



# *Taking Off* *in a New Retirement* *Income Direction*

BY BRUCE SHUTAN

Innovative advisors are implementing new approaches to the decumulation phase of retirement.

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ost plan advisors have blinders on when it comes to addressing the controlled distribution of assets after participants have retired via a stream of income. But some innovative advisors are shaking up that model, leading a new approach to the decumulation phase of retirement.

Leading academics, such as Boston University's Zvi Bodie and MIT's Robert Merton, have long argued that retirement plans should focus less on creating wealth and more on ensuring steady income streams in retirement. But finding the sweet spot for plan participants requires a delicate balancing act.

Steve Utkusis, a principal and director of Vanguard Center for Retirement Research, noted in a recent blog, "It's not that we have to wholesale switch our mindset from accumulation to income payouts. Rather, participants deserve more of an 'income orientation' to their defined contribution plan, without going so far as adopting a liability-driven approach in its entirety, and investing mostly in cautious investments."

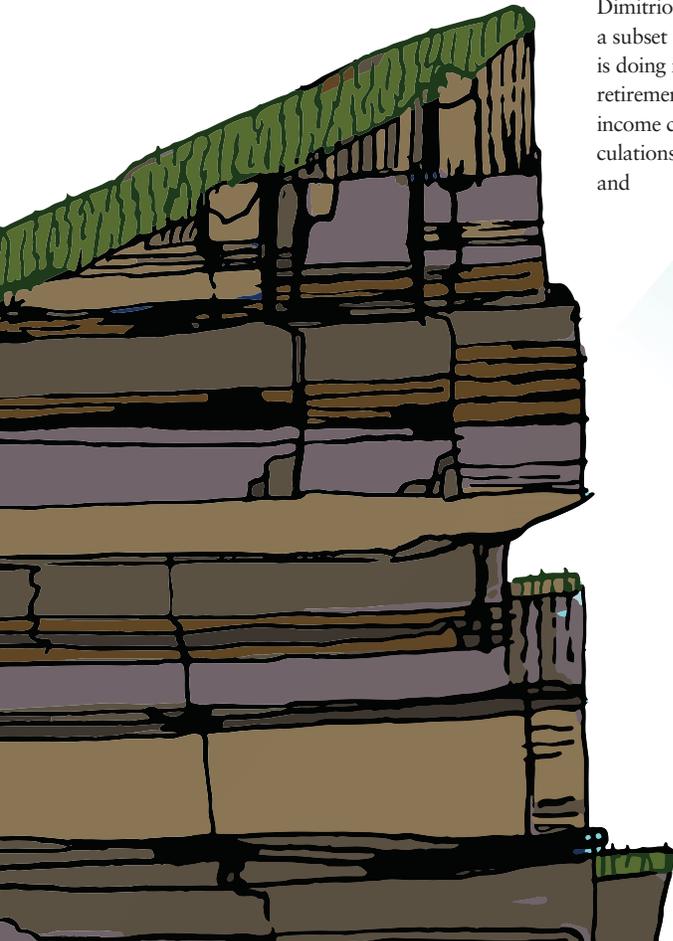
NAPA President Steve Dimitriou reports that a subset of advisors is doing in-plan retirement income calculations and

projections for participants, citing independent broker dealer LPL as one industry leader in this area.

Dimitriou says the industry just doesn't have a mechanism in place to help people decumulate while they're still in a retirement plan. Another challenge is that the few products currently available aren't portable and lock clients into vendors. However, the old thinking is starting to change.

So too might the way this phase is described under the retirement planning umbrella. "Decumulation is the wrong word," says Francois Gadenne, founding chairman of the Retirement Income Industry Association, calling it a misnomer. Rather, he says decumulation is actually a risk-management period across both the asset and liabilities of a retiree's household balance sheet. Gadenne suggests that a more appropriate view would

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be to look beyond portfolio optimization. “Language is really important because it can serve to clarify, as well as to obfuscate,” he adds.

Kathleen Kelly, a founding and managing partner with Compass Financial Partners, is seeing much greater interest in decumulation strategies, but no meaningful results ... yet. She describes the most dominant issue as a disconnect between plan participants seeking more help in terms of managing the decumulation phase of their life and the type of assistance plan sponsors are offering. Possible barriers include operational or administrative challenges, fiduciary concerns and portability problems.

Whatever the case, these issues clearly must be resolved. A recent LIMRA Secure Retirement Institute survey shows 80% of working Americans believe employers should provide ways to convert their savings into retirement income.

“What’s fascinating,” Kelly says, “is 90% of those workers who are 18 to 34 said that they were somewhat or strongly agreeing that employers should provide an avenue to convert savings into an income stream at retirement. It’s really wonderful for Millennials to be looking at retirement thorough such a long-term perspective — and to have an appreciation and recognition of establishing predictable retirement income.”

#### Approaching Participants in Transition

Advisors would love to provide assistance, but their hands are often tied. Michael Kane, managing director of Plan Sponsor Consultants, says the DOL’s ERISA 408(b) (2) regulation caused issues with regard to rollovers and scared off registered investment advisors from approaching participants when they leave their plan.

“If you’re an RIA and get fees, and you take fiduciary responsibility for the investments in the plan, which we do on all our plans, we have no means of getting compensated for that,” explains Kane, a certified behavioral finance analyst who’s helping lead the charge on decumulation.

Apart from recommending that participants salt away 10% of their income in a diversified portfolio at the earliest possible age, Kane and many of his peers believe investment

advice ultimately will move the needle on helping clients transition from work to retirement.

He lauds the work of Adam Sokolic, who created LPL’s Worksite Financial Solutions retirement planning services platform, which enables practitioners to advise clients throughout their careers and after they transition into retirement. “LPL permits us to work with other independent LPL advisors, and we can arrange with them to provide education on these plans, based on an aggregate financial wellness assessment tool, as well as be there as a source of rollover,” says Kane. This is all coordinated

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through employer-approved campaigns set up by LPL’s call center.

The effort, which Kane says has a financial-wellness benefit component to address both retirement readiness and financial literacy issues, features 350 plan sponsors with about \$5 billion in assets. Strategic partners include Morningstar, Financial Finesse and Wealth Management Systems.

Worksite Financial Solutions features several components, depending upon the needs of the plan and record keeper. They include engagements, education (with a focus on financial wellness), transitions (i.e., rollovers), advice and plan termination.

“The record keeper, within a week of their

departure, sends a file to LPL just like in the engagements campaign when new workers who become eligible for the plan are contacted by the LPL home office,” Kane explains. “This is done through a letter campaign that encourages them to join the plan and consider rolling other qualified dollars into the plan. They’re offered an opportunity to move money into the plan under a separate agreement between LPL and the plan sponsors.”

#### On the Right (Glide) Path

The hope is that retirees can live on a 3% or 4% annual withdrawal rate “based on an asset allocated formula or portfolio that is now in some sort of a wind down of equity risk,” says Bud Green, chief investment officer and principal consultant with MJM401k. Among the limited options he de-

scribes for people with low- or middle-range net worth who transition from accumulation to decumulation: Take an annual distribution from a target-date fund, pay an advisor 1% to essentially accomplish the same goal, or purchase a variable annuity at a higher cost with no inflation adjustment.

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Green says dollar cost averaging into an inflation-adjusted deferred immediate annuity built into a 401(k) platform may make the most sense as interest rates move. The big question then becomes: Who will guide them through the decumulation phase and ensure that assets are being properly allocated?

There’s also a portability problem. “If we want to move someone from Fidelity to Schwab or Prudential to Fidelity,” he says, “it becomes very difficult to be fiduciaries to these 401(k) plans if we’ve got products locked into that 401(k) program that can’t be traded elsewhere.”

One possible solution would be a self-directed brokerage account featuring multiple insurance companies offering competitive products that could be held within a brokerage account inside a 401(k) plan, according to Green.

“What would be the best at this point,” he suggests, “would be for every plan out there to have either a company or an advisor tied into it that would be paid a fee to provide individual guidance to people in terms of how to make these decisions and structure their portfolio.”

Gadonne would like to see product-based planning. His point is that everyone knows how to shop — even those who aren’t sophisticated about finance, which would simplify the process. “If you can basically create financial products that are like buying tomatoes at the grocery store — in other words, buying income by the pound — like what BlackRock is doing, I think that helps the mass of the people.” So why beat participants over the head with behavioral finance, he asks?

In a recent interview with *Advisor Perspectives*, Financial Engines founder Bill Sharpe addressed the issue of establishing glide paths in the decumulation phase — a phenomenon that academics call “path dependency.” His point was that investors shouldn’t have to worry about how the market arrives at a particular destination between the time their money is invested and when it’s withdrawn in retirement. He also warned that “the inefficiency for a target-date strategy could be as much as 8% to 10%” for income streams that are being considered 20 years down the line.

#### Need for Greater Flexibility

Demographic trends certainly point to the need for such solutions. “With 10,000 Baby Boomers turning age 65 every day, the ability to provide solutions in managing decumulation from retirement plans is going to become much more front and center,” according to Kelly.

She notes that “the handful of lifetime income products in the marketplace today are vastly different from one another,” but her expectation is that these options will become more accessible with greater flexibility and portability, just as the marketplace for target

date funds has evolved, and especially now in light of newly released IRS and DOL guidance.

As a first step, she says advisors need to ensure that plan provisions are structured in a way to allow participants to maintain their account balances post-retirement via flexible distribution options such as systematic withdrawals provisions and partial lump-sum options rather than be confined to only a one-time lump sum distribution.

Kelly believes institutional pricing available within a retirement plan versus what is available to individual participants outside of a plan provides a tremendous opportunity to help elevate the level of retirement security for plan participants.

Despite her earlier comment about a dearth of meaningful results, there are promising signs across the industry. Marc Pester, senior vice president of Prudential Retirement, told attendees at a recent Insured Retirement Institute conference that, “Plan participants with an income guarantee saved 38% more than those without” such a guarantee. He also noted that the latter group’s focus on fixed-income and stable-value investments during the financial crisis caused them to miss the “200% market increase” that started in March 2009.

#### Improving Regulatory Climate

Whatever direction financial markets take, observers agree that the regulatory environment is finally ripe for change that could bolster decumulation strategies. Kelly says steps in the right direction include recent rule tweaks and guidance from the IRS and DOL that make it clear to employers they can include annuities within target-date funds. If certain conditions as specified in the notice are satisfied, then lifetime income would be made more accessible in workplace retirement plans. Another noteworthy development she cites is the DOL’s plan to address the annuity purchase safe harbor regulations on their guidance plan for 2015.

The U.S. Treasury is also encouraging longevity insurance within both DC plans and IRAs, though skeptics cite behavioral economic hurdles — with one industry observer noting how they “require investors to be exceptionally far-sighted.”

There's an expectation that annuity use in retirement plans will skyrocket in a more investor-friendly climate, but Kelly thinks any such trend will be predicated on establishing a regulatory comfort level, and although more guidance is necessary, she says that "additional clarity is exactly what is needed to improve the retirement security of American workers."

Before there's any greater movement toward annuities, perceptions will need to change. "The idea of annuitizing and turning it over to the insurance company was problematic in the sense that a lot of folks just didn't like giving up control," Kelly says. "But many of the in-plan products that we have looked at in the marketplace aren't anything like that. They are a new age of annuities that is much more flexible and consumer-friendly."

"With many of the current lifetime income products in the marketplace, you are not actually annuitizing them to access the guarantee," she continues — "at least some of the in-plan products are structured with the intent to guarantee an income stream without necessarily at the same time giving up control."

Kelly also noted increased interest and awareness from legislators in doing more to secure lifetime income. As an example, she noted the Universal, Secure, and Adaptable (USA) Retirement Funds Act of 2014 proposed by retiring Sen. Tom Harkin (D-IA), chairman of the Senate Health, Education, Labor, and Pensions Committee through the end of the current session of Congress. Under Harkin's proposal, if an employer with more than 10 employees does not offer a retirement plan with automatic enrollment and a lifetime income option, the employer would be required to automatically enroll their employees in a USA Retirement Fund.

The Secure Annuities for Employee (SAFE) Act, a bill proposed by Sen. Orrin Hatch (R-UT), likely the next Chairman of the Senate Finance Committee, includes a similar, "Starter 401(k)" idea.

Jeffrey Brown, a finance professor who directs the Center for Business and Public Policy at the University of Illinois, wrote in a blog published by *Forbes* that the DOL "could do a huge favor to the retirement security of millions of Americans if they would simply clarify that QDIA investments can include lifetime income guarantees."

### From Account Balances to Monthly Income

One hot communications trend for participants is the emergence of more comprehensive planning. At least half the major vendors no longer show account balances on participant websites, Dimitriou notes. Instead, he says the key metric is estimated monthly income at retirement based on assumptions and that balance.

Green's firm has been holding pre-retirement workshops or webinars for clients who are desperate for education and have no choice but to take action, many of whom are between the ages of 57 and 65. The educational sessions steer clear of old-style thinking, such as long-term averages, and instead focus on examining various routes designed to invest their portfolios in a way that lasts the rest of their lives.

"The reality is that 401(k) education is an abysmal failure," he observes, noting that the chief objective moving forward is to simplify financial planning information that's targeted to retirees.

Green is hopeful that the changing regulatory environment will help make lifetime-income solutions more consumer-friendly and perhaps lower expenses. But he's unsure how the government will address "the conflicts of interest inherent in those products" or fix the portability problem.

It's no secret that participants struggle to replace the

recommended 80% income ratio at retirement because they don't fully understand investment concepts or personal finance. "So unless those underlying causes are addressed, then you have some issues," says Kane, who sees "tremendous parallels between financial wellness and health wellness." He notes that one survey found 84% of Americans experiencing financial stress, noting that it manifests itself both at home and work through anything from migraine headaches to heart palpitations.

Kane's firm measures these

impacts through a series of nine metrics. Each financial-wellness assessment asks participants whether they spend less than they earn each month; are uncomfortable with the amount of non-mortgage debt they have, have a general knowledge of stocks, bonds and mutual funds; are confident that their investments are allocated properly; know they're on target to replace at least 80% of their income in retirement; regularly pay off their credit card balances in full; have an emergency fund to pay bills for a few months if they lose their job; pay bills on time each month; and contribute to a retirement plan at work.

Kelly predicts a wave of marketplace innovation with regard to addressing the decumulation phase. "Just as we look at the target-date landscape where all of the assets are flowing and every provider has their own unique spin on what they should look like," she says. "I think we're going to need to do the same thing as it relates to annuities and retirement plans, and the whole concept of in-plan guarantees and lifetime income." **N**

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