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Baby Boomers and Retirement Planning

Baby Boomers, finished paying for their kids' college education, in their highest earning years, and with retirement looming, offer a distinctive opportunity. By **Howard W. Wolosky**

With the first of the Baby Boomers approaching retirement, planners will be advising a generation different from previous retirees. Many are very active, have substantial amounts socked away in qualified retirement plans, will live longer, and must cover more of their medical costs during retirement.

Their Starting Point

"The Baby Boomer generation is filled with service providers, including doctors, lawyers, financial professionals, and sales/marketing managers. Unlike past generations, they will not receive a company pension, and rely on their own savings for retirement. As a group, this generation has spent a lot of money on homes and luxury goods, and hasn't saved as much as they will need for retirement. They are a professionally successful group who understand the value of financial advice, but find it hard to save instead of spend," concludes David Borden, a principal with CCR (Carlin, Charron & Rosen) in its wealth management services practice area in Westborough, Mass.

Derrick Kinney, president of Palladium Consulting, in Arlington, Texas, which specializes in marketing for financial professionals, finds that Baby Boomers have different expectations. Kinney, author of Master the Media to Attract Your Ideal Clients: A Personal Marketing System for Financial Professionals, explains, "Boomers want the freedom to go, see, and do on their timetable. They tend to be more focused on return on life, than return on investment. Being successful with Boomers requires going beyond the numbers. You really need to help them create a picture of what their unique retirement experience is all about."

Jim Hardeman, director of product management for Financial Profiles, a financial planning advice software provider, sees Baby Boomers offering a substantial advantage in one sense. "They have a much clearer picture of what their assets, their income sources, and their expenses are at retirement, that lends to a greater degree of exactness or detail that can be plugged into the software to drive an analysis."

Sal Geraci, principal at Evergreen Management, an affiliate of the accounting firm of Henderson Hutcherson & McCullough, both in Chattanooga, Tenn., believes that as Baby Boomers approach retirement, they need re-education. "All their life they were in an accumulation stage adding to 401(k)s, IRAs, and Roths, and acquiring assets, and now they are entering a drawdown or distribution phase. That entails a whole different set of skills and philosophies," he explains.

Seismic Shift in the Advisor/Client Relationship

The dynamics and interaction between advisor and Baby Boomers may prove very interesting. Because much more active management is required, Jim Hardeman, director of product management for Financial Profiles, believes Baby Boomers, in retirement, will take on a more hands-on role, and, because they aren't reluctant to question authority, they will use the advisor more for validation. To meet this demand, he sees tools being developed for advisors and clients to communicate more and view information in a collaborative manner. From a technology standpoint, he predicts retirees will want to continuously have ready access to return information, including plan performance comparisons, rather than just getting quarterly statements.

With the end of the defined benefit era, Charlie Davidson, vice president of strategy and business development for Financial Profiles, reports there is much discussion over what investment strategy should be used by those entering retirement. "In the defined contribution arena, all bets are off, as you have the ability to do whatever you want, and that makes the situation far more complex. The consequences of being wrong are far more draconian. All risk is shifted to the individual," he concludes.

Hardeman points out that on retirement, rather than accumulating assets, there is a greater degree of asset management and income planning. According to him, that means advisors widely use tax-sensitive modeling software that play out different scenarios.

Thomas Drake, a financial advisor and a member of The Alliance of Cambridge Advisors in Wood River, Ill., also sees inherent differences when comparing Baby Boomers with older generations. "Baby Boomers have developed higher expectations. They have in general been more affluent, and have grown accustomed to having what they want. In contrast, previous generations seemed more frugal and cautious."

Ronald Schranz, a member of the accounting firm of Burt & Nagel in Albuquerque, N.M., sees a real diversity among Baby Boomers. "From those very well positioned for retirement, to a good number just starting to understand they are going to retire." Schranz believes it is important to get that second group to understand the reality of it, specifically that there is a finite time frame even if they don't think they will fully retire for some years. His idea is "to put a date out there, so we can do some projections to show them what that means for them. Although some Baby Boomers get off to a late start, once they start they can save significant amounts for retirement."

Schranz indicates that many Boomers have different pools of assets that they can use as resources for retirement, such as businesses, inherited wealth, home equity, art, and other collectibles. He points out, "Conversion of those assets into an efficient means for retirement is a very important process."

Living Longer

"It used to be that as an individual neared retirement he or she would be advised to move investments into fixed income classes," observes Schranz. Now, he says, although planners might advise changing the mix to reduce some exposure, you still want growth because individuals are going to live longer.

Although his firm doesn't do investment management, Schranz talks to clients and their investment advisor, if they have one, to get an idea if the investment categories make sense with regard to the client's situation, risk tolerance, diversification needs, etc.

Drake believes that clients must be told that their active lifestyles can result in a correspondingly greater drawdown of savings in the early years of retirement, impacting what will be available in later years. In fact, Drake encourages all middle-income clients "who desire to live active and relatively more costly lives in the early years of retirement to continue working, at least part-time, to defray some of those costs." Drake sees planners playing an important role, acting as the Baby Boomers' reality check.

Since many retirees are in good health, Schranz finds some will work part-time when they retire. He sees them doing so for the income as well as stimulation. The added income, he points out, often means money doesn't have to be drawn from other sources.

People aren't just living longer, but many want to retire early. Geraci points out those that do, catch it on both ends, "also picking up additional years on the front end." Kinney believes, because of longer life expectancies, it is a best practice to plan on clients living to be 100, and educating them on prudent income withdrawal strategies.

Because retirees will need more equity-weighted portfolios, Hardeman suggests, advisors may have to compare existing investments to a model portfolio to show clients they need to take more risks to get the desired return.

Ramifications of 401(k) and IRA Holdings

"The fact that most of the money spent in retirement will come directly from 401(k) plans and IRAs has greatly increased the importance of the Baby Boomers' financial planning and investment management team. Because their savings will need to last for such a long time, it is imperative that the assets are properly invested," observes Borden.

According to Geraci, some experts indicate that many 401(k) plan participants experience only an average rate of return of about four percent because they haven't been sufficiently educated on the importance of moving money between funds. With regard to retiring Baby Boomers, he sees this educational gap continuing, "because not only do you have to understand the principles of asset allocation and everything else, now volatility and predictability of return becomes paramount."

Geraci indicates that it almost always makes sense to take a lump-sum distribution from a 401(k) plan and roll it over into a self-directed IRA. "Most 401(k)s are still designed for accumulation, with the bulk of the choices centered around equity and volatility choices, not to safety and yield-oriented investments, which I think become more appropriate upon retirement," he explains. Besides the investment return, the method and rate of withdrawal is equally important. Drake says planners will need to become familiar with the rules for qualified savings plans to be sure their clients are in compliance. Kinney agrees, and cautions, "While most Boomers understand the concept of accumulating assets, current research shows a gap in their understanding about how to best withdraw assets from retirement accounts. Financial professionals will need to be well-versed on retirement distribution strategies, and learn to explain them in easy-to-understand language."

Borden also focuses on the importance of a careful drawdown from 401(k) plans and IRAs. "This money usually comes out as ordinary income upon distribution. Thus, it is necessary to have a game plan for systematically withdrawing this money to optimize each individual's specific tax situation."

Escalating Medical Care Costs

When considering early retirement, the determination might turn on whether there is a reliable source of health insurance before Medicare kicks in. "Without insurance, the medical costs might get to the point where they distort the whole economics of retiring early," Geraci concludes. Drake sees medical care costs as also taking more of a retiree's dollars. "Companies are decreasing their contributions to retirees' medical insurance coverage, and most don't make contributions for long-term care insurance." Because of the higher expenses, Drake predicts, "some things that were desired will have to be deferred, or perhaps the retiree will work part-time."

Borden predicts that for many, medical care coverage will be one of the largest financial obligations during retirement. "In the past, people assumed they would spend less during retirement then when they were working. While this still may hold true for some, the added expense of medical care coverage has closed the gap. If you talk about finances with Baby Boomers, you are almost certain to hear they have a concern about long-term care. There isn't a set answer on whether to purchase a long-term care policy. The planner must analyze specific needs, asset levels, and money available. If investing in long-term care insurance, the policy at a minimum should have an inflation adjustment rider and in-home care coverage."

Geraci cautions that some clients are overconfident that their pool of money will last if extended long-term care is needed. He explains that for a married individual with Alzheimer's disease, most of the time long-term care costs are additional, not substituted costs, and exhaust the pool of resources much faster and over a longer time than most people think. Kinney believes that understanding Medicare is a must. In fact, he recommends holding an event where a Medicare, Social Security, and long-term care expert speaks.

Numbers Are There

"Baby Boomers retiring represents one of the greatest opportunities for financial professionals in the history of this profession. Advisors who position themselves as retirement income specialists will attract more affluent clients and build more profitable businesses. Becoming an expert in retirement income, retirement plan distribution strategies, and healthcare and long-term care issues puts you in a powerful planning position for Baby Boomer investors," predicts Kinney.

The Really Big Picture

Because of the sheer number of Baby Boomers retiring, Ronald Schranz, a member of the accounting firm of Burt & Nagel in Albuquerque, N.M., advises also looking at retirement from a global perspective, asking:

* How will the Social Security system be affected when the wave hits and continues for a number of years?

* How will the healthcare system be impacted?

* What about investment markets as substantial assets are liquidated, as some worry this will have a suppressing effect on the market?

* Will real estate prices continue to be robust as many more people take out equity?

Sal Geraci, principal at Evergreen Management, an affiliate of the accounting firm of Henderson Hutcherson & McCullough, both in Chattanooga, Tenn., provides an example. He observes, in catering to aging Baby Boomers, much of the new housing is designed for primary living on one floor and this may result in a decline in the prices of older, multi-level homes.

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