Why Clients Fail At Retirement

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Financial advisors can spend decades working with clients to craft a retirement plan that, on the surface, appears bulletproof from the standpoint of investments, retirement income and asset-liability management only to see it fall apart in short order. The fact is it happens a lot more frequently than many advisors want to admit.

Reality is that advisors don't control financial markets, or clients' savings and spending habits, much less the interpersonal dynamics of individuals' lives. So all advisors can do is help make clients aware of the numerous pitfalls they face when their life faces the radical transformation to a post-work era.

Honest conversations about why clients fail in retirement aren't always comfortable. But it is one that Greg Sullivan, CEO of Sullivan, Bruyette, Speros & Blayney, has with prospects even before they become clients.

If an advisor asks a client or prospect why they think most mass affluent Americans fail in retirement, Sullivan finds they'll typically say it is investment performance. In 34 years as a financial advisor, he has seen many people flunk retirement, but investment performance has never been the cause.
So what are the reasons well-off clients lose financial independence after entering their golden years? Sullivan likes to tell them "it's the things you own or maintain responsibility for that are over 50 pounds that constantly need to be fed."

Cats and dogs of reasonable size are fine. It's the adult children and big animals that Sullivan cites as cash drains. His home state of Virginia is populated with horse farms. "Horses are worse than kids," Sullivan quips.

Divorce
The first topic Sullivan raises with prospects is divorce. That's not a pleasant thing to tell a couple in their 40s or 50s whom you've met once and hope will pay you fees for decades to come.

Sullivan does it in a way that lets the prospect know he isn't making any judgment about their marriage. "I just put it on the table," he says. "If it happens, it will disrupt your financial independence and change your lifestyle."

The reality is that divorce among Americans over 50 years old has been rising for several decades, doubling between 1990 and 2010. According to an article dubbed "The Gray Divorce Revolution" by Bowling Green University sociologists Susan Brown and I-Fen Lin, roughly one in four divorces in 2010 occurred among couples over 50.

One conclusion of their article was that one divorce tends to breed more divorces. Why? Because the rate of divorce is 2.5 times higher among remarried couples.

As life expectancies increase, the trend is likely to continue. The explanations vary. Children have grown up and are no longer around to mask
dysfunctional relationships. Baby boomers in search of meaning tell themselves there has to be more to life than this. Over time, many people simply change and grow apart.

Sullivan's clients typically have $3 million to $4 million in assets, placing them near the upper end of America's mass affluent. That's enough for a comfortable retirement in most people's book, but when the assets are split along 50/50 lines and living expenses are increased, it's no longer the cruise either spouse signed up for.

Like so many challenges that surface in retirement, divorce is often symptomatic of two people finding it difficult to make a major lifestyle transition together. “It can be his vision versus her vision,” says Mitch Anthony, author of *The New Retirementality* and a columnist for *Financial Advisor*.

Both couples and individuals need to find a balance between vocation and vacation, personal renewal and connecting with others. “Couples may agree on two of the four so they need to resolve the other two,” Anthony says.

Second Homes

For many affluent clients, a separate vacation home represents the fulfillment of the American dream. If it is close enough to their primary residence, it's a getaway place to go on weekends. If it's further away like Florida, it's a future retirement home and winter escape haven.

But in clients' eyes, it's almost always a good investment. They rarely consider the problems likely to arise.

Most popular places for second homes tend to be located in nice areas, often near water or mountains. From Florida to Maine, these properties are particularly vulnerable to hurricanes and other natural disasters. In California, one can add brush fires to the list. After inevitable disasters occur, the scramble for home insurance becomes an expensive obstacle course.

For a client still working and earning between $150,000 and $400,000, buying a second home after they have paid off the mortgage on their primary residence doesn't seem like that serious a stretch. Once upon a time, accountants would recommend it; now tax deductions on second homes no long exist.

Still, buying that dream vacation home is a situation many advisors typically confront when clients reach their peak earning years prior to retirement, notes Karen Salvatore, principal with Shine Investment Advisory Services in Lone Tree, Colo. "They don't understand the impact of maintaining two homes when they have smaller cash flows [in retirement]," she says.

Once a client retires and their income drops to the $70,000 to $120,000 area, upkeep and maintenance on two homes—even if a mortgage on the first home is paid off—can quickly assume an outsized position in their spending. "In many cases, an all-cash [purchase of a second home] could be ideal, but that takes a great deal of capital relative to their resources and may not be an option," Salvatore says.

And when a downturn in the real estate market occurs, second homes in vacation areas typically become even more illiquid than other real estate markets. "Renting can become a necessity," Salvatore notes.

According to Sullivan, the problems can become magnified for more affluent clients who earn annual incomes in the high six-figures—for several reasons. First, they are likely to buy more expensive second homes. Moreover, while they are working and making $900,000 a year, they are far less likely to scrutinize their spending, so when the paycheck stops the falloff in income can be much more dramatic.

Adult Children With No Shame

Many advisors say this problem dwarfs all others. Some children never grow up to become independent, even when they are far into adulthood. Jonathan Pond, who runs an eponymous RIA firm in Watertown, Mass., has often considered penning a generic letter entitled “Have You No Shame?” to send to certain clients’ offspring.

More than a few of his clients are “getting sucked dry by children who couldn’t care less,” Pond says. “I’ve been seeing it for 40 years.”

Pond is not talking about a grandparent who picks up her grandchildren’s tuition for a semester or two when the child loses a job. The problem, as he sees it, is that there can be a very thin line at first when “something to help a son or daughter through a rough patch” eventually “becomes an annuity.”

Part of the problem can be traced to the fact that the child probably was overindulged from the start. Pond says he has told clients to tell their children “to go on welfare” or the parents will end up in public housing.

One example Pond cites is that of a retired client whose assets were down to $1.5 million even though they were spending a modest $60,000 annually right in line with the 4% rule. He finally told the father to ask his son, a 60-year-old with a doctorate, to prepare an annual budget of what he needed. When the aging Ph.D. finished his assignment, his own budget came to $110,000 a year, almost double Dad’s.

Compounding the issue is the fact that parents can often be embarrassed about unsuccessful offspring and refuse to address the problem. Spending dynamics, especially with children, is an “emotional minefield,” says Mark Balasa, partner with Balasa Dinverno & Foltz in Itasca, Ill.

When the client doesn’t have the money, it should be the “end of the discussion,” Balasa argues. If the client does have the money, then it becomes “all about choices.”

Intra-family issues frequently surface after a family patriarch, often an alpha male and a control freak, dies, and “dear sweet Mom” is left to manage family financial affairs with which she has little familiarity, according to Dan Moisand, a principal with Moisand Fitzgerald Tamayo in Melbourne, Fla.

It’s commonplace for children to think, “Mom has more money than she’ll ever need,” when that may or may not be the case, Moisand says. If one sibling wants to start a business and make an investment, she is probably the first place he will turn.

In some cases, the grown up child’s action rises to the level of outright malice. Moisand says he has seen too many cases of adult children convincing a frail parent to take money out of an account on their behalf, and, if the parent is cognitively impaired, she may forget about it.

Starting A Business

Retaining some form of meaningful engagement and having a sense of purpose is critical to enjoying retirement. Many high-powered former business executives and professionals still need some semblance of a structure in their lives.

“Men, in particular, can go stir-crazy,” says Mitch Anthony. Earlier this year, Anthony found himself talking with a 75-year-old ex-CEO who had been retired less than a year and was re-entering the job market for reasons of mental health.

But today’s Darwinian labor market isn’t inclined to roll out the red carpet for folks in their mid 70s. That helps explain why both entrepreneurs and retired executives with substantial means who always had an entrepreneurial itch find the temptation to start a business irresistible.

If a client can get a new company up and running without a substantial capital commitment, most advisors will applaud them. But according to Salvatore, finding consulting work or engaging in some type of service work that doesn’t force them to dip into their capital is usually preferable.

Balasa recalls that in 2009 a number of clients viewed the devastated real estate market as an obvious opportunity to make a killing. Real estate requires capital and expertise. Many giant investors with deep pockets, invaluable connections and access to capital like Blackstone had the exact same idea and numerous advantages.

The post-recession experience of Balasa’s clients as real estate investors varied. Some lost serious amounts of money, while others treaded water or eked out marginal gains. But none earned what they would have if the funds had remained in their portfolios.

Health Care
Perhaps the biggest wild card is health care. Clients can look to their parents and analyze their genes to get an indication of problems they may face.

On this front, there is actually a lot of positive news. Breakthroughs in biotechnology and immunotherapy are slowly turning some fatal diseases into chronic conditions that can be managed.

But the costs of new treatments are going right through the roof at the same time as Medicare is likely to cover less than it once did. This year, Medicare Part B premiums are expected to rise 30% for beneficiaries earning more than $133,000. Going forward, less affluent folks over 65 years of age may find themselves forced to share the burden.

Of equal importance is not just a client's longevity but her quality of life as well. Here again, it's a bit of a crapshoot. Pond, who numbers many physicians at Massachusetts General Hospital in Boston among his clients, finds that clients who become ill in their 70s and 80s often have more strength and fight in their system. In contrast, those in their 90s are more likely to succumb fairly quickly—and less expensively.

Overspending Assets

Most clients with more than $1 million never imagined they would have that kind of money when they were young adults. All sorts of rules for retirement spending exist, from Bill Bengen's 4% rule to the old saw that retirees need to replace 80% of their pre-retirement income to maintain a comfortable lifestyle.

For many individuals, these rules are unrealistic. "I don't have a single client who spends less in retirement than before," says Linda Lubitz Boone, who runs the Lubitz Financial Group in Miami. "There is more time to spend at the mall and people spend money in retirement to replace happiness."

Advisors say it's understandable for new retirees to live large in the first year or two after they leave the workforce. Pond says he budgets excess funds for that first year when a client will want to take their dream vacation, remodel the house or do something else that is special.

The problem is that the overspending habit is very hard to break. "Once you set a certain spending level in retirement, it is very hard to reduce it later," Pond notes.

Sullivan has encountered this phenomenon even among clients with very substantial assets. When you think you are rich, and you are, it's easy to outspend one's assets.

Wealthy clients often are charitably inclined and, coming out of the brutal 2008-2009 recession, there were no shortages of charities needing help in most communities. There is no reason for any client not to engage in philanthropy, as long as they stay within their means.

"They get so much in the way of accolades that they get a rush from it," Sullivan says. Fortunately for affluent clients, this is often an area where a spouse can step in.

For the less affluent with limited resources, reverse mortgages are an option. And more leading financial advisors are recommending fixed annuities to clients with several million in assets so they receive steady predictable income and don't have to worry about selling assets on a regular basis to cover expenses.

Swindled By Elder Fraud

Never before in history have there been so many people over 60 years old with so much money. The majority may not have enough money, but the surge in senior fraud is becoming a national epidemic.

A survey of 2,600 financial advisors conducted in August 2012 by the CFP Board of Standards estimated that the average senior victim of financial abuse lost an average of $140,500. Scamsters disguise “educational presentations” to offer sweepstakes, cash prizes, free meals where they often tout unsuitable investment products.

These vehicles range from high-yielding, “guaranteed” investments that fail to deliver to legitimate products that are simply inappropriate for the specific person. For example, there may be many legitimate reasons to buy a variable annuity, but not if the client is in his 90s.

Sadly, the CFP Board survey found that 20% of advisors surveyed said they knew seniors who had been exploited by a guardian or power of attorney. If that were not enough, 35% of advisors told the CFP Board that at least one of the incidents of senior abuse they encountered was the work of someone the victim knew. In Sullivan’s limited experience, it tends to be a family member in difficult financial straits.
