of the retirement income phase of retirement planning. What is needed for successful and comprehensive retirement planning is not just well-thought-out accumulation strategies but detailed and custom distribution strategies designed to provide lifetime retirement income and reduce the risks associated with it.

Academics, industry professionals, and retirees should not just focus on "climbing up" the mountain of retirement planning but should develop a well-thought-out risk management strategy for "coming back down" the mountain. This article provides an overview for how financial planners, while navigating their clients' retirement planning mountain, can assure that they reach the summit and return safely. ■

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TABLE 2

Solution	Dollar Amount Invested	Equities	Fixed Income	Withdrawal Percentage	Income	Equity % of Portfolio	Fixed Income % of Portfolio
Variable annuity w/ living benefit rider	$300,000	80%	20%	6.00%	$19,080	24%	6%
Lifetime income annuity	$250,000	0%	100%	6.56%	$16,387.68	0%	25%
Asset management	$400,000	40%	60%	3.63%	$14,532.32	16%	24%
Hybrid LTC	$50,000	0%	100%	0.00%		0%	5%
Total	**$1,000,000**					**40%**	**60%**

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