Article from

Financial Wellness Essay Collection

2017 Call for Essays

A Framework for Multilayered Post-Retirement Financial Planning Strategy:

Critical Assessments of Individual Needs and Available Resources

Joonghee Huh

Financial preparation for one's post-retirement often requires a high degree of tailoring to recognize various factors involving individual circumstances. Given the idiosyncratic nature, one cannot effectively address this problem with a one-size-fits-all or rule-of-thumb approach. Rather, the approach needs to be based on a more sophisticated paradigm that can capture necessary inputs and formulate objectives in a clearly articulated and solvable manner.

Preparing for one's financial wellness in post-retirement years begins with understanding one's needs and expected financial resources and translating them coherently into a tangible and actionable strategy. A general framework that connects these ingredients can be helpful in addressing this issue.

This essay outlines a framework for formulating one's post-retirement planning strategy. Numerous relevant considerations can be categorized into the items related to **post-retirement needs** (i.e., what one will need) and **available resources** (i.e., what one will have). The first two sections of this essay provide detailed discussions on these items. The third section builds upon these two sections by incorporating them into an implementable multilayered approach to post-retirement financial planning.

Assessments of Retirement Needs

The financial needs in post-retirement years can be articulated in three levels of hierarchy. These needs can be met sequentially given availability of financial resources. These are **basic living cost, cost of comfortable living** and **needs for intergenerational transfer**. A brief description of each follows.

- **Basic living cost.** The amount needed to cover basic expenses such as food, housing and health care to maintain a minimal lifestyle.
- **Cost of comfortable living.** Expenses necessary to cover one's desired lifestyle. One example would be to maintain the same lifestyle as in one's pre-retirement years.
- **Needs for intergenerational transfers.** From a retirement planning perspective, this item is more of a want than a need. Nevertheless, one needs to take into consideration leaving one's legacy to the next generation.

Understanding the needs by the previous categorization is critical to post-retirement financial planning since one's appetite to meet these needs varies across individuals. This categorization can also be refined in a more granular way as required.

Assessments of Expected Financial Resources in Post-Retirement Years

An understanding of expected financial resources available in post-retirement years is a critical component in planning for financial wellness in post-retirement years. Considerations of financial resources can be seen in the following groupings.

- **Government safety net.** Government financial support such as Social Security benefits in the United States.
- **Social safety net.** How much one can rely on family and extended family for one's support if needed in the future.
- **Retirement plan accounts (both employer-sponsored or individual-based accounts).** One's funds earmarked for withdrawals in retirement years.
- **Additional personal savings.** All other financial products (e.g., investment, insurance and savings) that could be used to support financial well-being in post-retirement years.

Safety net availability from both government and social supports is important since it would have a meaningful influence over one's risk tolerance associated with investments of retirement plan accounts and additional personal savings. A person with higher safety nets would typically be more comfortable making riskier investments compared to those without the same support. Availability of a government safety net would be less variant among people in a given nation; however, the social safety net would vary substantially across individuals and should be recognized as part of individually tailored post-retirement planning strategies.

Multilayered Retirement Planning Strategy

Assessments of one's retirement needs and expected available resources facilitate a formulation of a well-defined problem for determining one's optimal post-retirement financial planning strategy. In particular, based on three levels of retirement needs mentioned in the first section, the post-retirement planning strategy would need to reflect the following considerations/constraints:

1. Meet the basic living cost with **certainty**
2. Meet cost of comfortable living with **X%** probability
3. Meet the need for intergenerational transfer with **Y%** probability

Based on the earlier discussion, one can establish a post-retirement planning strategy in a systematic way. For example, the basic living cost can be in part met by government safety nets, but post-retirement planning strategies may need to address the portion of the expected basic living cost not covered by a government safety net. One way of meeting these needs would be setting aside a portion of one's retirement plan accounts and personal savings into financial products with guaranteed fixed income streams such as payout annuity or guaranteed lifetime income variable annuity products.

On the other hand, the costs associated with comfortable living and intergenerational transfers can be met with a certain probability threshold and not necessarily with certainty, given that these may not be absolutely critical needs for individuals. Based on an individual's profiles and preference, this framework allows for making riskier investments as appropriate within specified tolerances leading to more optimal allocation of one's financial resources.

A tax strategy associated with post-retirement financial planning is another example of how this framework can be utilized. For instance, the individuals with primary concerns on meeting the basic living cost would have higher appetites for financial products allowing for tax deferrals (e.g., traditional 401(k)). Their expected tax rates associated with meeting the basic living cost only in post-retirement would likely be lower compared to their current tax rates. On the other hand, those whose goal is to meet the cost of comfortable living with a reasonably high probability may have inclinations for financial products allowing for tax-free growth (e.g., Roth 401(k)). For these individuals, their expected tax rates in post-retirement would likely be higher. Lastly for those highly interested in intergenerational transfers, life insurance products such as universal life may be more palatable within their portfolios.

Conclusion

Financial wellness begins with a better understanding of one's post-retirement needs and expected available financial resources. This short essay provides a framework for formulating post-retirement financial strategies leading to financial wellness. This framework is a skeleton that needs further developments with substance. Each component within this framework has potential as a research topic. For example, more studies can be conducted in the following areas:

- Comprehensive views of one's post-retirement needs in connection with one's expected financial resources
- More robust formulation of an optimization problem for determining strategies for post-retirement financial planning
- Exploration of efficient methodologies for solving such an optimization problem

Joonghee Huh, FSA, CERA, MAAA, Ph.D., is investment vice president at Prudential Financial. He can be reached at *Joonghee.huh@prudential.com.*