A Review of Research in Financial Planning

By Shawn Brayman
President, PlanPlus Inc.
Shawn Brayman

- PlanPlus Founder with 20+ years experience in financial planning sector
- Support financial advisors in over a dozen countries and 8 languages
- International speaker on financial planning
- Winner of the Financial Frontiers Award 2007 for leading research in Financial Planning, Canadian Investment Awards, “Advisor Education Award”.
- Member of FPA Global Advisory Council, founding supporter for www.planipedia.org, Advisor to Institute of Financial Planning, Russia
What is research?

Research can be defined as the search for knowledge or any systematic investigation to establish facts. The primary purpose for applied research is discovering, interpreting, and the development of methods and systems for the advancement of human knowledge on a wide variety of scientific matters of our world and the universe.
A Research Review

The FPSC Foundation has engaged PlanPlus to carry out an environmental scan of research carried out between 2003 and today, from Australia, Canada, United Kingdom and the United States, in the field of financial planning. The principal objective is to try and highlight research areas where there may be gaps that may warrant FPSC Foundation focus.
# Categories

## Investment Planning
- General Investment Planning
- Portfolio Objectives
- Portfolio Analytics
- Use of Investment Policy
- Aggregation
- Tax Optimization
- Client Reporting
- Rebalancing
- Guaranteed Minimum Products

## Insurance Planning & Risk Management
- General Insurance & Risk Management
- Needs on Death
- Needs on Disability
- Critical Illness
- Long Term Care
- Term vs. Permanent Insurance
- Property & Casualty Insurance
- Key Man
- Buy-Sell
- Pricing

## Estate Planning
- General Estate Planning
- Will Review
- Estate Distribution Analysis
- Succession Planning
- Charitable Giving
- Estate Taxes
- Gifting
- Power of Attorney for Property Review
- Power of Attorney for Personal Care Review

## Tax Planning
- General Tax Planning
- Personal Income Tax
- Corporate Tax
- Capital Gains Harvesting

## Cash Flow & Liability Management
- Real Estate/Mortgages
- Debt Management
- Lending Metrics
- Income Profile
- Savings Behaviour

## Portfolio Management
- General Portfolio Management
- Efficient Frontier
- Post-Modern Portfolio Theory
- Active vs. Passive Management
- Tactical vs. Strategic
- Product Allocation
- Socially Responsible Investing
Categories

**Retirement Planning**
- General Retirement Planning
- RRIF/LIF/PRRIF
- IRA, Distributions
- Investment Liquidity
- Pension Alternatives
- Government Benefits
- Healthcare
- Annuities
- Mortality
- Employee Benefits
- Sustainable Withdrawal Rates
- Stochastic vs. Deterministic Forecasting

**Behavioural Finance**

**Business Practices**
- General Business Practices
- Information Technology
- Product Shelf
- Recruitment
- Marketing
- Fee Structure
- Best Practices
- Business Models
- Practice Succession Planning
- Cost of Compliance
- Professional Issues

**Other Planning**
- Specialized Financial Planning
- Business Planning
- Education Planning
- Other Accumulation Goals
- Multi-Goal vs. Modular
- Average vs. Graduated Tax
- Divorce Planning
- Terminal Illness
- Non-traditional Families
- Job change/loss
- Dependents with Special Needs
- Islamic Financial Planning
- International Planning
- Econometric Assumptions

**Holistic Planning**
- General Holistic Planning
- Demographics
- Holistic Planning vs. Modular

Visit: http://www.planplus.com/fpsecsurvey.html
Today’s Review

- Behavioural Finance
- Investing
- Portfolio Management
- Insurance
- Retirement Income Planning
- Fiduciary Responsibility
Today’s Review

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Behavioural Finance

- [http://www.youtube.com/watch?v=f94WI-0chv4](http://www.youtube.com/watch?v=f94WI-0chv4)
  - Brains have evolved little since the Stone Age
  - Optimized for physical survival not contemporary threats
  - On threat, reward, brain’s Limbic System wired to shut down Prefrontal Cortex – don’t think, RUN! (or grab)
  - Very poor system if threat is a market downturn
  - Technology is “bad” because it allows immediate change as opposed to when took time to execute
  - Brain has “neuro-plasticity”, can change and learn
Investors Follow the Performance Trend

Investors are often tempted to buy high and sell low...

Source: RBC Asset Management

Research Review – CIFPS Niagara Falls
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The Client Reality

• Fidelity Magellan Fund had 12.5% compound return over 25 years (#1) and the average investor received 2.5%

• Dalbar study 1984 to 2003
  ➢ S&P 500 Index 12.2%
  ➢ Average investor 3%

• Dalbar study 1987 to 2005 (published 2007)
  ➢ Buy and invest starting with $10,000 became $94,555
  ➢ Average investor $10,000 became $21,422
Planning Response to Market Volatility

Since the market has changed over the past year, what actions, if any, have you taken?

- I stayed the course, continuing to save at the same rate as I did prior to the recent market downturn. 38%
- I have rebalanced my portfolio. 31%
- I added more money into existing accounts. 16%
- I have taken advantage of the low interest rates. 12%
- I have moved into more of a cash position. 14%
- I have taken advantage of the down market by investing in low-priced stocks. 9%
- I added more money into new accounts. 15%
- I have taken advantage of the down market by investing in real estate. 10%
- I have taken more money out of accounts than I have added in. 5%
- None 5%

Source: Value of Financial Planning Study, FPA & Ameriprise

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Risk Tolerance Questionnaires

*Insights from Psychology and Psychometrics on Measuring Risk Tolerance*

- Most industry questionnaires are portfolio pickers not risk tolerance tests
- As good as “Client is moderate +/- 50%”
- Too few questions
- Many “bad questions”
- Not enough good questions

Source: *Journal of Financial Planning, April 2005*
An Improved Approach

Risk Profile
• A proper psychometric risk profile to determine your risk tolerance
• 25 validated questions so +/- 4% reliable in measuring risk tolerance

KYC
• Facts about your client – net worth, income, experience

Portfolio Objectives
• Time horizon until funds are needed
• Risk capacity, the ability to adapt if markets are down
• Other considerations like:
  • Desire to support socially responsible investing
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- Fiduciary Responsibility
Going Green

• Investors Want to Turn Green, *Journal of Financial Planning*, April 2009 based on survey by Allianz Global
  • 64% of investors consider the environment as most desirable opportunity among 10 categories
  • 68% said would need to consult advisor
  • 85% said their advisor never recommended “environment related”
• US Department of Labour (January 2009) “does not permit fiduciaries to make investment decisions on the basis of any other factor than the economic interest of the plan”.
• Western University Endowment Fund confirms same “operating rules”.
Active vs. Passive

• Can managers outperform?
• If a few can, can we pick them?
• Study on value added of 1,302 Active Management funds vs. Chance from 1962 to 1995 – 2/3rds under perform
Were Managers Better 5 or 10 years ago?

- **Survivorship bias** in available data
- Poor funds are merged, go bust or drop from the picture
- Data is not easily available to consumers or advisors in Canada that does not include this bias.

Source: Data from Morningstar Dec 2008
S&P/TSX Indices vs. Active Funds Scorecard – Q4 2009

Active managers outperforming index

Source: Standard & Poor's Indices Versus Active Funds Scorecard for Q4 2008
Manager Performance Isn’t Persistent

• How do top quartile managers over 3 years (rolling) performed in subsequent 3 years – data from December 1985 to 2005
• US Equities – 50% below median, 42% above and 8% dropped from database
• Non-US Equities – 45% below median, 47% above and 8% dropped from database
• Additional studies under S&P

Source: Alliance Bernstein - Australia
Research on Manager Past Performance

• Reviewed 100 studies over 40 years from US, UK and Australia
• Focused on studies with proper methodology
• Many studies that found manager persistence failed to account for survivorship bias.
• Good past performance seems to be, at best, a weak and unreliable predictor of future good performance over the medium to long term.
• About half the studies found no correlation at all between good past and good future performance.
• Where persistence was found, this was more frequently in the shorter-term, (one to two years) than in the longer term and of small magnitude. The cost of swapping would outweigh trying to follow.

Source: Australia Securities and Investments Commission and Funds Management Research Centre – June 2003
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What Determines Portfolio Performance?

1. Markowitz – Nobel Prize for MPT.
4. Fama (1965) – nominated for Nobel Prize that you cannot pick stocks or mutual funds (Efficient Market Hypothesis).
Another Interpretation by Ibbotson


2. Decompose into “market return” the equally weighted return for a given period for all the funds in the applicable universe, allocation policy and active management.

3. Measuring the variability in returns in a peer group. “Is the difference in returns among funds the result of asset allocation policy or active portfolio management?”
Markets are down so...

- Markets are more positively correlated in down markets
- Need to introduce more alternative investments with lower correlations
- So what? The free lunch is getting harder to find!
- Part of our obsession to feel we add value.
Again – Buy & Hold is Dead (Again)

• Buy & hold works in bulls, secular bulls, bears but not secular bears.
• “Ironically the belief in the buy and hold approach probably died at just about the time it deserves to reborn.”
• “How Active is Your Fund Manager? A New Measure That Predicts Performance”, Cremers & Petajisto.
• “researchers found conclusive evidence that active management consistently and significantly does add value…”
• “small funds that had the best performance in the prior year and the highest active share…”
• Spoke at FPA Anaheim – “trying to catch back up to index”.

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Efficient Frontier to Construct “Optimized” Portfolios

- William Sharpe algorithm
- Locate asset class mix that gives best return for a desired level of risk

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Estimation Error

- Different timeframes, different capital market assumptions – what to use?
- Because different choices give different results does this invalidate any single choice?

**25 Year Rolling Portfolio Returns**

- Return
- Inflation
- Real Return
- Std. Dev.
Estimation Error

“The 1/N asset allocation rule typically has a higher out-of-sample Sharpe Ratio, a higher certainty-equivalent value, and a lower turnover than optimal asset allocation policies”

<table>
<thead>
<tr>
<th>Table 1</th>
<th>Very Conservative</th>
<th>Conservative</th>
<th>Moderate</th>
<th>Aggressive</th>
<th>Very Aggressive</th>
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<tbody>
<tr>
<td>Fixed 1</td>
<td>45.0%</td>
<td>35.0%</td>
<td>25.0%</td>
<td>15.0%</td>
<td>5.0%</td>
</tr>
<tr>
<td>Fixed 2</td>
<td>45.0%</td>
<td>35.0%</td>
<td>25.0%</td>
<td>15.0%</td>
<td>5.0%</td>
</tr>
<tr>
<td>Equity 1</td>
<td>2.5%</td>
<td>7.5%</td>
<td>12.5%</td>
<td>17.5%</td>
<td>22.5%</td>
</tr>
<tr>
<td>Equity 2</td>
<td>2.5%</td>
<td>7.5%</td>
<td>12.5%</td>
<td>17.5%</td>
<td>22.5%</td>
</tr>
<tr>
<td>Equity 3</td>
<td>2.5%</td>
<td>7.5%</td>
<td>12.5%</td>
<td>17.5%</td>
<td>22.5%</td>
</tr>
<tr>
<td>Equity 4</td>
<td>2.5%</td>
<td>7.5%</td>
<td>12.5%</td>
<td>17.5%</td>
<td>22.5%</td>
</tr>
</tbody>
</table>

1/N versus Efficient Frontier

Efficient frontier does worse:
• Shorter the series of data,
• Lower the volatility of the individual assets or asset classes,
• The greater the number of asset classes

How much worse does it do?
• If volatility was 20% with 4 asset classes it required 50 years of data for EF to do as well as a 1/N strategy.
• Increase the number of assets from 4 to 100 it would require the estimation window in excess of 1,000 years.
Throw Away Allocation?

- Efficient Frontier is not Asset Allocation
- Believe your own disclaimers, “History is not a guarantee of future performance”
But there is always someone that ruins a photo!
A Simple “predictive model”

• Garrison, Carlos, Cribbs (Feb 2010 JFP) “A Simple Dynamic Strategy for Portfolios Taking Withdrawals: The Case for Using a 12-Month Simple Moving Average.”
• Take the simple average market price for prior 12 months.
  – If current price higher stay in equities.
  – If current price lower move to bonds/cash
• Looked at S&P 500 from 1926 to 2009
• Compared various portfolios (0/100, 40/60, 60/40, 80/20, 100/0 and the 12 month moving average)
• 12 month SMA had comparable returns and less risk for periods of 10 years, and higher returns and less risk on longer periods.
A Doubting Thomas

• Fama addressed “weak relationship”
• Assumed the accumulation, decummulation, various portfolios were “noise”.
• Question is, did the indicator actually work for decision to be in or out of the market?
Today’s Review

- Behavioural Finance
- Investing
- Portfolio Management
- Insurance
- Retirement Income Planning
- Fiduciary Responsibility
Insurance Needs

Brayman (March 2009) “Income Replacement versus Expense Approach to Insurance Needs Analysis”

Results

• The study compared 2,300 actual client cases and found that the income replacement method overstated requirements 73.4 percent of the time, by an average 68.9 percent, compared with an expense analysis.

• Income replacement understated needs 20.8 percent of the time. It was determined that advisors articulated 28.5 percent more goals and averaged 15.7 percent higher replacement percentages with the discovery methods of expense analysis.

• A random review of 12 popular insurance needs calculators on the web illustrated significant variation. At least half the calculators estimated an insurance need greater than full replacement of the deceased’s after-tax income. The spouse is better off with the client dead than alive.
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Retirement Income Planning

The most popular topic/discussion

• Sustainable withdrawal rates
• Market cycle impact
• Equity Index Annuities
• Target Date Funds
• GMWB - Guaranteed Minimum Withdrawal Benefits
• Product allocation
How do we allocate accumulated wealth to achieve safe and sustainable income in retirement?
Sustainable Withdrawal Rates

- Cooley 1998 concluded 4% withdrawal had 100% success for any 30 year period from 1926 to 1995
- Michael Kitces, using 60/40 portfolios concluded 4.5% in overvalued markets, 5% in fairly valued and 5.5% in undervalued.
Behavioral Reality

- Guyton & Klinger 2007 concluded if included behavioural flexibility, with 40 year periods, adds between 0.5% to 1.0% per annum to withdrawal rates (ie 5.0% to 6.5% overall)
- James Shambo 2008 “The Hedonistic Pleasure Index – An Enhanced Model for Spending Inflation” found:
  - In periods of deflation consumption declines more rapidly than the price index…shows our intuitive behavior to cut back spending by more than just the price decline, but also on quantity and quality.
  - In periods of rapidly rising prices consumption growth lags the price index …shows an intuitive behavior to cut back on quantity or quality when prices are rising too fast.
New in 2009/2010

- Blanchett & Frank April 2009 *JFP* “A Dynamic & Adaptive Approach to Distribution Planning & Monitoring”
  - 80/20, 60/40, 40/60 and 20/80 portfolios.
  - Inflation + (3%, 0, -3%)
  - Decrease if
    - failures >20% with 20 year timeframe
    - failures >10% with 11-19 year timeframe
    - failures >5% with 10 years or less timeframe
- Most successful strategies:
  - 4% (revised by rules)
  - 5% (revised by rules)
  - 4% (fixed withdrawal)
  - 6% (revised by rules)
  - 5% (fixed withdrawal)
  - 7% (revised by rules)
New in 2009/2010
Market Cycles

• Harris (September 2009) JFP “Market Cycles & Safe Withdrawal Rates”
  • Look at Financial Cycles (average 30 year) – Secular Bull/Bear.
  • From 1881 to 2000, S&P 500
    • Average 4.8% overall
    • 4 Secular Bulls average 13.3%
    • 4 Secular Bears average -1.4%
  • Very hard to predict where we are in a cycle, but can use Tobin’s Q, P/E Ratio, etc.
  • Will impact save withdrawal rates +/- 1% based on where we are in the cycle.

Figure 2: S&P Composite Secular Periods Inflation Adjusted
Target Date Funds

- Dolvin, Templeton, Rieber (March 2010) *JFP* “Asset Allocation for Retirement: Simple Heuristics and Target Date Funds”
  - Most target date fund providers use Equity = 120 - age.
  - Certain static approaches equal the dynamic strategy. Consider 100% equity until Retire – 10 then 100 – age
  - 100- age = 50/50 (min/mean/median/ standard deviation). If no extra fee OK, otherwise why?
  - 120-age = 70/30
- Bodie, Fullover, Treussand (March 2010) *JFP* “Unsafe at Any Speed? The Designed-In Risks of Target-Date Glide Paths”
  - Major issue of measuring risk in these funds
GMWB

- Xiong, Idzorek, Chen (February 2010) *JFP* “Allocation to Deferred Variable Annuities with GMWB for Life”
  - The higher the risk tolerance the lower the GMWB
  - The higher the age the lower the GMWB
  - The higher the “subjective life expectancy”, the higher the GMWB
  - The higher the ratio between wealth and income gap, the lower the GMWB
  - The preference for bequests has little impact
  - Should the insurance companies charge a fixed fee for GMWB, no matter what the risk of the portfolio (the current practice), investors should select an aggressive asset allocation
  - Investors should strive to find a combination in which the stand alone VA fees are comparable to the mutual fund fees and the GMWB are close to (about 80 bps based on annual reset, age 65, aggressive portfolio)
Optimizing Government Benefits

  - For single tax payer with average life expectancy, PV of benefits the same no matter when
  - For a couple, key is survivor benefits. For average couple PV is maximized when low income does early election and high income elects at age 70.

<table>
<thead>
<tr>
<th>Single Person</th>
<th>60</th>
<th>61</th>
<th>62</th>
<th>63</th>
<th>64</th>
<th>65</th>
<th>66</th>
<th>67</th>
<th>68</th>
<th>69</th>
<th>70</th>
</tr>
</thead>
<tbody>
<tr>
<td>2010 Rules, Age 60</td>
<td>50.412</td>
<td>50.200</td>
<td>49.563</td>
<td>48.851</td>
<td>47.214</td>
<td>45.698</td>
<td>43.747</td>
<td>41.702</td>
<td>39.501</td>
<td>37.182</td>
<td>34.779</td>
</tr>
<tr>
<td>New Rules, 60 Today</td>
<td>50.412</td>
<td>50.200</td>
<td>49.563</td>
<td>48.851</td>
<td>47.214</td>
<td>45.698</td>
<td>43.747</td>
<td>41.702</td>
<td>39.501</td>
<td>37.182</td>
<td>34.779</td>
</tr>
<tr>
<td>New Rules, Endstate</td>
<td>46.091</td>
<td>47.030</td>
<td>47.387</td>
<td>47.227</td>
<td>46.512</td>
<td>45.989</td>
<td>44.738</td>
<td>43.489</td>
<td>41.912</td>
<td>40.061</td>
<td>37.989</td>
</tr>
</tbody>
</table>

| Married, Current Rule                              |       |     |     |     |     |     |     |     |     |     |     |
| Spouse elects 60                                   | 123.045 | 123.796 | 124.077 | 123.932 | 123.398 | 122.512 | 121.310 | 119.828 | 118.098 | 116.154 | 114.028 |
| Spouse elects 65                                   | 122.512 | 123.262 | 123.544 | 123.395 | 122.865 | 121.579 | 120.777 | 119.295 | 117.565 | 115.521 | 113.495 |
| Spouse elects 70                                   | 114.029 | 114.776 | 115.060 | 114.915 | 114.381 | 113.495 | 112.293 | 110.811 | 109.081 | 107.137 | 105.011 |

| Married, Endstate Rules                            |       |     |     |     |     |     |     |     |     |     |     |
| Spouse elects 60                                   | 102.763.64 | 104.298.57 | 105.264.39 | 105.707.39 | 105.808.39 | 105.233.99 | 105.000.63 | 103.337.36 | 103.296.39 | 101.926.68 | 100.275.13 |
| Spouse elects 65                                   | 105.233.99 | 106.778.91 | 107.744.73 | 108.187.73 | 108.180.73 | 107.714.33 | 107.490.97 | 106.917.70 | 105.776.73 | 104.407.02 | 102.755.47 |
| Spouse elects 70                                   | 100.275.13 | 101.820.06 | 102.765.87 | 103.229.87 | 103.201.88 | 102.755.47 | 102.522.12 | 101.858.85 | 100.817.98 | 99.446.17 | 97.756.62 |

**Sensitivity**
- Used 5% discount rate. Lower the discount rate, greater value of future revenues, bias to delay
- Based on 1997 Mortality Stats Can Tables. Longer mortality bias delay
- Based on male tables. If factor in gender will bias to delay
- Client family history and mortality bias
Equity Index Annuities

- Collins, Lam, Stampflo May 2009 JFP “Equity Indexed Annuities: Downside Protection But at What Cost”
  - Structured product with zero coupon bonds to cover minimum payments and options for market upside
  - Pay off guaranteed floor or % of reference index
  - “Potential customer base for EIAs is limited and utility theory underlying classical economics cannot explain the popularity of EIAs among retail investors”
- Proposal in US SEC to make these “securities products” not insurance as the insurance industry does not have training to understand.
Annuities in the Spotlight

  - Systematic MF withdrawal
  - Fixed Payout Life Annuity
  - Variable annuity
  - Variable Annuity & GMWB
  - MF and Fixed Annuity Lump at retirement
  - MF and Fixed Annuity, gradual at certain ages
- Assume scenarios to 100
- “None of the strategies obviously dominates, given the confluence of uncertainty on asset returns, length of life and bequest preferences.”
The Luck Factor

- Sequence is the chance that although long term returns are OK, some initial bad years cause you to fail in meeting your objectives.

- “Beyond Monte Carlo: A Replacement for a Misunderstood Practice” Brayman 2007 showed the method of utilization of Monte Carlo gave no different results than Statistics 101 and all subject to capital market assumptions.

- “Understanding the Luck Factor”, Brayman 2009 (Academy of Financial Services, CA), can quantify sequences with good returns but bad luck.
Large single withdrawal in 1 year

Success-Failure by Year of Major Withdrawal

Still see a modest relationship to withdrawal strategy
Summary

- Sequence risk does not appear to be linked to portfolio volatility
- Minor relation to withdrawal strategy where withdrawals 4 to 8 years out have biggest impact

<table>
<thead>
<tr>
<th>Overall Failure</th>
<th>4%</th>
<th>5%</th>
<th>6%</th>
<th>7%</th>
<th>8%</th>
<th>9%</th>
<th>10%</th>
<th>11%</th>
<th>12%</th>
<th>13%</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>5.70%</td>
<td>11.90%</td>
<td>22.40%</td>
<td>37.40%</td>
<td>52.40%</td>
<td>66.70%</td>
<td>79.00%</td>
<td>87.80%</td>
<td>93.40%</td>
<td>96.80%</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>% Fail by Sequence</th>
<th>4%</th>
<th>5%</th>
<th>6%</th>
<th>7%</th>
<th>8%</th>
<th>9%</th>
<th>10%</th>
<th>11%</th>
<th>12%</th>
<th>13%</th>
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<tbody>
<tr>
<td></td>
<td>63.16%</td>
<td>53.78%</td>
<td>42.86%</td>
<td>31.55%</td>
<td>20.23%</td>
<td>11.99%</td>
<td>6.71%</td>
<td>2.85%</td>
<td>1.07%</td>
<td>0.31%</td>
</tr>
</tbody>
</table>

- Significant link to overall probability of success where the higher overall probability of success impact of sequence risk proportionately higher.
The Luck Factor

- Sequence risk events is not related to the portfolio volatility.
- A more conservative portfolio will have no impact on failure due to sequence risk but reduces the overall portfolio return.
- Increased withdrawals in years 3 to 8 of a strategy increases sequence risk.
- Reduce sequence risk by equalizing or deferring withdrawals, avoid larger commitments in early years - behavioral flexibility.
- Guarantee products with enforced non-withdrawal periods need to be considered in light of fees and if it helps during the high risk period.
Annuities in the Spotlight

Lemoine, Cordell, Gustafson, January 2010 JFP
“Achieving Sustainable Retirement Withdrawals: A Combined Equity & Annuity Approach”

- 100% Equity & Lock
- 128-age in equities
- 100% equities
- Living benefit annuity
- 50% equity and 50% bond

Assume scenarios to 100

- 100% Equity and Annuity Lock had 3.2% failure.
- 128-age had 5.4% failure.
- 100% equity had 12.3% failure.
- Living Benefit annuity had 15.7% failure.
- 50/50 portfolio had 26.2% failure.”
I can give you my 93.4% assurance that there is less than a 65.6% possibility that this exercise will simply generate 34.8% more meaningless statistics.
Annuities in the Spotlight

- Annuity analysis assumed scenarios to 100
- 0.2% probability of achieving this, so really saying the return failure is a variance of a 0.2% likelihood
- Annuities, GMWB are products with a fee to combine “lives” and secure against longevity risk
- If assume life to 100 of course they look better
- If assume mortality (randomization), they cannot be better as the fees must make less efficient

What we must look at

- There is no free lunch.
- Your client’s personal “mortality” circumstance based on family history
- Behavioural finance says people 2.5 times more concerned about downside than upside. Not logical but reality.
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Where is the “Fundamental” Bubble

Do you believe that Financial Services represent 24% to 30% of our economy?
The Quiet Coup

- 1973 to 1985, the financial sector earned 16% or less of US domestic corporate profits.
- 1986, that figure reached 19%.
- 1990s, it oscillated between 21% and 30%, higher than in the postwar period.
- This decade, it reached 41%.
- 1948 to 1982, average compensation in the financial sector ranged between 99% and 108% of the average for all domestic private industries.
- From 1983, it shot upward reaching 181% percent in 2007.

The Quiet Coup, The Atlantic, May 2009 Simon Johnson, a professor at MIT’s Sloan School of Management, was the chief economist at the International Monetary Fund during 2007 and 2008.
Our Course from Here

"I never had the heart to tell my mother I left my job as a piano player in a brothel to become a financial planner."
Placing the Client First

USA

- July 2008 FPA in the US stated all members must act as fiduciaries if using the CFP and holding out as financial planners.
- Active and ongoing debate in Senate and Congress on standards

UK

- RDR/CAR – Consumer Agreed Remuneration
- Client must be aware of and agree to any hidden trailers, fees.
- Fees must be clear for admin, fund management, advisor sales
- Commissions are BANNED as of 2012, all compensation must be paid by the client.

Source: *Customer Agreed Remuneration – ABI summary of research*
Placing the Client First

India
• Summer 2009 banned all front end loads on funds.
• Still evaluating ban on commissions for 2010

Australia
• FPA banned DSC for financial planners - “While the FPA doesn't consider taking a trailing commission wrong per se, it perceives it is as a conflict of interest in the case of a financial planner taking compensation from a investment product provider, such as a mutual fund company, and also offering advice on investment selection.”
• Regulator announced no commissions by 2012, required parliamentary assent, failed, new bill by government. (insurance exempted)
Placing the Client First

Finland
• Banned all commissions in 2008

Netherlands
• Government recognized many firms income generated from small percent of clients that subsidize the “practice” and smaller clients
• Passed legislation 2009 allowing “inadequate billing” of clients but capping exorbitant billing of others. Has effectively killed commissions.
FAIR Canada Conference 2010

• “Near fiduciary” standard of care for mutual fund and IIROC licenced advisors
  – Put the client’s best interest first;
  – Act with prudence; that is, with the skill, care, diligence and good judgement of a professional;
  – Not mislead the clients; provide conspicuous, full and fair disclosure of all important facts. This is usually interpreted as fully disclosing “who compensates the advisor, for what and how much?”;
  – Avoid conflicts of interest;
  – Fully disclose and fairly manage, in the client’s favour, unavoidable conflicts.

• Banks and insurance channels are not subject to this standard of care. Considered a sales channel.

• FPSC, Cary List “financial advisors have an obligation to act with the care of a fiduciary”

• Not being a “fiduciary” but being obliged to work with the same standard of care in Canada, if a breach, allows “attribution of fault”. Fiduciary 100% “at fault”

Canada
What should/will happen?

  - CFP practitioners must keep signed statements about their contractual and compensation disclosure
  - One large US insurer recently encourage agents with the CFP certification to stop using the mark.
- UK insurances have indicated they will disclose once they “redesign their compensation models”
- Most NAPFA members in US have dropped insurance licence
- What can we do in Canada?
  - Have FPSC, IQPF, CIFP and others encourage insurers to create more transparent products
  - Create a task group to create best practices for insurance disclosure
And in Canada?

- Canada has been isolated from much of the chaos internationally and the debate, where it exists, is not as vocal.
- We have an extremely powerful banking and insurance lobby that will not be rewarded by change.
- The “profession” of financial planning can and should set standards above requirements of product regulators.
- Have FPSC, IQPF, CIFP and others encourage insurers to create more transparent products, no load insurance, etc.
- The association should create a task group to create best practices for insurance disclosure which live up to the fiduciary requirement of full and clear.
- The profession must continue to raise the bar with a focus on research and higher standards.
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Questions…

**DISCLAIMER:** This presentation intentionally covers a lot of ground to try and provide advisors with a collage of what fundamental research is teaching us. Shawn has made his best efforts to interpret many of these papers (but could easily have made mistakes). Advisors are encouraged to check it out themselves!