Delaware Life®

Delaware Life Income Planning Institute℠

Part 1: Educate clients about risk management strategies in retirement

Client conversations: How to talk about risk

Note: This is the first part of a four-part series on risk management and retirement readiness.

When it comes to retirement, there's no shortage of alarming statistics about the risks that clients face. The rising costs of health care, sustainability of Social Security, volatile markets and inflation can all impact your clients' finances in retirement.

An essential part of your role as a trusted advisor is helping clients understand what they need to prepare for in retirement and how to manage those risks over the course of their retirement. It's what clients want. According to EBRI's 2017 Retirement Confidence Survey, 86% of people expect an advisor to help them convert their savings into retirement income. Yet, only 19% of advisors make that a primary focus.

Help clients identify and manage risks

It's easy for clients to be overwhelmed by the issues they may face in retirement. Here's a suggested risk framework that may help clients better understand the types of risk and how each can be managed appropriately.

1 Identify systematic risks

Systematic risks are generic and uncontrollable and affect everyone. They include political and public policy changes (such as tax rate changes), inflation, business (such as stock market or company performance and credit ratings), and interest rate fluctuations. You can equate systematic risks to the daily weather report—you can't control whether it will be sunny or rainy, hot or cold—but you can prepare for it.

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2 Identify unsystematic risks

Unsystematic risks are client specific, may affect each client differently, and are somewhat controllable. How much money clients plan to spend, their longevity, their health and unexpected expenses that may arise fall into this category. Some of these are unknown, but clients can prepare for them by saving, maintaining a healthy lifestyle, and having an emergency fund.

Equate these risks to how people react and prepare for the weather. If it's raining, they'll bring an umbrella and wear a raincoat; if it's sunny, they'll grab their sunglasses. If it's hot, and they like hot weather, they'll be happy. But if it's cold, they may feel otherwise—everyone reacts and prepares differently.

To provide a visual, you could organize the risks this way:

How's the weather?

Systematic risks	Income
	Credit
	Market
	Inflation
	Policy (taxes, etc.)

How will you prepare for the weather?

Unsystematic risks	Spending
	Unexpected
	Health care
	Longevity

3 Discuss the probability a risk will occur

Ask your clients: Is this a high frequency risk that could happen regularly, or a low frequency risk, which may only happen once, if at all? Use the weather analogy; how likely is it that it will rain? Much more likely in Seattle than in Miami. How cold will it be? Much more likely to be cold in Minneapolis than in Phoenix. For instance, if a client's parents or grandparents lived well into their '90s, it's likely your client might too.

4 Make sure the client understands the consequence of a risk

Would specific risks impede the client's ability to maintain his or her retirement lifestyle, or would it be insignificant? What if it rains? Is it going to cause a flood, or will it simply be a passing shower? Has it rained much previously, or is this the first rain in months, etc. For example, if the stock market is down when a client first starts taking withdrawals out of investment accounts in retirement, it's very hard to make up for those early losses.

5 Determine a client's risk tolerance

Risk tolerance is the amount of risk that an investor is comfortable taking on and how much uncertainty an investor can handle. Age, income and financial goals help determine the level at which an investor can invest but still be able to sleep at night.

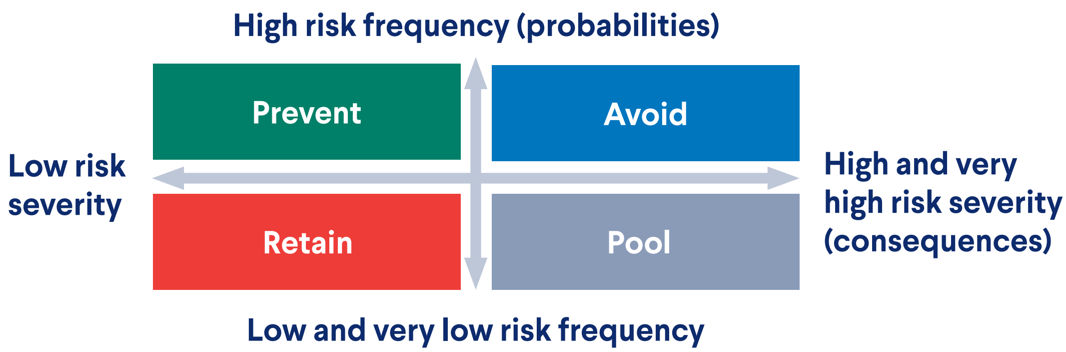
6 Determine how much risk a client can take on

Unlike risk tolerance, risk capacity is the amount of risk that a client can reasonably take to reach financial goals. The return needed to reach goals can be estimated by using timeframes and income requirements to decide the types of investments and the appropriate level of risk. A client's financial situation, age and circumstances must also be considered to determine the amount of risk that he or she can take on.

Keep in mind, a client's risk tolerance and capacity may not match. Some clients may have a high tolerance for risk, but in reality, they shouldn't be taking on as much. Conversely, some clients have the means and capacity to take on much more risk, but they're not comfortable doing that. One way to manage this situation is to review each potential risk individually. (Use our Risk assessment worksheet to do this.)

7 Discuss the different ways to help manage the risk

Once each risk is identified—a client likely has several—there are four ways to manage them. Which strategy to use depends on the probability that it will occur and the severity of the consequences if it does.



Prevent High frequency/low risk severity like taxes, inflation and spending risks can be managed through traditional risk management strategies like diversification and asset allocation.

Retain Low frequency/low risk severity like market volatility, credit and income risks can be managed by self-insuring to hedge the risk—also known as flooring.

Pool Low frequency/high risk severity such as longevity and health risks can be managed with insurance and annuity products, which provide guaranteed lifetime income.

Avoid High frequency/high risk severity such as unexpected expenses and health risks can be managed through keeping cash on hand for insurance.

Once the risk management strategy is determined for each risk, you can create an appropriate solution allocation for the client—and within each solution, an investment allocation. A portfolio can be planned and allocated integrating client needs, risk tolerance and risk capacity, rather than simply by asset class. (Read part 3 of this series, "A client-centric approach to retirement-income planning," for more details.)

Highlight the expertise that sets you apart

Creating a framework for managing the risks your client will face in retirement will help you to develop a productive ongoing conversation. Solution allocation is a way of organizing the conversation in terms that are relevant and personal for your clients. Engaging clients is an important step to help them plan for their income needs in retirement.

About Anders Smith

Anders is a director for Delaware Life National Sales Consulting (NSC). With more than 30 years in the financial services industry, he can share proven retirement income, advanced sales, and practice management strategies to help build a successful and profitable business. He is a nationally known speaker at industry events.

About National Sales Consulting

Our goal is to help financial advisors be successful. Learn more about the value we can bring to you and your clients. Please contact the Delaware Life National Sales Consulting Team for additional information at 855-NSC-OWLS (855-672-6957) or NationalSalesConsulting@dlmarketing.com.

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