

## A Unique Way to Help Clients Close the Retirement Gap

By Dan Richards

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Clients facing a shortfall in retirement savings can bridge that gap in many ways. But one technique is often neglected: spending reductions – even small ones – in their everyday lives. A new web site gives clients the tools to quantify and manage those reductions.

If you're meeting with clients in their 40s and 50s, chances are you're run into a common question: How do I close the gap in hitting my retirement goals? Weak equity markets over the past decade, low interest rates and a new consensus on a muted outlook for future returns means that some clients who five years ago were on track to retire at 60 or 62 can no longer be confident about doing so.



It's here that advisors can add real value, as you're able to engage clients facing a shortfall in a discussion about the six options available to them:

- Option 1: Work longer.
- Option 2: Work part time after retirement.
- Option 3: Increase the risk in asset mix before and during retirement to increase potential returns.
- Option 4: Change retirement plans – downsize houses earlier or cut back on spending.
- Option 5: Reduce spending now and invest more leading up to retirement.
- Option 6: Buy lottery tickets.

Setting aside option six, every solution to closing the gap en route to retirement will include some combination of these alternatives. And it's here that financial advisors can add real value – clarifying alternatives and helping clients understand the tradeoffs available to them.

Historically, some advisors have been reluctant to get into conversations about client budgeting and spending, focusing on the investment side of the equation. That may have worked in the past – but for clients looking to close a shortfall in retirement plans, you can't ignore the impact of spending, both now and in retirement. As part of that, an interactive new web site gives clients the tools to quantify and manage those reductions.



## **Quantifying “the latte effect”**

Most advisors have heard of “the latte effect” – the big impact that a small reduction in non-essential spending makes on retirement portfolios.

And while many clients are vaguely aware of this, the challenge is getting them to take action.

Inertia is an incredibly powerful barrier to change. Telling people they need to alter behavior doesn’t work – they have to discover this for themselves. That’s why an interactive savings calculator on a website called [bills.com](http://bills.com) offers an effective way to show clients what happens if they reduce spending.

There are three simple steps. First, clients choose the return that they’ll earn on their savings – from 1% to 10%. Next, they select the length of time for which these savings will be maintained – anywhere from one year to 30 years.

Finally, the site allows people to look at 20 ways they can cut back – from daily coffees and snacks to bottled water, gym memberships, lottery tickets, entertainment and dining out. You pick a category and how much you think could be cut – depending on the expenditure, the savings are shown on a weekly or monthly basis. As people go through the different categories, there is a running tally of how much better off they’ll be as a result.

Clients could go through this process in two different ways. One is to go through each category looking for savings and see where they end up. The other is to set a monthly savings goal and then go through each category looking for ways to get to that goal.

## **Helping clients stick to their plan**

Imagine that a 45-year old couple chooses a 20-year timeframe and a 6% return on the amount they save, based on an all-equity portfolio of quality-dividend stocks. Having done that, they decide to eliminate their two daily lattes while at work. At \$4 each, that adds up to \$80 a week that they put into a retirement account. By doing this alone, in 20 years they end up with an extra \$160,000 in retirement savings; at a 4% withdrawal rate, that works out to an extra \$125 a week to spend in retirement.

Or let’s suppose they identify weekly savings of \$200, adding up to \$10,400 annually. Of this amount, half goes to fund quarterly long weekend mini-vacations in nearby cities, the other half goes into an account for retirement.

After 20 years, that \$100 a week into their retirement fund accumulates to just over \$200,000. One way to translate this into concrete terms is to tell clients that at a conservative 4% withdrawal rate, setting aside an extra \$100 a week for the next 20 years results in an extra \$150 a week for the duration of their retirement, indexed for inflation.



The reasons behind the other half of their savings that's allocated to quarterly mini-vacations are driven by two pieces of behavioral research.

One relates to the need for short-term reinforcement to maintain discipline. People need more than the prospect of a more comfortable retirement in 20 years time to sustain short-term sacrifice. That quarterly mini-vacation provides regular immediate rewards en route to that long-term goal.

The other research is on the payoff from holidays, something I've written about before. There are three ways that people get a lift from vacations – the anticipation leading up to them, the enjoyment while on holiday and the positive memories afterwards. What's fascinating is that as a general rule, the most powerful of these three benefits from vacations is the anticipation in advance of getting away.

The conclusion is very simple: In addition to taking periodic longer breaks to decompress and recharge, we'd all be better off if we scheduled more frequent, shorter holidays, so that we always have something coming up to look forward to. That's true for us – and it's just as true for our clients.

A last observation on this site: Many clients who are fairly frugal or who don't have to be concerned about their retirement still worry about the "live for today" mindset of their children. The site can be a useful resource for your clients, but can be even more effective if they can persuade their kids to spend some time with it.

Note: The site does not incorporate inflation, and works with nominal amounts. The extra dollars at retirement are actually greater than shown on the site, since the cost of those lattes and gym memberships will go up with inflation. Offsetting that, the dollar amount the site shows clients ending up with down the road is in today's dollars and will have lost purchasing power. In the interest of simplicity, I suggest you set this aside when having this conversation with clients.

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