How to Help Your Middle-Class Clients Retire

By Dan Richards
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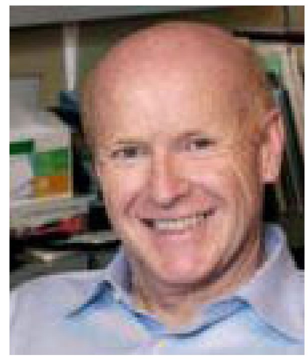

Middle-class Americans face a retirement savings crisis. Based on a report by the Center for Retirement Research at Boston College, at the end of 2010 over half of Americans will be unable to maintain their pre-retirement lifestyle at age 65. Even among the top third of income-earners, 44% won't be able to retire at 65 without a drop in living standards.

This may not be a big issue for advisors who serve affluent investors with multi-million dollar accounts. For most advisors, however, the bulk of their clients are middle-income, middle-class investors. And even advisors who focus on the top end of the market often work with the adult children of their clients, whose accounts are much smaller.

The news is not all bad, however. The burgeoning field of behavioral finance points to some simple methods to help clients save more, invest their savings more effectively and maintain motivation through tough patches. Using these methods, advisors can help middle-income clients take the steps to increase the odds of being able to retire when they want, how they want – and to reduce their stress along the way.

Helping clients increase savings rates

University of Chicago economist Richard Thaler is one of pioneers in behavioral finance. In this *New York Times* article earlier this month, he laid out a two-step formula to increase savings among middle-class Americans.

Make payroll savings plans mandatory. And second, incorporate design features that have been proven to dramatically increase savings levels.

Thaler suggested that the default entry level of savings in these plans needs to be higher. Three-quarters of existing plans start at 3% of savings, unless employees make a conscious decision to move to a higher level. As a starting point, he advocated increasing the default savings level to at least 5%. Employees would still be able to change this, of course, but we know that the power of inertia is such that few will.

Then Thaler moved to the real heart of his recommendation, to implement a plan that he calls Save More Tomorrow. The concept is simple: Don't ask people to reduce their income today. Rather, ask for a commitment that a large proportion of future salary increases will be automatically allocated to increased savings.

Thaler referred to this program as automatic escalation. One of the first companies that implemented this plan saw a quadrupling of savings rates among employees over a four-year period, from 3.5% to 13%. In 2011, half of US companies with payroll savings plans offered this as an option; Thaler believes that all should. Further, he recommended that automatic escalation be the default option when people sign up for savings plans.

The positive results from automatic escalation plans have been replicated in other research. One recent academic paper explained why this approach is so effective. Some people are active savers, in which they make conscious decisions on how much to spend and to save. Most, however, are passive savers – their decision on saving depends on how much money they have left over after their expenses have been met.

Using the Save More Tomorrow approach, people are not asked to give anything up today and never see the money from future pay increases, so don't feel the same sense of sacrifice that they otherwise would. Click here to read more about Richard Thaler's research on automatic escalation programs.

Using "mental buckets" to take the right amount of risk

Another leader in research into behavioral finance is the University of Santa Clara's Meir Statman. One concept Statman pioneered is "bucketing" savings, essentially putting savings into different time-frame silos with appropriate levels of risk in the way the money is invested.

One bucket might be for needs coming up in the next three years – for example savings for a holiday or home repair. A second might be mid-term needs from three to six years; that would include university tuition or the purchase of a car. And the final bucket would consist of savings for retirement and other longer term needs.

Clearly delineating the timeframe for each bucket allows investors to adopt the right risk-return mix for each component of their savings and encourages even risk-averse investors to adopt strategies for their long-term savings that are more likely to get them to their long-term goals. Click here for more on how to explain the concept of savings buckets to clients.

Employing "the progress principle" to maintain motivation

The final insight on helping middle-income clients increase savings rates comes from Harvard Business School's Teresa Amabile.

Amabile conducted in-depth research among professionals inside larger organizations – so-called "knowledge workers" – to identify what helped them maintaining a positive attitude. The one factor that correlated with sustained motivation, even in the face of setbacks: A sense that these knowledge workers were making progress. The wins didn't have to be big ones; even small wins helped keep knowledge workers motivated an on track.

The same principle applies to helping middle-class clients stay motivated and adhere to their plans. By using annual reviews to focus on how they're progressing towards their plans, you can help clients stay on track. And provided that they are on track, consider building an annual reward into their plans; even a long weekend away can serve as an incentive that will help clients stay focused on their goals. Click here to read more about "the progress principle."

As daunting as the challenges are for many middle-income investors, by using these proven approaches you can help them get their retirement planning on track and seize control of their financial futures.

Dan Richards conducts programs to help advisors gain and retain clients and is an award winning faculty member in the MBA program at the University of Toronto. To see more of his written and video commentaries, go to www.clientinsights.ca. Use A555A for the rep and dealer code to register for website access.