Your Clients Won't Run Out of Money. Now What?

by Jonathan Guyton, CFP®

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"There are only two amounts of money: less-than-you-need and more-than-you-need."

Over the years, I've often used this statement as an introductory framing for various client conversations. Our financial planning profession is increasingly good at putting people on a path to the latter, and that's all the more likely the better you've been at comprehensive and holistic financial planning.

There will be money left over … and likely more than clients imagine. For starters, fear and retirement spending have an inverse relationship. When spending "cuts" were triggered 10 years ago via the capital preservation rule of the Guyton-Klinger dynamic withdrawal policies,[1] clients' most common reaction was, "Don't we need to cut even more?" No, they didn't, unless things had gotten worse.

Spending Drops over Time

Research by the Center for Retirement Research[2] and, more recently, David Blanchett[3] validates what common sense has always told us: spending for even moderately affluent retirees declines in real terms over time. And this real decrease can approach 30 percent for retirees spending $100,000 or more annually from their mid-60s to their mid-80s.

This spending pattern is a big deal.[4] In a nutshell, once clients reach their late 60s, lifestyle cost inflation not offset by declining discretionary spending can mostly be covered by Social Security cost-of-living adjustments. It obviously makes a big difference in the value of future inheritances when annual increases of portfolio withdrawals are closer to 0 percent than 3 percent in the last two decades of retirement.

Furthermore, when retirees hold off withdrawing Roth IRA assets and gradually transition unneeded IRA required minimum distributions (RMDs) to post-tax brokerage accounts (with their eventual basis step-up), the tax impact can turbocharge this cross-generational transfer. (Remember, it's RMD for distribution; not RMS for spending!) Estate tax exemption portability, combined with room for more than $11 million per person (or even just half that),

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has taken that so-called "problem" off the table for millions who planned well for their retirement.

It's time to engage these clients in conversation about what they would like to do about having more-than-enough.

Clients with children, grandchildren, and favorite (grand) nieces and nephews especially like this. And they are often content to assume that the final value of their estate will be divided amongst their kids. However, looking at this from the opposite perspective, they are well-advised to wonder: what does it mean for an adult child to inherit a million dollars (or two or three) in their 40s, 50s, or 60s?

The impact is life-changing. It can create the ability to pay off (or avoid) a significant debt load, invest in a new business or other venture, or rescue/accelerate retirement funding. Leaving $1 million to someone who is 55 to 65 years old is equivalent to giving an additional $45,000 to $55,000 annual income for life. But such an inheritance can sometimes stifle ambition or the rewards of personal achievement and/or cause such guilt over its receipt that it harms an adult child's sense of self-worth or life balance, not unlike what can befall lottery winners. Consequences like these are usually impossible to foresee.

The Concept of "Enough Money"

Rather than further exploring the analytics of such inheritance events, let's consider some possibilities that engaging retired clients in conversation about all this may open up.

For starters, realize that probing the psychological, emotional, and even spiritual aspects of this reality will be significant. The number of millionaires in the U.S. is increasing rapidly; many never imagined even approaching such status. Consider that a 65-year-old retiree with $600,000 today who earns 5 percent annually and withdraws $18,000 yearly, rising 1 percent per annum, will have more than $1 million, should they see their 90th birthday.

The concept of "enough money" is fascinating. After being well aware during their 20s, 30s, 40s, and 50s that they didn't yet have the assets they would ultimately need later in life, it can take someone time to fully grasp that they now do. Some never get there.

As it becomes financially clear that this is the case, it is a great service to a client to patiently lead her to embrace this financial freedom, even if this takes several years. Not that she can now do everything, but that nearly anything is feasible. Otherwise, the bitter seeds of regret are more likely to germinate. Just because there are only two amounts of money doesn't mean it's easy to live like you know which one describes your situation. But then what?

While such a realization is not technically a sudden money event, the two share some characteristics. A person slowly moving from "I'll never have enough" to "I still don't have enough" to "I think I have enough" to "I really think I have enough and can finally stop" to "OMG, I really do have enough!" has undergone quite a transition. Let them sit with it. Watch for changes in what they do and don't do. Ask what it's like. How it feels. What and whom they find themselves thinking about. What has changed in relationships, how they see their world, and what matters most. They may even ask, "Do I really want to give my kids that much?" Only then is it time to talk about what this means.

It will help to dispel potential misconceptions: "Yes, you are way more likely at the end of your life to have more money than today, not less." "No, half of it won't eventually go to taxes; in fact, surprisingly little of it will." "No, you probably don't need to redo your will/trust each time your wishes change." And, "Considering your real estate, the size of your portfolio, and your most likely future spending pattern, daughter Suzie and son Jerry stand to receive a little over X million dollars each after taxes, based on what things cost today (and your church and favorite charities would receive the other Y dollars)."

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After a significant pause (until the next meeting?), it's time to ask their perception of what this means. Do their kids have any idea of this? Would they like them to? What would it have meant to them five or 25 years ago to receive such an amount? What would have been different? For the better? For the worse? And how do they feel about the amounts of money that will go to the people, places, and causes they most care about?

Regardless of the answers, if nothing further comes of this conversation, it will still be invaluable. But don't be surprised when a client (though possibly just one-half of a client couple) wants to make some changes. And expect to eventually hear something like, "So what can/should I do now rather than waiting until then?"

Here are two possibilities: for clients withdrawing less than their recommended "safe spending amount," increase withdrawals to this level to fund living gifts now to these ultimate beneficiaries. If any recipients are charities, then qualified charitable distributions, or donor-advised funds will likely be beneficial. Or, they could have a custodian transfer assets into new IRA and/or brokerage accounts to be managed and reported on as a distinct "giving portfolio" from which they make "living gifts." This would separate money to be given away from their core portfolio, which must retain sufficient assets to sustain ongoing withdrawals for their lifetime spending needs. Of course, clients could go further if they were inclined to begin a spend-down of their assets.

Such strategies or tactics are secondary to having conversations about such things. What works best for a client will sort itself out, after you help them clarify their wishes and intentions. Be patient and know that your listening and encouragement to let clients find their way in these choices will be time and effort that they, their families, and their favored charities will appreciate for years and lifetimes to come.

Endnotes

1. See "Decision Rules and Maximum Initial Withdrawal Rates," by Jonathan Guyton and William Klinger in the March 2006 Journal at FPAJournal.org.
2. See "The Retirement Consumption Conundrum: Evidence from a Consumption Survey," by Jonathan Fisher and co-authors at crr.bc.edu/working-papers/the-retirement-consumption-conundrum-evidence-from-a-consumption-survey.
3. See "Estimating the True Cost of Retirement," by David Blanchett at corporate.morningstar.com/ib/documents/methodologydocuments/researchpapers/blanchett_true-cost-of-retirement.pdf.
4. See "Why David Blanchett's Retirement Spending Research Is a Big Deal," by Jonathan Guyton in the May 2016 *Journal* at FPAJournal.org.

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