

**Editor's Note: This paper was written by the author in the format of a financial planning report to convey the author's concepts.**

Dear Mr. and Mrs. Smith,

Welcome to The Company! Below is a summary of the Program we have agreed to implement. Further details of the Program are provided in an accompanying document; however, there are no material differences between this summary and the detailed document.

Taxes and inflation have been incorporated into the retirement income analysis; however, the amounts shown in this document are given on a pre-tax basis and in terms of today's dollars.

### **Entering Retirement—Your Savings and Target Income**

You are both entering retirement at age 65 with \$500,000 savings, Social Security benefits and a pension. Based on our analysis of your income needs, including costs related to health care, your target income is \$60,000 per year through age 74, \$50,000 from age 75 through 84, then \$45,000 beginning at age 85 for the rest of your lives. Should one of you survive the other, the target income is reduced to 70 percent of the amounts just listed.

### **Social Security Income**

You are entering retirement with a Social Security benefit of \$21,000 per year. This amount will be received for life and the amount is expected to generally increase with inflation. Should one of you survive the other, the benefit will reduce to \$14,000 per year.

### **Pension Income**

You are entering retirement with a defined benefit pension benefit of \$12,000 per year. This amount will be received for as long as either of you are alive and the amount will remain flat at \$12,000 per year.

### **Rainy Day Fund**

Of your \$500,000 of savings, \$80,000 will be earmarked as a “rainy day fund” and will be invested in mutual funds, a fixed account and/or an inflation-linked account. These assets can be taken as income at any time during retirement should your income needs be higher than anticipated. These are your assets—you are free to withdraw them as income in any pattern you wish and can withdraw the entire balance at any time without penalty. All assets within this account will be received as income by you, or in the event of your premature deaths, by your beneficiaries.

### **Program Income Next 25 Years—The First Stage**

Of your \$500,000 of savings, \$333,000 will be invested in mutual funds, a fixed account and/or an inflation-linked account. The plan is to draw down this amount as regular income over a 25-year period. These are your assets—you are free to withdraw them as income in any pattern you wish and can withdraw the entire balance at any time without penalty. All assets within this account will be received as income by you, or in the event of your premature deaths, by your beneficiaries. If asset performance and inflation are as you expect, you will be able to withdraw the amount needed to reach your target income after receiving Social Security and pension benefits. For assets allocated to mutual funds, and to a certain extent the fixed account, you bear the asset performance risk; therefore, should assets perform better or worse than you expect, you will receive more or less income over these 25 years.

### **Program Income Beyond 25 Years—The Second Stage**

The remaining \$87,000 of your savings will also be invested in mutual funds, a fixed account and/or an inflation-linked account. These assets will provide annual income beginning after 25 years should either or both of you survive to that time—this income will then continue for as long as either of you are alive. These assets will grow by both performance and survivorship. If either or both of you survive 25 years, your asset balance will be increased by 41 percent to reflect your survivorship. If neither of you survive 25 years, you will not receive income payments from these savings—you will forfeit these assets. These assets cannot be withdrawn nor can the pattern of scheduled benefits be changed. The level of the annual income will be determined by the asset performance. If asset performance and inflation are as you expect, your annual income from these assets will be \$29,000, increasing with inflation. For assets allocated to mutual funds, and to a certain extent the fixed account, you bear the asset performance risk; therefore, should assets perform better or worse than you expect, you will receive more or less income from these assets. The Company bears the longevity risk, meaning it will pay the income benefits for life, even if your lifetimes extend beyond what is currently expected.

## Fixed Accounts and Inflation-linked Accounts

Fixed accounts and inflation-linked accounts credit interest to assets in the account on a daily basis. These accounts offer portfolio credited rates, meaning that all assets deposited into one of these accounts receives the same credited rate regardless of the timing of deposit. Credited rates are set semi-annually.

- ***Fixed Accounts:*** The Company bears the risk of underperformance of assets by guaranteeing that the credited rate will never be less than 3.00 percent. The credited rate will be set to the projected asset portfolio yield minus a charge for administration of the account and a charge for transferring the risk of asset underperformance to The Company. These are experience-rated accounts meaning that credited rates will reflect the actual experience of the asset performance, subject to the 3.00 percent minimum guaranteed by The Company.
- ***Inflation-linked Accounts:*** The credited rate consists of two components: a real-interest rate component plus an inflation component. The real-interest rate component is set for the life of the inflation-linked account. The inflation component is set semi-annually.

Assets can be withdrawn or transferred from a fixed account or inflation-linked account at any time. To provide equitable treatment between assets leaving an account and assets remaining in an account, a market value adjustment will be applied to withdrawals from an account. The market value adjustment is designed so that the performance of the assets remaining in an account is unaffected by the assets leaving. At the same time, the assets leaving are adjusted to a fair market value equivalent of the value had they stayed in the account. The Company does not receive any revenue from the market value adjustment. A market value adjustment is only applied if you withdraw more than 20 percent of your assets within an account in a calendar year.

More than one fixed account or inflation-linked account may exist, but only one of each will be available for new deposits at any time. The Company will open new accounts for deposits when the difference between market rates and the current account rates differs materially. Assets cannot be moved from an older account to a new account. The purpose of opening a new account is to provide equitable treatment of both past deposits and new deposits. The Company does not receive any revenue from the creation of a new account.

## Sweep Account

All income withdrawals from your assets will be made into an interest-bearing sweep account from which you can write checks, use debit cards or can leave the money in to save for a later day or for your beneficiaries.

## Asset Allocation

Your currently planned allocations are:

Age	Rainy Day (\$80,000)			First Stage (\$333,000)			Second Stage (\$87,000)		
	Equity	Fixed	Infl	Equity	Fixed	Infl	Equity	Fixed	Infl
65-74	75%	25%	-	75%	25%	-	-	-	100%
75-84	50%	50%	-	50%	50%	-	-	-	100%
85+	25%	75%	-	25%	75%	-	-	-	100%

Assets will be automatically rebalanced to your requested allocations quarterly. At each anniversary, you will have the opportunity to change your allocations. Although this account is not designed for active trading (there are limits on frequent trading activity), you can change your allocations at any other time; however, ticket charges assessed on any non-anniversary allocation changes will be passed on to you.

## Advice

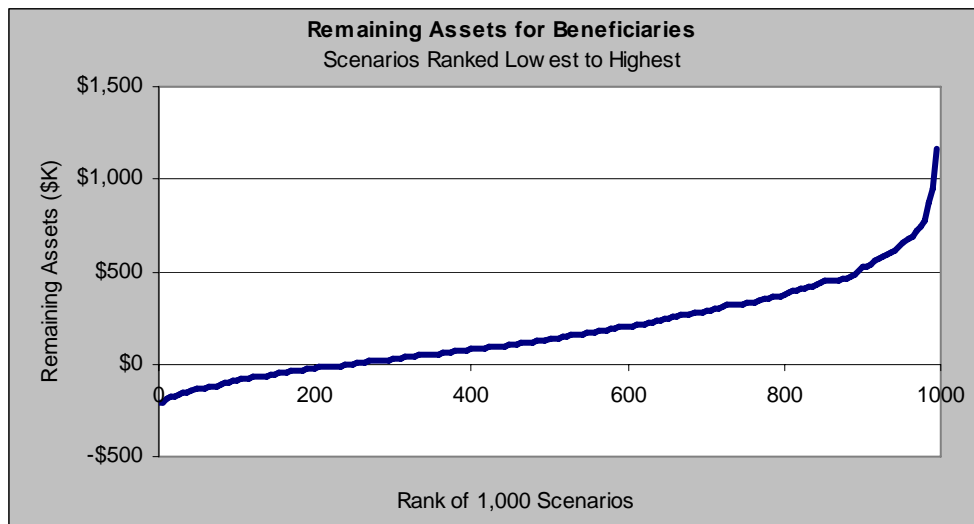
You have elected to receive advice concerning asset allocation, tax-strategy and income planning. You will be provided with annual reviews of:

- your asset allocations to ensure they are appropriate for your investment horizon and risk profile,
- your investment and withdrawal strategies to ensure tax efficiency and
- your withdrawal levels so that you will know when it is appropriate to increase or decrease your planned income levels.

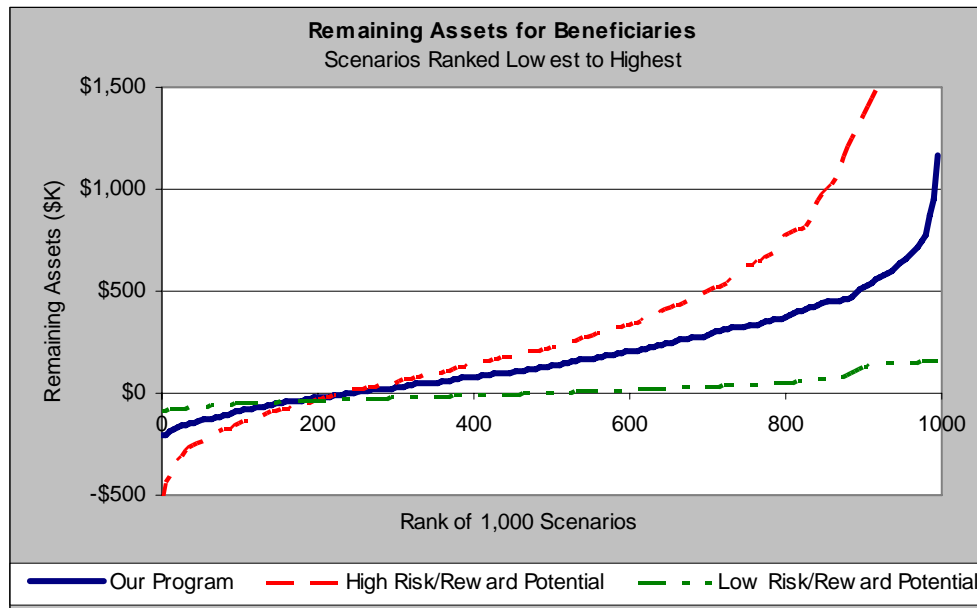
The annual review work can be done via Internet, phone or in person, as you request. You will be charged a fee for each annual review you receive. You are free to stop or start advice at any time.

## Risk/Reward Profile

As we have reviewed, your Program's risk/reward profile can be described in the chart below. The line shows the distribution of potential assets in today's dollars to be left to beneficiaries over 1,000 representative scenarios considering different levels of asset performance and inflation and different lengths of lifetime. In higher outcome scenarios, you can increase your income. In lower outcome scenarios, you should decrease your income. In 9 percent of the scenarios tested, you should decrease your income by 5 percent or more each year to maintain adequate assets to last your lifetime. In 39 percent of the scenarios tested, your income can be within -5 percent to +10 percent of your target each year and you will maintain adequate assets to last your lifetime. In 52 percent of the scenarios tested, you could increase your income by more than 10 percent each year and still maintain adequate assets to last your lifetime. Your annual review will provide suggested changes in your level of income to maintain an adequate level of assets.



As a point of reference, the risk/reward chart is enhanced below to include the distribution of results under two other approaches to retirement.



The solid line (blue) represents the tested scenarios under your program. The dashed line (red) represents an approach where you would retain all longevity and investment performance risk by investing all assets in equity and by not applying any assets to this Program’s second stage. It can be seen that this approach offers the highest potential reward but also provides the highest downside risk. The dash-dot line (green) represents an approach where you would transfer almost all longevity and investment performance risk by investing all assets in inflation-linked accounts and by applying assets to this Program’s second stage. It can be seen that this approach has very little risk, but at the same time, limited upside potential. The solid line (blue) representing your Program provides moderate upside potential and a moderate level of downside risk.

### Program Charges

All Program charges are described in the table below. The total charge for the Program and all of its features summarized above is approximately 1.37 percent of your assets per year, assuming your current elections remain unchanged and asset performance is as expected. There are no hidden fees or other sources of revenue to The Company not shown here. Charges made by The Company for services or risk transferal are set for the duration of the Program and will not change. Charges made by

mutual fund companies, which do not provide revenue to The Company, are subject to change and are described in the mutual fund prospectuses.

Services	Provider	Charge	Comments
Consultation and Program Development	The advisor and The Company	\$1,500	
Mutual Fund Company Administration	Mutual fund companies	Average of 0.50% of Fund assets	Fees may differ—described in each fund's prospectus
Administration of Your Mutual Fund Accounts	The Company	0.30% of mutual fund assets	
Administration of Fixed and Inflation-linked Accounts	The Company	1.25% of account assets	Includes cost of state regulated capital requirements
Allocation and Income Advice Development and Consultation	The advisor and The Company	\$300 per year	

Risks	Who Bears Risk	Charge	Comments
Mutual Fund Asset Performance	You	none	
Fixed Account Asset Underperformance	The Company	0.50% of fixed account assets	
Inflation for First Stage Assets	You	none	
Inflation for Second Stage Assets	The Company	0.50% of inflation-linked account assets	
Premature Death	You	none	Beneficiaries receive rainy day, first stage and sweep account asset balances upon premature deaths
Longevity	The Company	0.60% of second stage assets	

Assets	Total Charge	Comments
First Stage Mutual Fund Assets	0.80%	Based on 0.50% estimated average mutual fund admin
First Stage Fixed and Inflation-linked Account Assets	1.75%	
Second Stage Mutual Fund Assets	1.40%	
Second Stage Fixed and Inflation-linked Account Assets	2.35%	
Set-up and Annual Advice Fees	0.10%	Estimation of annualized charge

Average Charge over All Assets	1.37%	
--------------------------------	-------	--

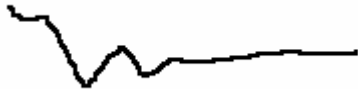
## **Fine Print**

There is none. The only purpose of the detailed document is to provide further information on situations which were not incorporated into this document in order to improve its readability. The spirit of the detailed document is fully in line with that of this document.

Although you can leave our Program at any time, we believe you will stay if you are satisfied with the Program's performance and service, so that is our goal. This Program is designed so that The Company earns its reward only if we deliver what we promise.

Please call with any questions.

Sincerely,

A handwritten signature in black ink, consisting of a series of connected, somewhat irregular strokes that form a cursive-like shape.



## William Leslie's Model Retirement Income Program

### **Author's Commentary**

Through this paper I submit what I believe will be a successful retirement income Program, shown in the form of a Program summary given to retirees. It is intended to be read as though the reader is a retiree who has recently completed a consultation with an advisor and is now reviewing the resulting plan.

Although not strictly defined, the target market for this model Program is the group of retirees and pre-retirees with investable assets in or near the range of \$100,000 to \$1,000,000. Although each participant's Program may be unique, the analysis is generally similar and the process can be greatly standardized. It is not intended to include the sophistication required by high-net-worth individuals.

As we enter the 21<sup>st</sup> century, retirees have a simple question to ask, "Do I have enough money to retire?" The asking of this question is a new phenomenon as the fundamentals of retirement are changing; mainly, retirees will be depending less on Social Security and defined benefit pensions to provide a substantial portion of retirement income, and instead must depend more on transforming assets into sustainable income. So, they ask this question.

And the financial industry has not yet answered this question. Or, more accurately, we're working on it and at this point have given the question many answers, which are not consistent or cohesive, and as a result, are not yet credible. For us to answer this question, we must have a plan on how financial risks will be managed in this 21<sup>st</sup> century retirement. If our current models are not sufficient, reasons may include our offering of product-based rather than outcome-driven solutions, our complication of products which drive up distribution and administration costs, can force illiquidity, and can generate customer mistrust and frustration, or not having incentives for financial institutions and distribution aligned with those of the customer.

This Program provides retirees with the comfort of having a credible and transparent plan which can be easily monitored and requires little future decision-making—a plan which lets them keep control of their assets, has a risk-reward profile they desire and uses a low-cost standardized process that produces a unique plan for the retiree.

The following Program features are targeted toward the retirees:

- **Meaningful Projection Results:** The focus of this Program is the range of potential ending balances at the end of retirement. Both the *probability* and *magnitude* of success and failure are given in terms of today's dollars. The retiree is aware of the likelihood that it may be appropriate to raise or lower future income levels through the risk/reward profile section.
- **Risk Management:** Retirees can transfer or retain any level of longevity, investment performance, inflation, and liquidity risks. The risks of high healthcare costs including long-term care are not explicitly described in this Program, but are assumed to be pooled through insurance.
- **Risk/Reward Profile:** Through the risk/reward profile section, retirees can see that transferring away downside risk comes at the cost of giving away potential for sizable gains. Similarly, keeping the potential for reward comes at the cost of retaining greater risk of loss.
- **Simplicity of Decision-Making:** The retirees are given comfort knowing that a credible plan is in place which requires little decision-making in the future. The advisor will provide guidance for decision-making annually.
- **Control:** The retirees retain control of the majority of assets, being allowed to withdraw this money at any time without penalty.
- **Ease of Reading:** The Program document is designed to be easily read and understood. It does not refer to any particular underlying products or financial instruments, but rather to the end result of the Program. The financial instruments are only the means to arrive at the goal.
- **Transparency and Guarantee of Costs:** Clearly stating and guaranteeing what the costs of the Program are should help build the retirees' trust. Advisor pay is intended to be independent of the actual advice.
- **Low-cost Program:** A standardized process for the development of individual plans promotes consistency and efficiency.

The following Program features are targeted toward the financial institutions:

- **Service:** This Program allows the financial industry to provide the enhanced service the next generation of retirees needs.
- **Risk Pooling/Hedging:** This Program makes good use of the industry's ability to bear risks on behalf of individuals. Through insurance company pooling, retirees can transfer their longevity risk. The financial industry can provide retirees with hedges against poor investment performance including inflation. Liquidity risk is mitigated by allowing retirees access to most of their assets without penalty (while a financial company would

naturally feel at risk with easy access to assets, I believe this risk would be overstated).

- **Fairness of Costs:** Fairness of costs will be driven by transparency. The quality of advice and service will generate provider differentiation. Retirees will find a Program a “good deal” if it provides good service and comfort for a fair cost. In addition, retirees will not require the “best deal” but will be satisfied with a “good deal.”
- **Retention:** Incentives between the institutions and retirees are aligned. Following this lifetime Program properly will promote retention of company managed assets and service.

The following Program features are targeted toward intermediaries:

- **Advisor Pay:** The timing of advisor pay is aligned with the lifetime of the Program. Payment levels should be guaranteed so that the promise of future pay levels is credible.
- **Time versus Pay:** The amount of pay is related to the effort and time involved. The standardized process will promote efficiency and consistency.
- **Client Satisfaction:** The advisor will be delivering a high-quality unique plan with the benefits of the retiree-targeted features listed above.

Final notes:

- **Pre-retirement:** Although the Program here has been modeled for two new retirees, this approach should be considered when planning during pre-retirement with the added element being how much to save before retiring. The reason to accumulate savings for retirement is to build toward this plan, so the starting point should be post-retirement life.
- **Phased retirements:** Phased retirements can be incorporated with adjustments such as targeting lower income in years of partial employment.
- **Fixed Account MVA:** Although typical MVAs are calculated with a defined maturity date, I envision, without any technical analysis, a rolling 5-year MVA for the portfolio rate fixed account described here.
- **Example Simplicity:** This example is intentionally simpler than may be found in real-life to help improve readability. Simplifying assumptions include one-time retirement, calculation of income needs and healthcare costs outside of the model, cursory mention of taxes, etc. Such details can be incorporated as necessary. Program charges are purely illustrative. In this form, it is hoped that the reading of this document will give a picture

of how the financial services industry can successfully serve future retirees.

Asked: "What if you could start with a clean slate and devise completely new retirement income systems...?" I answer with this Program, and I invite your comments, questions and criticisms.

- William Leslie