

# Retirement Income Fever

August 13, 2011 | Penton Business Media

Product development in the retirement income space has exploded, and for good reason. With about 77 million Baby Boomers coming up on retirement, advisors will have to deal with a larger pool of clients transitioning from the asset accumulation phase of their lives to the asset distribution phase. On top of that, the future of social security benefits is in doubt, and many employers no longer offer defined benefit pension plans and instead put the onus of savings on the employee in defined contribution/401(k) offerings. Oh, and then, of course, was the equity market debacle of 2008, which crushed many a nest egg. And now investors and retirees have to worry about the threat of another recession.

The industry has responded to the great wave of retirees that has just begun with an increased focus on creating retirement income streams—successfully. It’s always a tough feat, what with expanding life expectancies and estimating health care needs far out in the future.

The good news is: Assets in retirement income have doubled since 2006 to total \$3.3 trillion at the end of 2010, or about 11 percent of total household investable assets, according to a study by Hearts & Wallets, a research partnership between Chris Brown of Sway Research and Laura Varas of Mast Hill Consulting. (Retirement income assets are based on the amount of assets held by households age 65 and older that are in retirement income drawdown mode, defined as taking annual income from their investments that is equal to 4 percent or more of their assets.) The researchers expect retirement income assets to grow to 25 to 30 percent of U.S. household investable assets by 2020. Since June 2010, retirement income mutual funds have grown from about \$560 million to over \$1 billion in net assets, according to Morningstar.

Not surprisingly, the market has been flooded with new and/or improved products promising income in retirement. In 2010, there were 15 new variable annuities introduced and 21 new living benefits rolled out, with an additional three VAs and eight living benefits in the first quarter of this year, according to Ernst & Young. There are currently 62 open-end mutual funds focusing in Morningstar’s retirement income category.

The problem, industry experts say, is that advisors and plan sponsors haven’t really cottoned to these products. When asked their opinion of retirement income funds, 44 percent of advisors surveyed by Cerulli Associates said they could replicate a similar portfolio for their clients using other products, the top answer. (See Table.) Another 38 percent complained the products do not give them enough control over their clients’ portfolios. According to a Cogent Research survey, 42 percent of current and pre-retirees claimed they could effectively manage their retirement income on their own, while 39 percent said they wanted to maintain control and access to their principal.

### **Attacking the Annuity Market**

“Retirement income is the holy grail of the investing business for the next 20 years,” says Bob Reynolds, president and CEO of Putnam Investments. Many vendors are working on finding the best solution, he says.

Some of the newest retirement income products on the market have excluded annuities. Putnam is the latest to join the trend, introducing its Retirement Income suite in March, which includes three funds with varying degrees of risk tolerance. Designed to focus on the asset distribution phase, the funds will include absolute return funds.

Reynolds says a retirement income product without annuities allows investors to have more flexibility, as they don’t have the same lock-ins as annuities. There are generally more upfront costs associated with annuities because you’re paying for a guarantee, and there can be some single-company risk associated with annuities, he adds. “You can replicate annuities without paying for the guarantee.”

Other providers moving into the non-annuity space include Dimensional Fund Advisors, which is rolling out its Dimensional Managed DC product this year, and Financial Engines, which launched its Income+ in January, which provides a steady monthly income from an employee’s 401(k) to their checking account early in retirement. There’s an optional annuity later in retirement, but employers are not required to add it.

But, these won’t replace annuities, says Joe Connell, senior retirement benefit consultant at RIA Financial Concepts, because annuities are the only way to get a guaranteed stream of income. And, naturally, there is a hybrid product to address that. Some providers have created target-date funds with annuities embedded in them. BlackRock rolled out its LifePath Retirement Income fund in 2008, which promises lifetime income in the form of a deferred fixed annuity. The annuity is priced and traded every day, and it’s not owned by the individual until retirement, says Chip Castille, managing director and head of BlackRock’s U.S. and Canada Defined Contribution Group.

In November 2010, AllianceBernstein announced its new target-date fund, Secure Retirement Strategies, which also includes an annuity component. The fund promises guaranteed lifetime income to participants of large defined contribution plans. In this case, however, the fund is backed by three insurers—AXA Equitable Life Insurance Company, Lincoln Financial Group and Nationwide Financial—spreading out the company risk.

Prudential offered its IncomeFlex Target in 2009, an annuity-based target-date fund for 401(k)s.

Great-West Life & Annuity has a 401(k) annuity product—Maxim SecureFoundation—although the annuity is not embedded into a target-date fund. Since rolling it out last April, there are 1,080 plan sponsors using it, says Charlie Nelson, president of the firm’s retirement business. According to the Hearts & Wallets study, the most popular area for retirement income development is annuities for defined contribution plans.

### **Slow Takeup**

While product development in the retirement income space has been accelerating, some say adoption of these products has been slow. The Departments of Labor and the Treasury issued a request for information early last year seeking comments on lifetime income options for retirement plans. One consideration is whether to mandate annuities inside 401(k) plans. Hearings were held

late last year, and the two departments are currently analyzing the comments and testimonies. Sue Walton, senior investment consultant at Towers Watson, says the issue has been put off the front burner for now, and things are still up in the air as to what the government will do.

The concept of annuities in 401(k) plans is more sizzle than actual acceptance, says Financial Concepts' Connell. There are still challenges and kinks that have to be worked out in these types of products, such as the portability issue. If a participant changes jobs, you can roll over their assets, but you can't roll over the annuity stream. The new products haven't addressed this issue, he says. These products are also hard to understand and have high fees associated with them, Connell says.

Annuity-based or not, plan sponsors are not picking up on retirement income products, Walton says. Less than 5 percent of the plans they work with use these products.

"We are a bit challenged saying there's a perfect solution out there in the market," Walton says. "The market, in and of itself, continues to evolve."

No retirement income product has had widespread success yet, because a lot of them are "solutions in search of a problem," says Bing Waldert, industry analyst at Boston-based Cerulli Associates. "The industry is running around like chickens with their heads cut off creating products."

### **A Process Solution**

When providers present these products, they focus on their features and benefits, but they're not positioning these products in terms of how they fit into an advisor's retirement planning process, Waldert says. In fact, retirement income mutual funds have been met with ambivalence by advisors that Cerulli surveyed, who said they can replicate such strategies using other products.

The mutual funds have high turnover, meaning they buy and sell constantly, and this can add to expenses, says Mark Kennedy, president of Kennedy Wealth Management, an RIA based in Calabasas, Calif. He prefers to address income through a conservatively, professionally managed separate account, made up of less than 10 percent stocks and not a lot of long-term duration bonds to protect from interest rate risk.

Kennedy says the industry tends to be product-centered, but developing a roadmap is key when it comes to retirement planning. Gains are important, but he's more focused on preserving his clients' capital.

Waldert believes vendors need to reposition these products, taking into account what advisors are doing to plan for their clients and how the product can improve their process.

"Advisors are not seeing this as a product solution. They see this as a process solution."