BridgePoint
Delivering Vision and Value
to the Financial Services Industry

POINT of View

Retirement Income Opportunities

by Steve Mitchell, Managing Consultant

10,000 baby boomers are retiring daily, creating opportunities for those in the retirement industry. Many firms have focused their attentions on the $5 trillion in 401(k) savings[i] that boomers have accumulated, yet few have successfully gained traction with innovative solutions that have successfully met the needs of this broad demographic.

In recent years, the growth within 401(k) plans has been primarily due to investment returns. In fact, net flows (contributions less distributions) have been negative since 2014[ii], largely due to the increasing number of rollovers from retirement plans into IRAs. While demographic and economic shifts could potentially impact this trend, it is unlikely that the net effect will change anytime soon. The challenge is further magnified by other industry dynamics such as fee compression, a move toward passive investments, fee transparency and new fiduciary standards. The aggregate result poses a significant challenge to those financial services firms heavily dependent upon investment revenue, particularly if they do not possess strong retail IRA capabilities.

Yet, despite the hurdles, there remains real opportunity for both investment managers and recordkeeping providers who are capable of developing solutions that address both plan sponsor and participant needs.

Current Retirement Income Approaches

The objective of retirement income solutions is to leverage plan assets to create a stream of income during retirement (ideally one that increases to keep pace with inflation). Several options exist today, with the table below providing a summary of the primary products and services, along with advantages and disadvantages of each.

Product/Service	Key Advantages	Disadvantages/Risks
Ad Hoc Withdrawals	• Complete flexibility	• Individual (or advisor) must manage, including investments, withdrawal amounts and compliance with RMD rules • Risk of outliving assets • Risk of loss of purchasing power due to inflation • Decline in account value
Systematic Withdrawals Fixed dollar amount, or fixed percentage of account balance, or based on RMD tables	• Complete flexibility • May be stopped, started, or changed at any time	• Individual (or advisor) must manage, including compliance with RMD rules, unless the RMD method is selected • Risk of outliving assets (although mitigated in the case of using RMD tables or a “safe” percentage) • Risk of loss of purchasing power due to inflation • Decline in account value

Product/Service	Key Advantages	Disadvantages/Risks
Managed Payout Funds Diversified funds managed to balance current income with sustainability, depending upon the specific design of the fund	• Considerable flexibility as individuals may stop payments and/or transfer funds at any time • Both investments and withdrawals are managed by the fund company to provide long-term stream of withdrawals, based on design of the fund • Shifts management and much of the risk from the individual to the fund company	• No guarantees • Risk of substantial declines in account value and associated withdrawals • May not automatically comply with RMD rules, especially for older individuals
Fixed Immediate Income Annuities	• Individual is guaranteed by the insurance company to receive income for life, joint life, or another selected period • Income, at least initially, is typically higher than prudently taken from other approaches	• No flexibility to stop or change – the annuity choice is irrevocable • Loss of purchasing power due to inflation, unless an annuity with a cost of living adjustment (COLA) is selected with a corresponding lower initial income • Premature death would typically result in heirs receiving substantially less than would be available by other approaches
Fixed Deferred Annuities Offer a minimum guaranteed rate of interest and typically a current rate of interest (similar to a guaranteed investment contract or bank investment contract) Additionally, these annuities offer a guaranteed rate at which to convert them at retirement to an immediate annuity. These products are most common in 403(b) and some smaller 401(k) plans	• Provide fixed current rate of interest with a long-term minimum guarantee • Provide guaranteed immediate annuity conversion rates which offer protection from rates potentially being higher in the future due to improvements in life expectancy and/or lower interest rates (see Fixed Immediate Annuities, above)	• No potential to keep pace with inflation • Limited flexibility to transfer or withdraw the balance – there is typically a requirement that withdrawals be spread out over five to ten years and/or be subject to a surrender charge

(Continued)

Product/Service	Key Advantages	Disadvantages/Risks
Variable Deferred Annuities Typically offer guaranteed minimum income and/or withdrawal benefits These are the type most commonly offered as in-plan annuities for 401(k) plans. There are many feature variations	• The annuity value can grow with market returns based on the investment options selected • The guaranteed value (frequently referred to as the guaranteed benefit base) is typically periodically stepped up to the market value but is not decreased if the market value falls • Typically, annual withdrawals up to a maximum percentage of the guaranteed benefit base (e.g., 5%) are permitted without reducing the base • There may also be a guaranteed rate to convert to a lifetime income • There is some flexibility in that additional or even full withdrawals are allowed, but only up to the market value, if lower than the benefit base and potentially subject to fees	• Annuity features are often very complex and difficult for the typical plan participant to fully evaluate • Expenses are typically higher than mutual funds with similar investment objectives, which can reduce long-term growth potential • While the guarantees provide significant protection in the event of a market downturn, the underlying market value reflects actual returns. Taking maximum guaranteed withdrawals after a downturn can deplete the market value, creating very little opportunity for the market value to ever exceed the benefit base, even if the market subsequently recovers and continues to have gains. As a result, allowed withdrawals may remain fixed and not grow to keep pace with inflation

The Plan Sponsor Point of View

Many plan sponsors have an interest in providing income solutions for their retiring participants; however, this objective is often offset by several concerns. Among them include fiduciary considerations, the seemingly high cost of in-plan solutions, how the needed education and advice would be provided, the lack of a full range of options, administrative considerations of keeping large numbers of inactive participants in the plan, along with the inevitable issues of tracking changes of address and lost participants.

The result is that many plan sponsors are satisfied with simply having participants roll over plan balances to an IRA, where they are more likely to access a wider range of support. Others are content with offering basic plan withdrawal features, such as a limited systematic withdrawal payments (SWPs), including payments of Required Minimum Distributions (RMDs). Few plan sponsors have interest in the administrative responsibilities of managing retired participants, and some have designed their plans such that if a participant takes a distribution, they must take their full account balance. This requirement essentially forces participants who want access to their savings, even for the purpose of complying with RMD rules, to roll over to an IRA in order to preserve the tax deferral benefits of the accumulated assets.

Certainly, any retirement provider who has the objective of retaining participant assets needs to be cognizant of all plan sponsor concerns and be prepared to have a strategic response to mitigate them.

Participants' Objectives

A critical perspective for financial services providers to understand is that retirement income is a need that extends well beyond any single account. In fact, given the frequency with which U.S. workers change jobs and the prevalence of IRA rollovers, most participants will have multiple assets from which they will ultimately generate income in retirement. These may include multiple plan accounts, IRAs, and taxable savings. Many retirees will require comprehensive household retirement income solutions, encompassing planning, advice on which accounts to utilize in what order to optimize the various tax benefits, advice on when to take Social Security and potentially various Social Security claiming strategies.

In some cases, producing a regular stream of withdrawals from a particular account will be part of the overall strategy, but often it will require flexibility well beyond a single payment stream. One-size-fits-all solutions are unlikely to be widely utilized as evidenced by the very low take-up rates for in-plan annuities. A 2014 LIMRA survey indicated that only about 5% of plans, representing only about $132b (less than 3%) of the over $5 trillion in 401(k) plans covering about 2.5 million participants, offer in-plan annuities. Even in plans where they are offered, participant take-up rates tend to be low, with only about 71,200 participants electing the annuity, with less than $4 billion (3%) in total assets invested in this type of option[iii]. Even projecting these numbers forward to 2018 at the 2014 growth rates (31% of plans and 24% of participants) suggests numbers are still very small, particularly since many plans choosing to adopt in-plan annuities are smaller in size[iv].

Objectives of Financial Services Firms

While extending services to plan sponsors and income solutions to participants are obvious goals, the overriding objective for most financial services firms is to retain assets – and the related revenue. While we generally see limited demand among plan sponsors for in-plan retirement income solutions, there are many firms with demonstrated success promoting this approach. Retirement services providers who extend retirement income solutions should also set realistic expectations of adoption rates. Narrow solutions that promote specific company products are not likely to gain much traction, as they tend to come across as paternalistic and self-serving. The exception would be a highly innovative product that addresses a real need, even for a percentage of plan participants, which can serve a valuable role as a firm differentiator.

Components of a Winning Approach

BridgePoint's perspective is that financial services firms who bring broad solutions are best positioned to win in a competitive marketplace. Components of a comprehensive solution should include:

- Unbiased education and advice that puts the participants' needs first
- Comprehensive retirement income planning, including Social Security claiming strategies and tax optimization
- Flexible systematic withdrawal options that give participants choices in the frequency of payments, the flexibility to stop and start, and

the ability to change the distribution amounts (specified as a flat dollar amount, a percentage of account balance, or an amount to comply with RMD rules)

- Multiple annuity options, including immediate lifetime income and variable annuities with minimum guaranteed withdrawal or income benefits
- Mutual fund solutions that provide for investment management appropriate for an individual taking retirement income and having managed payouts

BridgePoint has observed the greatest success among firms with strong capabilities in both defined contribution recordkeeping and retail wealth management, as they are able to maintain an unbiased perspective as to whether participants leave assets in the plan or roll them over to an IRA. They are also often better positioned to effectively address multiple sources of income.

Regardless, we recommend that all financial services firms develop a sound retirement income strategy – one that appropriately integrates the concerns of plan sponsors and needs of individuals with the objectives of the firm.

For more information on how BridgePoint can support your organization, please contact:

Shelli VanDeMark Kendig,
Practice Director, BridgePoint Group, LLC at
svandemarkkendig@getbridgepoint.com.

[i] https://www.wsj.com/articles/net-outflows-befall-401-k-plans-1434408836
[ii] www.ici.org/research/stats/retirement/ret_17_q4
[iii] www.plansponsor.com/sponsors-participants-warming-up-to-guaranteed-income-options
[iv] www.bpmcpa.com/News-Events/88438/In-Plan-Annuities-A-Solution-for-Retirement-Income-Security