

# Retirement Income Strategies

**The ASPPA 401(k) Summit  
Las Vegas  
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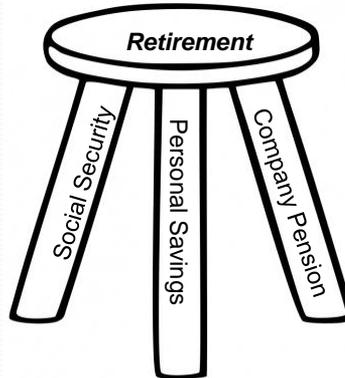
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## Retirement Income Strategies

- What is the need?
- What solutions are available?
- Why are strategies being adopted – and why not?

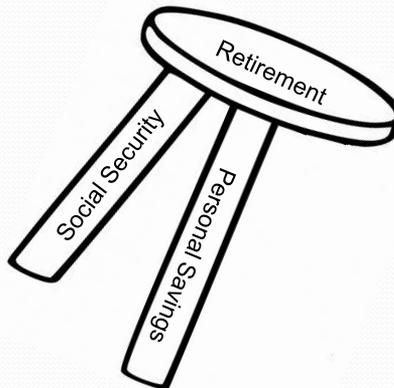
## Retirement Income Strategies

Yesterday: 3 legs of a successful Retirement....



## Retirement Income Strategies

Today: The stool is a lot wobblier with only 2 legs...



## What is the need?

### The Result:

- Inadequate income levels at retirement
- Greater risk and responsibility assumed by the individual

## What is the need?

Inadequate savings makes secure and predictable retirement income more critical

- Leaves no room for error
- Less margins to “self insure”

## What is the need?

Financial security is more about **CERTAINTY** than **ADEQUACY**

$x = \$5,000/\text{month}$  has a higher utility  
- than -  
 $\$2,500/\text{month} < x < \$7,500/\text{month}$

## What is the need?

Risks that impact retirement income

- Behavioral
- Market volatility
- Longevity
- Interest rates
- Inflation

## What is the need?

Understanding **behavioral risk**:

- Inertia
- Lack of skill and attention
- Skill and attention erode with age

*See Institutional Retirement Income Council ([iricouncil.org](http://iricouncil.org)) "Concerns About Participant Interest in Retirement Income Solutions" by Dorann Cafaro*

## What is the need?

Quantifying **market volatility**:

*Annualized returns for Morningstar Moderate 2010*

Year	Return
2008	-18.22 %
2009	+18.98%
2010	+12.05%
2011	?

*"With enough inside information and a million dollars, you can go broke in a year."  
- Warren Buffett*

## What is the need?

Quantifying **longevity risk** :

*What \$500,000 provides with 4% return to a 65 year old*

Monthly payment	Probability of outliving assets
\$3,050	50%
\$2,300	5%
\$2,150	1%

## What is the need?

Quantifying **interest rate** risk:

*What \$500,000 would purchase as a life annuity with 10 years certain for a 65 year old male*

Beginning of Year	Monthly Payment
1/1/2008	\$3,275
1/1/2009	\$3,375
1/1/2010	\$3,000
1/1/2011	\$2,900
1/1/2012	?

## What is the need?

Combining **interest rate risk** and **market volatility** :  
*What \$500,000 would have purchased 1/1/2008 vs. later if invested in a moderate 2010 target date fund*

Year	Monthly Payment
1/1/2008	\$3,275
1/1/2009	\$2,760
1/1/2010	\$2,900
1/1/2011	\$3,170
1/1/2012	?

## What is the need?

Quantifying **inflation risk**:

Probability	Number of future years (x)	Monthly payment assuming 4% return	Purchasing power after x years	
			2% inflation	4% inflation
50%	19	\$3,050	\$2,090	\$1,450
5%	30	\$2,300	\$1,270	\$710
1%	35	\$2,150	\$1,075	\$545

## What is the need?

All of which can seem a bit overwhelming!

*“No problem is too big to run away from.”*  
– Charles M. Schulz

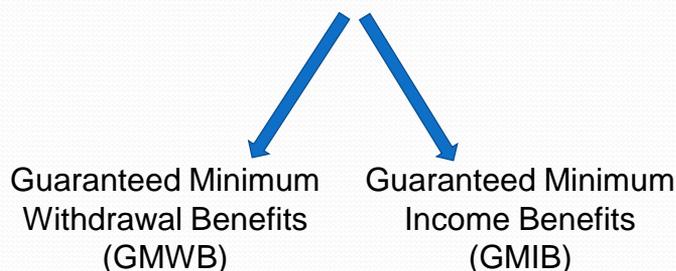
## What is the need?

Individuals are being exposed to **avoidable** risks

Risk	Impact	Institutional solution
Behavioral	Outlive assets	“Framing”, education, auto and de-cumulation features
Longevity	30% less income	Risk pooling
Interest rate	15% less income	Dollar cost averaging
Market volatility	10% less income	Diversification
Inflation	50-75% erosion in purchasing power	Inflation rider

## What solutions are available?

### Guaranteed Retirement Income Products



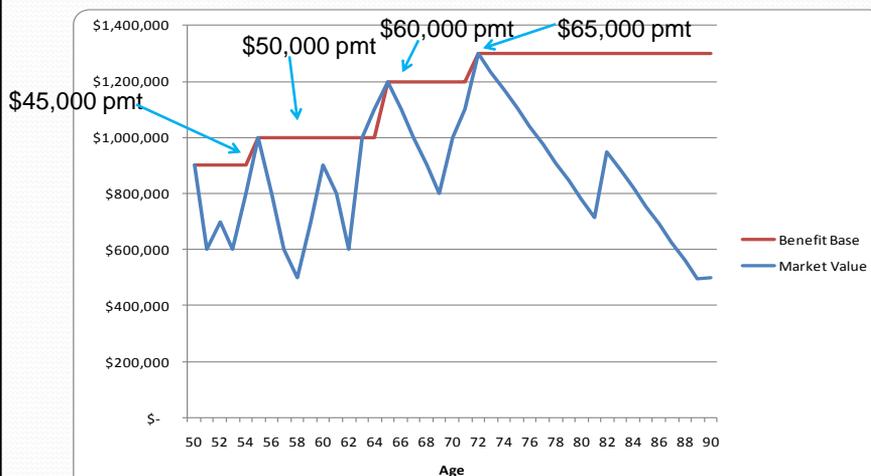
## What solutions are available?

### **GMWBs:**

1. Investors are guaranteed to receive a % of their “benefit base” for the remainder of their life (or spouses if purchased) – irrespective of market value fluctuations
2. Benefit payments are funded from participant balances
  - If funds are exhausted, insurance guarantee pays out
  - If funds remain at death, market value can be passed onto beneficiaries
3. Participants can participate in market upside in these products through pre-determined “step up” dates (typically birthdays)

## What solutions are available?

### GMWB with 5% guaranteed payment:



## What solutions are available?

### GMIBs:

1. Investors purchase deferred annuities throughout their career within the construct of an asset allocation program
2. At retirement, the contracts are annuitized and the annuitized assets are transferred to the insurer and payments from the insurer commence for the life of the annuitant(s). Note that annuitized assets are typically not able to pass to beneficiaries.
3. Any remaining portfolio (non-annuity portion) is still invested as the participant sees fit and can participate in market moves
4. GMIBs allow participants to “dollar cost average” into annuities throughout the accumulation phase

## What solutions are available?

*“In life, unlike chess, the game continues after checkmate.”*

*– Isaac Asimov*

## Why are strategies being adopted – and why not?

### **Reasons FOR plan sponsors to consider:**

- Workforce management
  - Greater productivity
  - Succession planning
- Transition from traditional DB pension
  - Greater awareness of what is “lost”
- Improved employee outcomes
  - Paternalistic attitude
- Reputational risk
  - Avoid “60 Minutes” spotlight

## Why are strategies being adopted – and why not?

### Reasons for plan sponsors NOT to adopt:

- Fiduciary risk
  - Questions about what standard is applied
  - Long term decision
  - Higher costs
- Evaluating and monitoring
  - Models do not incorporate income guarantees
  - Insurer risk
  - Complexity

## Why are strategies being adopted – and why not?

### Reasons for plan sponsors NOT to adopt:

- Lack of portability (at the plan level)
  - Recordkeeping impacts
  - Termination, replacement
- Lack of employee interest
  - If we build it, will they come?

*“As long as the world is turning and spinning, we’re gonna be dizzy and we’re gonna make mistakes.”*

*– Mel Brooks*

## Why are strategies being adopted – and why not?

### Reasons FOR participants to consider:

- Greater income certainty
  - Easier to budget
  - Larger income relative to self-insuring
- Institutional pricing
- Plan sponsor oversight
- Less responsibility
  - Requires less time and attention
  - Ability to manage will decline with age

## Why are strategies being adopted – and why not?

### Reasons for participants NOT to elect:

- Complexity
- Loss of control
  - Less ability to “play the market”
  - Less ability to leave inheritance
- Poor positioning or “framing”

*“When you see a rattlesnake poised to strike, you do not wait until he has struck before you crush him.”*

*– Franklin D. Roosevelt*

## Conclusions

- Accumulating the largest bucket of money is not the end game, it is a means to generating retirement income.
- Retirement income strategies offer ways to mitigate risk, provide greater certainty, and ultimately increase the utility of the accumulated savings.

*“If people concentrated on the really important things in life, there’d be a shortage of fishing poles.” – Doug Larson*

## Conclusions

- Market for GMWBs and GMIBs is in its relative infancy
- Current estimates from the 7 leading providers suggest that these programs have less than \$1.5b in total assets
- Lack of plan sponsor understanding on way to achieve safe harbor protection inhibits adoption.

## Conclusions

- Plan sponsors are reluctant to be early adopters when product innovation is so rapid
- Reasons for plan sponsors to adopt seem less compelling than the perceived barriers

*“It is better to be roughly right than precisely wrong.” –  
John Maynard Keynes*

## Conclusions

- The way annuities are “framed” for participants needs to change radically if participants are going to accept them

*“Yesterday I was a millionaire, today I live on \$79,700 per year.” – Meir Statman*