THE PLANNING GAP

Expectations vs. reality: What investors think – and how advisers plan – for retirement income

Nationwide®

IN RESEARCH

FOREWORD

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Kevin McGarry leads a team dedicated to educating advisors about the latest retirement income-planning trends. Kevin holds designations as a Certified Investment Management Analyst, Certified Investment Management Consultant, Chartered Retirement Planning Counselor, Certified in Long-Term Care and Certified Business Coach.

Today, financial advisers play a more important role in retirement planning than ever before. As responsibility for retirement income shifts increasingly to individuals, financial advisers have become retirement coaches for many individuals and their families – carefully helping them to navigate complex financial issues and plan for their futures.

While this need and demand for financial advice will likely continue to increase in the coming years, we believe that the type of advice you deliver to your clients will change dramatically as well. We saw in our 2016 research with InvestmentNews that more advisers are altering their business models and services to provide comprehensive and holistic planning to their clients, in addition to traditional investment management.

This, of course, will require you to deliver more customized sets of services to your clients – and charting a path to, and through, retirement will be their primary objective.

Nationwide has partnered with InvestmentNews on this new research project to specifically help you better understand investors' changing perceptions of retirement, how they believe they will fund their retirements – and ultimately the challenges and risks that are top of mind. In presenting this information to you, we also provide actionable ideas for how you can address many of the non-financial elements that investors believe could significantly impact their retirements.

In addition to this report, Nationwide and our Nationwide Retirement Institute has a range of resources that can assist you with retirement planning.

- Our Social Security 360® program simplifies the Social Security filing process for your clients. It includes insights you can use for your client conversations, like the basics of Social Security and retirement income planning, as well as details about when to file, which can have a significant impact on the benefit amount. Through the program, you'll get access to Nationwide's Social Security 360 Analyzer® tool, which generates a report based on your clients' personalized situations.

- Our Health Care program, which includes the Nationwide Health Care Cost Assessment tool, helps you provide a personalized report for each client. It includes a breakdown of estimated Medicare, out-of-pocket and long-term care costs during retirement as well as annual expense details. The program will also help you explain to your clients the benefits of using a solution-driven approach to covering estimated health care costs.

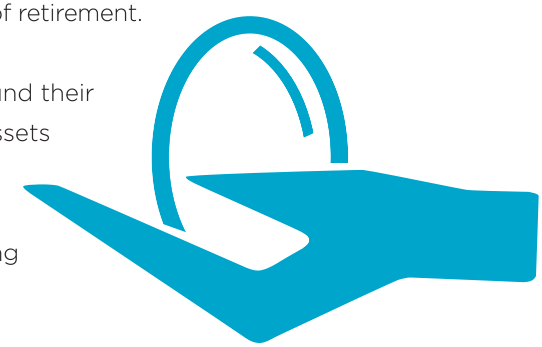
Nationwide looks forward to the opportunity to continue to support you and your clients, and we hope that you find this research to be valuable and informative.

Introduction

Years ago, when retirement income funding could be explained by envisioning a three-legged stool, financial advisers and their clients had the luxury of focusing on a singular objective: "The Number" – or how much money an individual would need to save to retire at the age of 65.

Now, of course, financial advisers must deal with many numbers and many more complex equations as they work to guide clients to and through retirement years that last longer than ever and less frequently begin at age 65.

That three-legged stool? One leg — employer-sponsored defined benefit plans — has all but disappeared for most, meaning more assets must be personally accumulated and managed. Only 21% of individual investors who participated in our survey reported that they have a defined benefit plan. The future of the second leg, Social Security, remains uncertain; many financial advisers plan as though this traditional retirement benefit will be substantially reduced in the not-too-distant future. And if that weren't enough, the remaining leg — personal savings — must cover the likelihood of greater healthcare and medical spending during an extended period of retirement.



Today, retirement strategies are driven by the individual investor's decisions around their own savings, defined contribution plans, and reliance on other non-retirement assets such as homeownership or business equity, as we will detail in this study.

These, of course, are just a few examples of the tectonic shifts that are re-defining retirement income planning, and ultimately the financial adviser's role and responsibilities, which now include retirement risk management in addition to asset management. To help better understand what advisers will be facing, we decided to explore investors' and advisers' expectations for retirement, and the differences between the two. Specifically, we conducted two surveys: one of individual investors and another of financial advisers, focusing on a range of elements that included:

- **RETIREMENT OUTLOOKS:** Anticipated savings, monthly retirement income and length of retirement
- **RETIREMENT RISKS:** The factors that have the greatest potential to erode retirement savings
- **RETIREMENT INCOME ADVICE:** The financial planning services that are in demand and could deliver the most value to clients and potential clients

This research has uncovered a clear "planning gap" – or a significant difference in what investors think and how advisers actually create a plan for generating retirement income.

The gap exists across all income ranges and wealth levels and clearly marks the need for advisers to emphasize the importance of managing potential post-retirement liabilities as well as assets. Our research will highlight the sources for these gaps, while also quantifying several of the most significant planning gaps. In addition, we will provide recommendations for closing the gaps and enhancing the value that advisers deliver directly to their clients.

Our objective with this research is to provide advisers – and their clients – with actionable intelligence that presents the key elements and variables that are re-writing the formulas for retirement income planning.

Overview and methodology

When surveying investors, we specifically focused on soliciting responses from individuals with more than $100,000 in investable assets. By focusing on a group that is already accumulating some level of wealth, we have an informed sample of investors meaningfully engaged with the notion of planning for retirement – and also able to directly speak to their active strategies and considerations for accumulating and managing wealth (including the use of financial advisers).

An overview of the key demographic attributes of our sample of 1,741 investors can be found below:

- Median age: 54 years old
- 65% male, 35% female
- 27% have investable assets over $1 million
- 45% have household incomes greater than $150,000 annually
- 12% are currently retired, 74% are working full-time, 7% are self-employed, 5% are working part-time
- 43% of respondents currently use a financial adviser

43%
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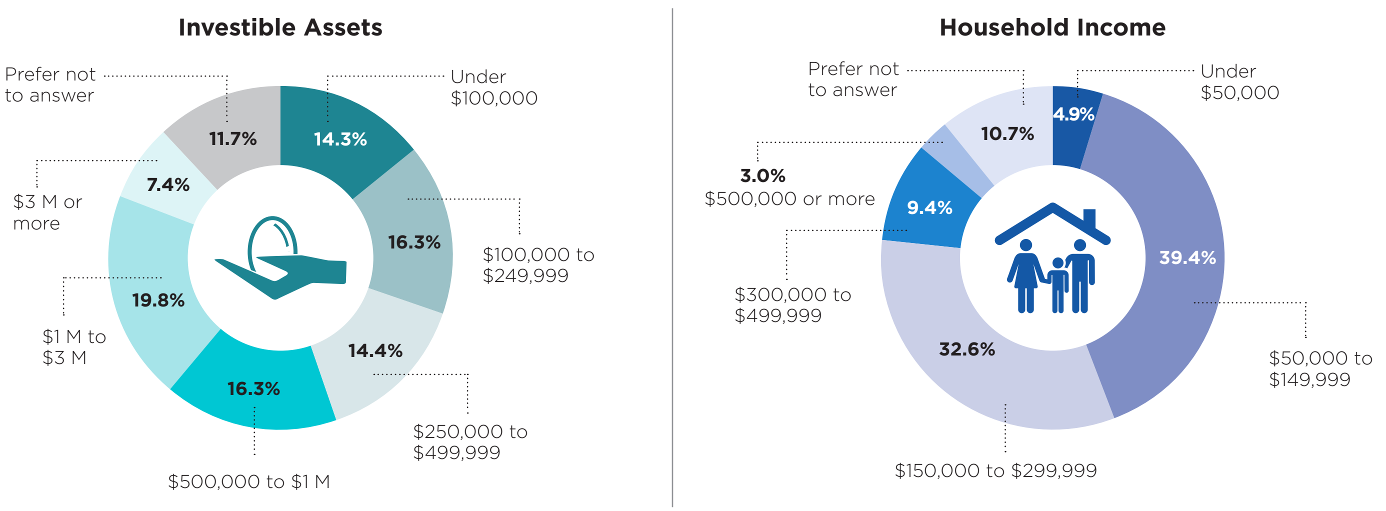
Figure 1: Investible assets and household income of investor respondents



Defining "The Planning Gap"

Across this base of investors there are indicators of uncertainty or concern about retirement at all income and wealth levels. Overall, when asked to rank their level of confidence in how prepared they are for retirement, the average participant reported a score of 7.2 on a scale of one to ten, where ten was the most confident that they will maintain a comfortable lifestyle in retirement.

Fifty-five percent of respondents indicated that they believe they are saving enough for retirement, while 46% noted that their standard of living during retirement will likely decline.

Not surprisingly, this prompted individuals in our survey to anticipate working longer: Retirees in our sample exited the workforce at an average age of 63. Individuals who are not yet retired, on average, noted that they anticipate being able to retire at the age of 68.

Digging deeper into their financial expectations for retirement, there is a clear difference between investors' view of their long-term financial needs and the recommendations of professional planners. The differences can be attributed to many factors, including a range of behavioral, fundamental and emotional biases. But practically, financial advisers and planners often account for a number of additional variables and risks when constructing retirement plans – with longevity risk at the top of the list.

While the majority of investors in our survey believe they are saving enough for retirement, their expected monthly incomes and the length of their retirements, on average, differ substantially when compared directly with the projections used by financial advisers. **Figure 2** illustrates the foundational differences in retirement expectations between investors and financial advisers:

46%
noted that their standard of living during retirement will likely decline.

Figure 2: Investor vs. adviser retirement expectations, concerns

MEDIAN VALUES	INVESTORS	ADVISERS
Expected length of retirement	**22 years**	**30 years**
Replacement rate	**65%** of working monthly income	**80%** of working monthly
Top concern/retirement planning risks	44% Medical expenses; 31% Health insurance premiums; 22% Longevity	53% Medical expenses; 43% Health insurance premiums; 29% Longevity

Looking first at the projections and underlying motivators, advisers clearly place a greater emphasis on longevity than investors – which is at the core of the planning gap. **Advisers plan for a retirement that will last eight years longer than the typical investor believes.** At the same time, advisers also plan that **investors will require a monthly income during their retirement that is 15 percentage points greater** than the amount that the typical investor estimates. It is worth noting that only 45% of investors indicated they have a written financial plan in place, which suggests informal estimates have shaped many of their projections.

Projecting both sets of expectations for retirement duration and average monthly replacement rates against investors' current income levels, we can assign top-line values to illustrate the so-called planning gaps. **Figure 3** maps out the differences in monthly retirement income projections (without specific tax considerations) by examining three key income levels of participants in our survey.

These calculations based on income levels of $100,000, $225,000, and $400,000, show how the gap between investors' median replacement rates and advisers' results in a difference of **$875, $2,438, and $5,667,** respectively, each month in retirement.

Further amplifying this gap is the discrepancies in expected length of retirement. Looking at how these differences in retirement duration and replacement rate estimates would add up over the full course of an individual's retirement **(Figure 4)**, we see a roughly 40% difference between the amount investors believe will be required to fund their retirements and what advisers contend is needed.

Advisers plan for a retirement that will last eight years longer than the typical investor believes.

Figure 3: Projections of monthly retirement income requirements

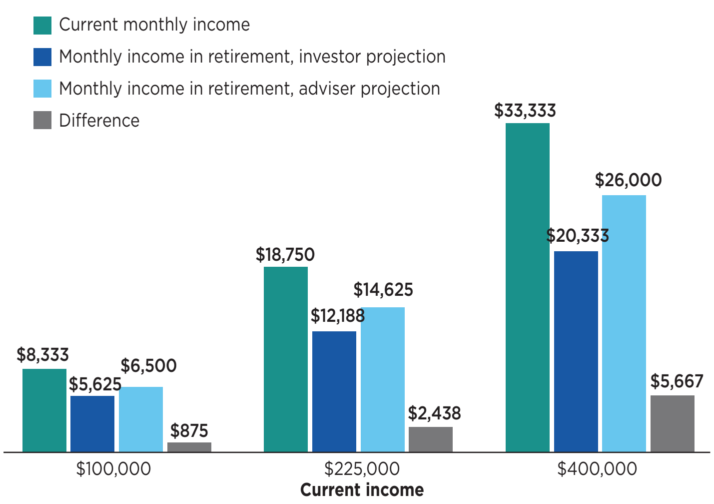
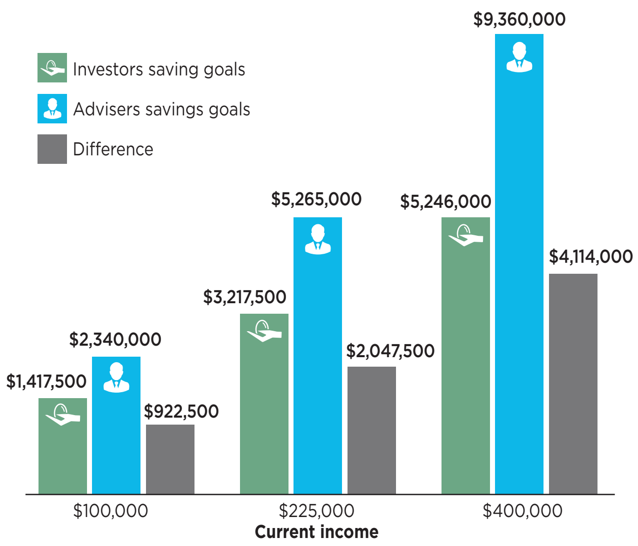


Figure 4: Gaps in savings for retirement, based on replacement rates and life expectancy



Note: Figures are hypothetical based on calculations derived from two InvestmentNews *Research surveys: one of individual investors and another of financial advisers. The numbers above are based on answers reported directly by participants.*

Sources of retirement income

It is worth noting that investors are aware that they will be largely responsible for funding their own retirement incomes. Just 21% of investors in our survey indicated that they are a participant in a defined benefit plan, while 76% indicated that they are currently contributing to a defined contribution plan, such as a 401(k) or 403(b) plan. These types of plans, along with personal savings and investments (such as Individual Retirement Accounts), are expected to fund the majority of participants' retirement incomes. At the same time, on average, investors indicate that just 18% of their total income during retirement will be funded by Social Security.

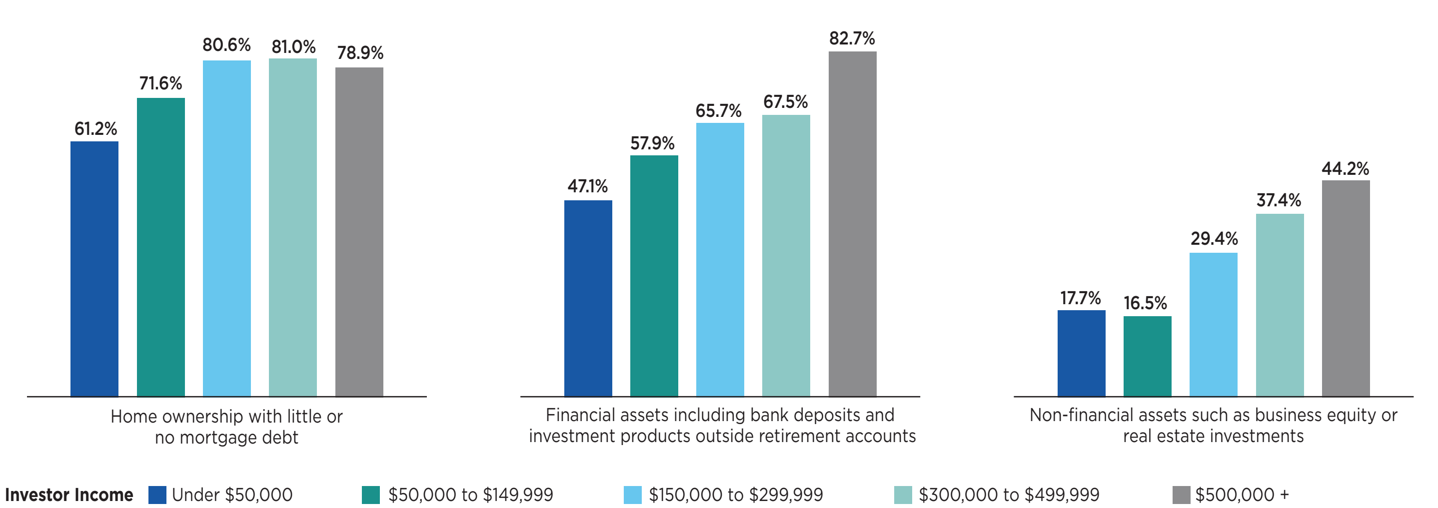
Figure 5 shows the sources of savings and retirement vehicles that individuals believe they will use to fund their retirements, broken out across the three primary income levels in our survey.

Figure 5: Projected retirement income funding sources, by investor income

	INVESTOR INCOME		
	\$50,000 to \$149,999	**\$150,000 to \$299,999**	**\$300,000 to \$499,999**
Your personal savings and investments	**31.9%**	**33.9%**	**39.2%**
Your employer plan(s) (e.g. 401(k) or pension)	**37.7%**	**41.3%**	**36.3%**
Social Security or other government benefits	**21.6%**	**16.0%**	**13.1%**
Other sources	**8.9%**	**8.9%**	**11.4%**

Just **21%** of investors in our survey indicated that they are a participant in a defined benefit plan.

Figure 6: Additional retirement resources, by investor income



In addition to dedicated retirement savings vehicles, a large majority of investors in our survey believe that they will fund a portion of their retirement with equity from their current home, potentially leveraging strategies such as reverse mortgages or down-sizing. **Figure 6** shows the most popular sources of additional retirement income, broken out across levels of investable assets:

With the responsibility of personally funding the majority of their own retirement income, investors presented mixed views on their expected standard of living during retirement. While 43% indicated that they believe their quality of living will not change during retirement, 46% believe that their standard of living will decline, while 11% anticipate it will actually improve, as noted in a more detailed breakdown in **Figure 7**.

Investors who work with advisers, however, are more confident that they will be able to maintain their current lifestyle in retirement: Of those currently using a financial adviser, 50% say their lifestyle will stay the same during retirement, 39% decrease. Among those who are not currently using an adviser, 35% say their lifestyle will stay the same, while 51% said it will decrease during retirement.

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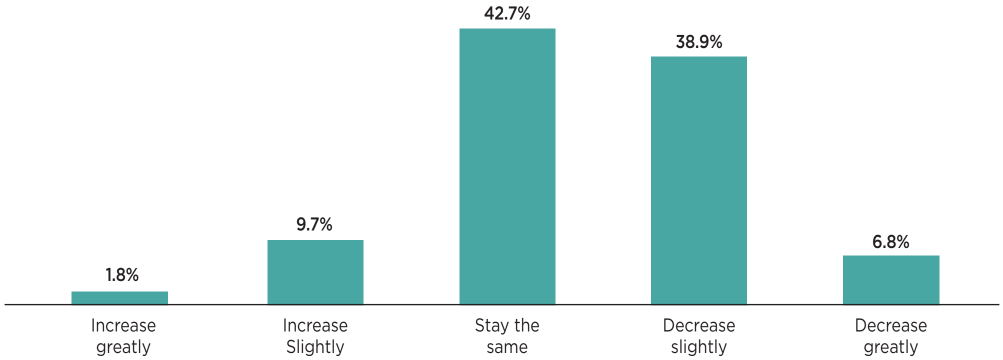
Figure 7: Standard of living expectations

How will your standard of living change in retirement?



Note: Investors were asked, "How do you think your standard of living will change in retirement?"

For advisers, an opportunity to deepen relationships and enhance value

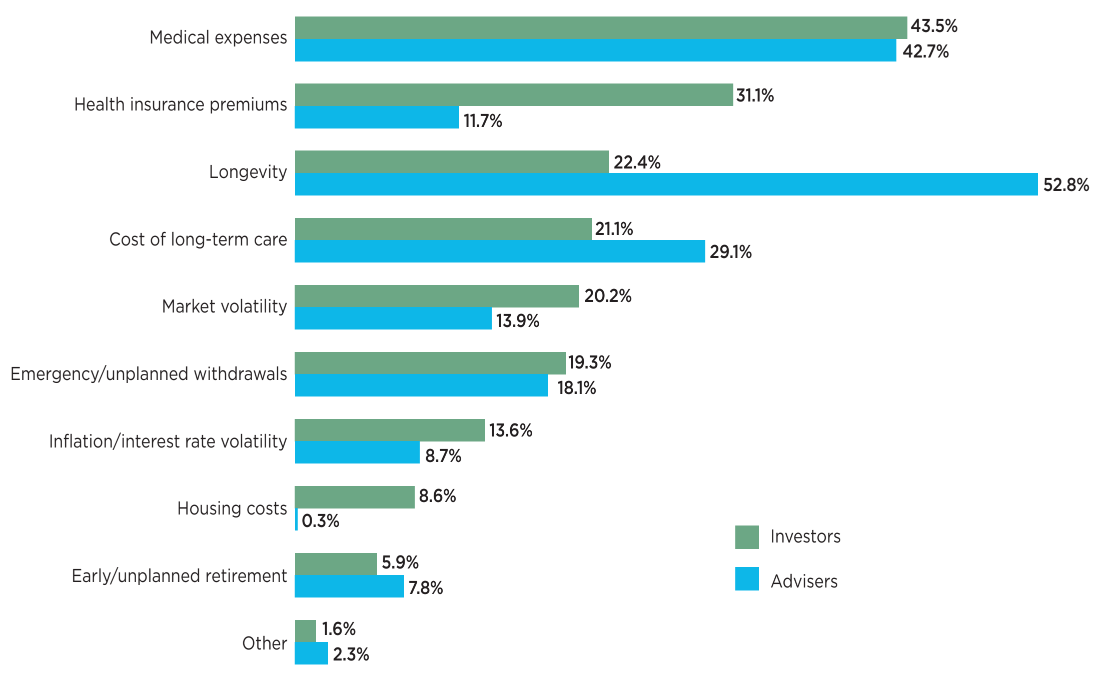
Investors' confidence and outlooks, combined with the core contributors to the planning gap outlined earlier, while seemingly challenging, can present opportunities for financial advisers. The divergences in adviser and investor retirement expectations clearly translate to substantial differences in the amount of wealth individuals may need to accumulate. These illustrative differences also reinforce that the conversation surrounding the planning gap is much broader than just the need to accumulate assets.

The gap underscores a change in the way individuals and advisers need to plan, collaboratively, to fund a retirement that could last significantly longer than most expect – and one that could contain many more variables than most anticipate. Life expectancies have increased significantly in recent years: As of 2015, the average life expectancy at birth is 79 years, up from an average of 75 years in 1995, and 73 years in 1975.[1]

The opportunity for advisers, we believe, is to place a greater emphasis on "life risks" – with longevity and healthcare at the top of the list – and integrate these variables more closely into the construction of financial plans. Many institutional investors, for example, have adopted liability-driven investment (LDI) strategies in recent years. While complex, at its core LDI is a strategy that aims to match income needs to an investor's future obligations, taking into account the effects of interest-rate changes and inflation. This is just one approach, among many, that could be embraced by financial advisers, especially as a way to address the pressing concerns of healthcare expenses and longevity risk.

Figure 8 shows the full list of retirement concerns presented to investors and advisers. For investors, retirement liabilities generally were of greater concern than traditional investment risks, such as market volatility and inflation.

Figure 8: Largest financial concerns in retirement

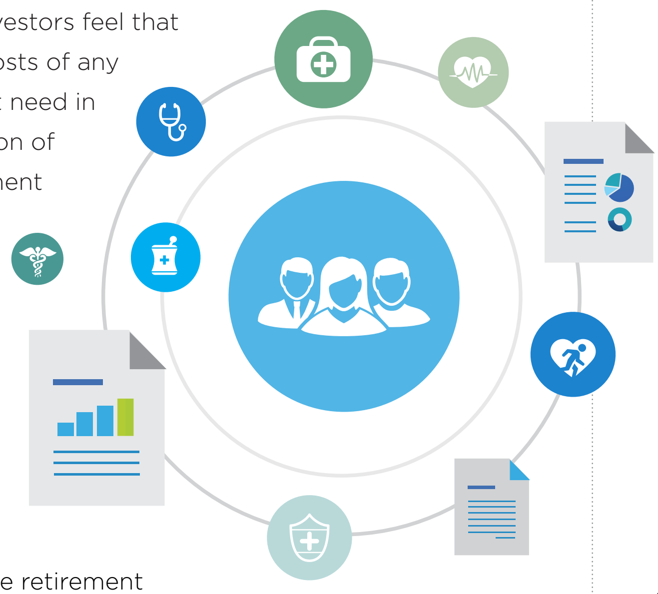


Note: Participants could select up to two choices.

[1] CDC

As of 2015, the average life expectancy at birth is 79 years, up from an average of 73 years in 1975, making longevity risk the top financial concern during retirement for most advisers.

Healthcare, medical planning and 'The Opportunity Gap'



Focusing further on healthcare, only 39% of investors feel that they are financially prepared to shoulder the costs of any medical care or long-term care that they might need in retirement – reinforcing why such a large portion of investors ranked healthcare as their top retirement concern. The average out-of-pocket health care costs for a 65 year old couple is between $259,000 and $392,000.[2]

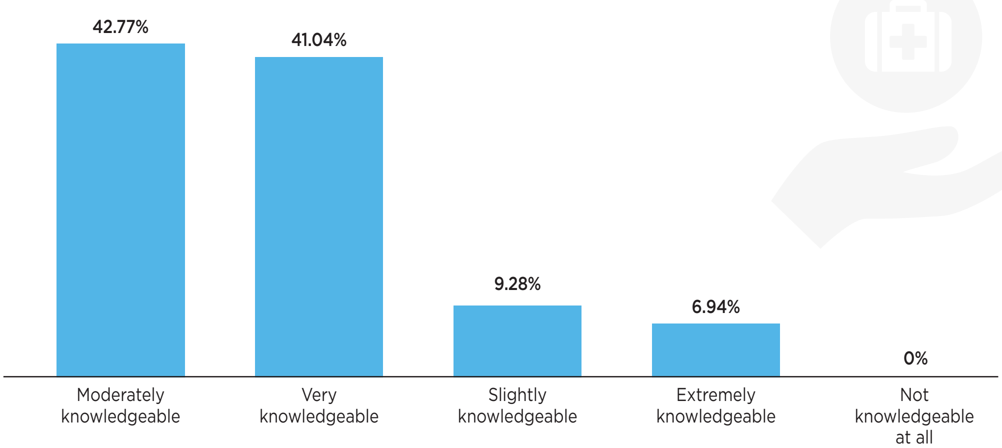
Advisers, almost universally, indicated that they are knowledgeable about healthcare and medical issues when planning for their clients, as indicated in **Figure 9**.

Notably, however, while 86% of advisers provide retirement income withdrawal strategies to their clients, only 55% of advisers in our survey said that they factor healthcare and medical planning into their clients' overall retirement plans.

45%

of advisers said they don't factor healthcare and medical planning into their clients' overall retirement plans.

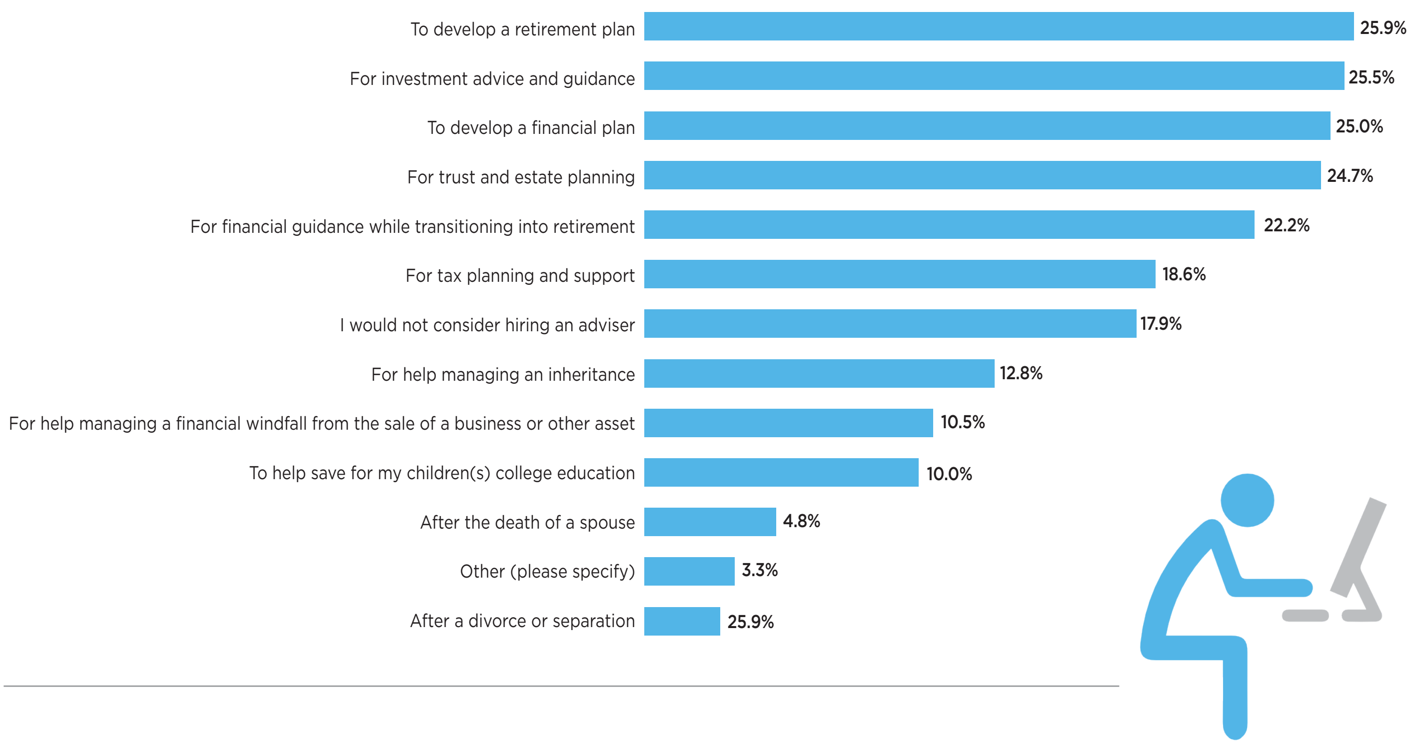
Figure 9: Financial advisers' health care knowledge



Note: Advisers were asked: "How knowledgeable and prepared do you feel when advising your clients on managing their healthcare and medical expenses in retirement?"

[2] Savings Needed for Medigap Premiums, Medicare Part B Premiums, Medicare Part D Premiums and Out-of-Pocket Drug Expenses for Retirement at Age 65 in 2015. Assuming a 90% chance of having enough savings. "Amount of Savings Needed for Health Expenses for People Eligible for Medicare: Unlike the Last Few Years, the News is Not Good," by Paul Fronstin, Dallas Salisbury, and Jack VanDerhei, EBRI, October 2015.

Figure 10: **Why DIY investors would hire an adviser**



This underscores perhaps another gap – "The Opportunity Gap" – which could allow those advisers who place an emphasis on more holistic planning, which includes healthcare planning, to build stronger relationships with existing clients and attract new clients.

Indeed, 82% of do-it-yourself investors surveyed indicated that they would consider hiring a financial adviser in the future. The need to create a retirement plan was the top motivator (25.9%) for potentially using an adviser, followed by investment advice and guidance (25.5%) and general financial planning (25%), as outlined in **Figure 10**.

The ability to combine those services that are most in demand – while including an increased focus that addresses potential healthcare, medical costs and long-term care decisions – could prove to be a key differentiator for advisers who are looking to capture an increased share of the growing retiree marketplace.

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Key takeaways and considerations

As financial advisers continue to partner more closely with clients to deliver tailored retirement portfolios, there are a number of factors to consider when navigating "the planning gap." Key takeaways and considerations include:

- **Advisers should conduct an initial "gap analysis" with clients who are in the process of planning for retirement.** This could be done at any stage of a client's planning, but it will help align advisers' and clients' expectations for life expectancy and replacement rates, at minimum. It will also force clients to discuss and visualize their retirement in more practical, versus conceptual terms. In addition to surfacing any potential "planning gaps," it will present advisers with an opportunity to discuss the specific reasons they may have longer horizons and higher overall retirement income requirements. This report could also be used in client communications to help introduce the concept of a planning gap.

- **Ask comprehensive sets of health history and family medical questions.** Leave it to the client to determine how much they wish to share, but make sure that discussions around non-financial risks are incorporated into the overall planning discussion. As noted throughout this report, these "life risks" – such as health care and medical expenses – are the top concerns for most investors and should be addressed head on when customizing retirement plans.

- **Incorporate discussions of health savings accounts directly into retirement planning.** As more individuals are faced with rising – and variable – health care costs, HSAs have becoming increasingly popular. For financial advisers, while these accounts are not frequently discussed within the context of retirement income planning, placing a greater emphasis on the potential need to contribute to HSAs – as well as the practical short- and long-term advantages – can help strategically close the planning gap over time and address the top retirement risk for many investors.

- **Address long-term care within the context of the general retirement planning conversation.** As people live longer, it becomes increasingly likely that your clients will require some level of assisted living services or facilities during their retirement. Employer and Medicare programs are limited in the long-term care expenses that they will cover, presenting clients with a potential financial risk that could significantly erode their savings. The younger and healthier your client, the lower the cost for a long-term care policy, so advisers should consider introducing this early in the planning discussion and strategy.

- **DIY investors are looking for advice that is focused on more than just investing and asset accumulation.** Only 29% of DIY investors claim their retirement plans are fully developed, 34% are confident in how to maximize their Social Security benefits, and 28% have tax-efficient withdrawal strategies. These present substantial opportunities for advisers to align expertise with specific needs – and ultimately articulate the value that they can deliver to potential clients.

About this research

To support this research, two surveys were conducted. The first was distributed to investors between July 25 and August 12, 2017 in which we received responses from 1,741 individuals. The second survey was distributed to InvestmentNews' audience of financial advisers between August 12–18, 2017. In total, 343 responses were collected.

IN Research

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Need more information? Contact Mark Bruno at mbruno@investmentnews.com or visit Research.InvestmentNews.com

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