Building a better retirement income solution

Insights for financial services firms

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- *Implementing goals-based planning and product allocation*
- *Asset location strategies*
- *Customer analytics*

Table of contents

Executive summary

The statistics are everywhere:

76 million
baby boomers retiring over the next decade[1]

10,000
boomers retiring every day[2]

$321 billion
rolled over into IRA's in 2012[3]

By 2020, nearly $22 trillion
in investable assets will be controlled by age-55-and-up US households[4]

Today, financial institutions face the unique challenge of helping a vast number of retail investors prepare for, transition into and live in retirement. So what steps are these firms taking, and what kind of progress are they making? We find that institutions and financial representatives are facing unexpected challenges as they begin to implement comprehensive retirement income offerings. In this paper, we will discuss these challenges and identify some key aspects of a successful retirement income offering.

For institutions, having a comprehensive retirement income solution is critical in the race to acquire new households and organically grow assets with existing households through asset consolidation and client retention.

[1] 2014 population reports, US Census Bureau
[2] "Annual Performance Plan for Fiscal Year 2012," Social Security Administration, 2012.
[3] "Evolution of the Retirement Investor 2013: Influencing and Addressing Retirement Savings," Cerulli Associates, 2013.
[4] *Retirement Income Reference Book*, LIMRA, 2012.

Today's reality — how we got here

Simple. Consistent. Flexible. These are some of the adjectives investors use when describing the type of solution they are looking for as they enter retirement. Alpha. VA with GMWB. REITs. ETFs. This commonly used technical jargon does not resonate with clients seeking simple financial solutions. Clearly, there is a gap between investors nearing retirement and the industry that serves them.

Let us take a step back to see how we got here. Today, retirees face retirement challenges unlike anything the industry has ever seen. Long gone are the days when an investor retired after 35 years at the same job to live off a generous pension and the guarantee of Social Security income. Employers are shifting from defined benefits to defined contributions, thus pushing the responsibility of retirement saving onto the investor.

Further complicating matters, investors have been conditioned to view their retirement assets as a lump sum with the goal of continued accumulation and protection of that nest egg.

Retirement income, an industry-coined term, broadly refers to the life phase where clients turn retirement savings into a sustainable income stream designed to last their lifetime.

Emerging comprehensive retirement income offerings are including an ever-expanding universe of income-producing products and services, planning tools and enhanced business processes. These new offerings are enabling financial representatives to more adequately prepare investors for a phase in their life that could last as long as their working years did. This is good, because these same clients are beginning to demand more comprehensive guidance from their financial firms and representatives.

When the baby boomer generation began to enter the workforce en masse in the 1970s, the retail investing landscape consisted primarily of stocks, bonds and cash. In the 1980s, modern retirement savings vehicles such as IRAs and 401(k)s became commonplace. In the 1990s, asset allocation and modern portfolio management became the norm. The "4% rule" and other systematic withdrawal programs came under scrutiny in the 2000s as the number of retirees begins to increase.

1970s	1980s	1990s	2000s	Today
Stocks, bonds and cash	IRAs and 401(k)s	Asset allocation and modern portfolio management	Systematic withdrawal programs become prevalent for retirees	Comprehensive income planning requiring a different set of offerings and planning solutions

Overcoming challenges

Financial institutions have begun to form strategic groups across lines of business tasked with commercializing retirement income offerings. If these efforts are to succeed, a number of unique challenges will need to be addressed.

1. Old mindsets need to change

Clients: The following attributes have led to a lack of confidence and preparedness for retiring investors: the Great Recession, shift from defined benefit to defined contribution plans, distrust of financial firms, and the proliferation of complicated and expensive investment products. Investors today are too often not saving enough and not adequately budgeting, and they are viewing the investment landscape with prejudice and preconceived notions (notably — and recently — annuities). While clients need to shoulder the responsibility of their retirement future, financial institutions and representatives alike have a commitment to help start (and keep) clients on track for retirement. Financial services firms need more simple and engaging education to help clients make decisions about what they want to do in retirement.

Financial representatives: From stock brokers picking the next hot stock, to relationship managers helping align a client's asset allocation, the role of the financial representative continues to evolve. Today, representatives too often provide advice solely focused on accumulation for their retiree clients; they fail to see the benefits that income-generating product allocation strategies have on their clients' long-term retirement success. Financial representatives can begin to adapt by incorporating additional behavioral-based planning,[5] addressing huge unknowns such as health care expenditure and discussing potential changes in client lifestyles through retirement.

Financial institutions: Financial institutions need to challenge the norm that retirement income can be solved with existing, "standard" income-generating products and strategies alone — such as an accumulation-focused portfolio with a systematic withdrawal from principal. Financial institutions are often under the false impression that their organization already has solved the retirement income dilemma. As baby boomers begin to retire in increasing numbers and firms face continued pressure for organic growth, it is necessary for an introspective look at the firm's end-to-end retirement income offering, inclusive of planning and investment advice. This effort will likely disprove the belief that a comprehensive retirement income offering exists today.

2. Innovation and digital disruption

Retirement income planning and the tools and methodologies used to solve retirees' complex needs are still in their infancy and are rapidly evolving. Organizations are faced with choosing stand-alone calculators and tools designed to solve specific retirement questions — both investment and non-investment-related (like health care). For example, according to research conducted by EY during July 2014, there are nearly two dozen different calculators designed to help clients develop their optimal Social Security claiming strategy. To add to the confusion, during our review of select tools, we were often presented with a slightly different answer for the exact same case.

A similar proliferation of tools exists across all facets of retirement planning, including health care and long-term care, annuity product allocation, asset location and withdrawal, tax optimization, account monitoring and aggregation, and income modeling and distribution planning. An interesting area of growth has been with "automated/digital wealth advisors" as several have begun to develop retirement income capabilities. While these platforms often do not provide sophisticated product allocation advice (a mix of annuities, equity and fixed income products), some offer industry-leading, dynamic portfolio withdrawal features.

As the volume of propriety and third-party planning tools and solutions has grown, so too have the complexities of IT integration, vendor selection and the desire to maintain a unified experience for the financial planner and client. Future front-office retirement income planning will likely resemble a consolidated platform environment with multiple interconnected best-of-breed components.

5 "The Current State of Retirement Income Sales Support," Mathew Greenwald & Associates, Inc., Practical Perspectives and GDC Research, 2012.

3. Compensation

Historically, financial representatives have been compensated by assets under management and asset growth. Forward-looking financial institutions will begin to think about how their compensation model should change as a large majority of their clients begin to retire. With the baby boomer population increasing their distributions as they reach retirement, two critical factors may force a re-evaluation of how top talent within firms is compensated and retained:

- The need for transparency has resulted in a preference for asset-based fees by both advisors and clients. It is unclear how sustainable this will be, due to years of asset distributions occurring for clients living in retirement. Under the most commonly used retirement income methodology (a systematic withdrawal), advisors are relying on market returns to prevent systematically reducing their compensation and assets under management.
- In the financial services industry, unlike many other industries, it is difficult for clients to determine the cost of services. As clients enter retirement and begin to withdrawal assets, they are likely to become even more sensitive of the cost of services provided. We will likely see a compression in advisor fees and an increase in services provided as retired baby boomers age and require additional services.

Change is good

By creating comprehensive retirement income offering, financial institutions and their representatives will be better equipped to provide value-added retirement services and optimize their clients' retirement plans — potentially preventing unnecessary asset distributions. In addition, firms should contemplate accelerating incentive efforts to reward advisors who adopt firm-endorsed holistic retirement income planning philosophies.

Changing the client mindset, transitioning advisors to behavioral-based[6] and goals-based planning,[7] growing digitally and effectively aligning compensation are just a few challenges that financial institutions encounter when commercializing a retirement income offering. As with any significant challenge, there is no single answer or silver bullet that firms can quickly implement. Addressing these retirement income challenges via a dynamic, end-to-end process to income planning is necessary for sustaining client relationships, consolidating retirement assets and driving successful outcomes for clients in retirement.

"Retirement income can be met with just a product and different planning solutions are not needed."
– Financial Institution

"My compensation is tied to assets under management – why would I focus on distribution planning?"
- Advisor

"The current tools do not make it easy to understand my Social Security options and how I should handle health care expenses."
- Client

6 Broadly defined as incorporating psychology of investing and financial planning to understand and manage client behavior.
7 Goals-based planning is broadly defined as a wealth management approach where focus is on investing for the household based on their risk capacity of various goals with performance measured against the goal.

Components of a retirement income offering

A comprehensive retirement income offering comprises much more than a standard systematic withdrawal, a portfolio of laddered bonds or a simplistic back-of-the-envelope calculation used to reach a "goal"; instead, it demands a dynamic goals-based approach supported by a host of additional retirement-specific support services.

We believe there are six key aspects of a successful retirement income offering:

1. Client understanding: The most foundational aspect of creating a robust retirement income plan is to understand the unique priorities clients have as they transition into retirement. During baby boomers' working days, it was easy for investors to measure their relative success and performance against a market benchmark. Measuring success in retirement is different. While clients still want growth, they are seeking simplicity, stable income, flexibility and limits to downside risk. A thorough understanding of client priorities and goals will allow the financial representative to succeed through both bull and bear markets. The best-suited firms will begin using structured and unstructured data and predictive analytics to better understand their clients and the potential future changes in their financial needs. Being proactive and adjusting income plans over time will allow the advisor to better meet investors' evolving goals over a long retirement journey. One strategy that has proven effective is the use of "playing cards" with planning, life goals and conversation topics. Financial representatives may use these cards to better understand client needs by allowing both spouses to rank what is most important to them during retirement. A difference of opinion often leads to an interesting conversation.

2. Client engagement: From January 2011 to January 2014, there was an 80.4% surge in users aged 55 years and older on Facebook.[8] The reality is plain and simple: baby boomers are quickly becoming tech-savvy, and financial firms need to create methods to engage them in retirement income planning. The industry is focused on improving engagement in the digital and mobile space, but winning client engagement both in and out of the online world is critical to educating clients of all ages on retirement planning and how their firm and representative can help. The financial services industry has long used client seminars as a way to engage clients. Because boomers are looking for retirement information, seminars on pressing issues, such as Social Security, have been successfully used to engage clients—no steak dinner required.

3. End-to-end platform: In an ideal scenario, firms could provide a fully integrated, goals-based financial planning platform that seamlessly transitions from accumulation planning into distribution planning, complete with customizable and consolidated client reporting. A consolidated view of the client might seem elusive, but creating a platform that seamlessly brings together advice on a client's goals and priorities, investments, insurance guaranteed products and retirement decisions such as Social Security and tax-optimized withdrawals is more critical today than ever before. Financial institutions building a comprehensive retirement income offering and looking to differentiate themselves in the marketplace should pay particular attention to this point. Proper technology integration of disparate systems designed to help display traditional Monte Carlo-based accumulation planning with income-focused product allocation engines, Social Security optimizers, asset location and tax-efficient withdrawals, and on-demand client and advisor monitoring is paramount to a successful retirement income offering.

While third-party technology solutions delivering tax-optimized trade execution are becoming more popular, integrating these solutions comes with additional complexities often reaching far beyond the retirement income offering.

8 "2014 Facebook Demographic Report," iStrategyLabs, 15 January 2014.

4. Sound methodology: Firms need a fully developed retirement income methodology or approach capable of creating customized investment portfolios with all available income-generating products. Those firms that are able to systematically create bundled, yet tailored, solutions with an easy-to-manage tax-efficient monthly income distribution will have a valuable differentiator in the marketplace. Firms should look to emerging advice solutions, focused on creating "objective-based allocations" or product allocation engines to help bolster their existing research capabilities and advice offerings. Implementing a modern retiree advice methodology capable of creating secure income over time may prove difficult but can generate tangible results.

5. Cash flow management: Cash generation, management and tracking is an area full of new developments. When helping structure portfolio distributions, financial institutions should have solutions for three interconnected aspects: tax-optimized withdrawals, automated cash flow aggregation and income delivery. Additional differentiation can be found in a firm's ability to advise clients on their cash reserves and tracking over time.

Financial institutions will need to decide how complex their asset location and tax optimization strategies will be. While third-party technology solutions delivering tax-optimized trade execution are becoming more popular, integrating these solutions comes with additional complexities often reaching far beyond the retirement income offering. Simple strategies focused on annual management of portfolio gains, losses, tax brackets, tax-favored portfolio construction and asset location strategies are a common first step.

6. Training and implementation: Rallying financial representatives to fully adopt a comprehensive retirement income offering is a tall order, so financial institutions should develop a robust training and adoption strategy. Many financial representatives indicate that serving retirement income clients is more time-consuming and complex, so firms are looking to centralized specialists who are well-versed in the intricacies of Social Security, health care, estate and tax planning, emerging retirement income products and other complex areas outside of the typical advisor comfort zone.[9] In addition to dedicated support, firms should look to create an environment that incentivizes representatives to fully adopt a firm-endorsed comprehensive retirement income offering. A recent study asking financial representatives what retirement income strategy they used most often found results almost evenly distributed between a systematic withdrawal (such as the "4% rule"), an income floor (guaranteed income to secure a set amount of income) or some other hybrid strategy such as a bucket strategy (time-segmented "pools" of assets).[10]

While executives of financial institutions look at a well-trained field force using the same comprehensive retirement income offering from a risk management perspective, clients will also appreciate the consistency in advice they will now receive. Regional "roadshows" or "boot camps" are effective ways to scale training efforts by gathering a group of financial representatives to provide hands-on retirement income training.

9 "The Current State of Retirement Income Sales Support," Mathew Greenwald & Associates, Inc., Practical Perspectives and GDC Research, 2012.
10 "Trends in Retirement Income Delivery: Advisor Portfolio Construction, Product Usage, and Sales Support," GDC Research, 2011.

How can financial institutions stand out?

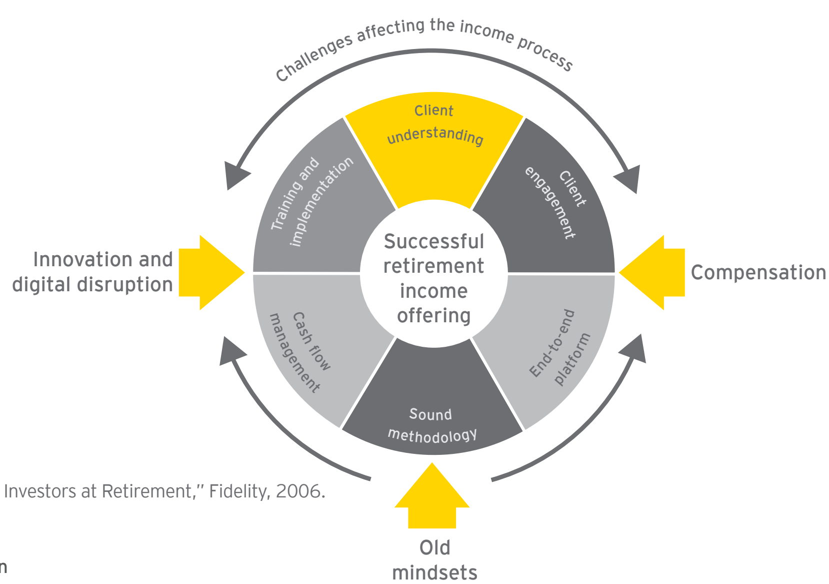
As the retirement landscape continues to evolve, financial firms have the opportunity to develop solutions and strategies to help clients plan for, transition into and live in retirement. The unprecedented challenges, such as longer retirements, overwhelming investment options, and the transition from accumulation to decumulation, can be addressed with the creation of a robust retirement income offering, adhering to these key aspects:

- Retirement income guiding principles — simple, holistic and flexible
- Consolidated view of clients, with a focus on their goals and outcomes
- Scalable approach to plan for and meet all retiree needs
- Bundled tax-efficient offerings that make cash management easy
- Commitment to adequately train and incentivize financial representatives for retirement income planning

Institutions competing for clients in or nearing retirement have begun to differentiate themselves through unique customer education and advertising as they build out comprehensive capabilities in the background. Research, insights and advice have also been central strategies for engaging clients nearing retirement. While firms are complementing education with a variety of online planning tools and calculators, it is not always clear to clients which tools and materials to utilize.

As financial firms face more pressure to grow organically using limited funding, a focus on developing a comprehensive retirement income offering should be core to this mission. A recent study found that more than two-thirds of investors between the ages of 55 and 70 consolidated their assets as a result of completing a retirement income plan, and an additional 19% say they would like to consolidate.[11] The retirement market represents a substantial opportunity for financial services firms. At the end of the day, substantial growth will be delivered only through understanding and embracing the rapidly changing distribution game. Firms able to capitalize on this change can benefit from increased referrals, increased asset consolidation, reduced attrition, and a growth in net new clients.

EY Wealth and Asset Management Advisory professionals have assisted many leading financial institutions with building out their own comprehensive retirement income offering and achieving asset consolidation, client retention and net new client growth. Our suite of services has helped firms create long-term plans to capture new market share as baby boomers retire and seek help generating sustainable retirement income. Contact us to join you in creating a comprehensive retirement income offering.



11 "2006 Survey of Investors at Retirement," Fidelity, 2006.

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