

Planning's Next Wave ▼

Challenge & Redefinition: Will Our Retirement Plans Perform?

by Francois Gadenne

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As we consider the long term viability of our existing retirement planning models, and then whether a systemic overhaul will be required, there are two key questions that are critical to innovative product and process development:

Are asset accumulation products, tools and processes likely to be inadequate for providing income generation?

Are early/traditional (insurance as well as investment-based) income generation products, tools and processes likely to meet the entire volume of money-in-motion?

To answer the first question, we need to know what is happening to the pool of customers. What we do know is that one-size does not fit all. Market segments are clearly differentiated in terms of needs and wants. While current accumulation products and processes are likely to continue to be adequate for high net worth investors, this may not be the case for others. Some high net worth investors, most of the affluent investors, and certainly the mass market investors are likely to require downside protections and income generation solutions to complement or, in some cases, replace traditional solutions. Current research indicates that such a trend may be forming, and that current asset accumulation products, tools and processes are likely to be inadequate for providing the necessary income gener-

ation for the majority of investors.

For instance, McKinsey & Co. (2006) reports that 55+ year old investors seek products that limit risk exposures and offer guarantees. In fact, these products are already growing at twice the rate of traditional "relative performance" products such as mutual funds.

In addressing the second question related to the ability of early/traditional (insurance as well as investment-based) income generation products, tools and processes to meet the entire volume of money-in-motion, it's not surprising to learn that early innovations in retirement income distribution products have come from the insurance industry. Many of the recent product announcements present refinements of traditional annuities ranging from new riders to extending annuities' application to the Defined Contribution (DC) space.

On the investment side, the industry's new product announcements have been less numerous. Instead, early developments seem to focus on software tools and systematic withdrawal programs as well as financial advisor-driven distribution advice processes. These processes do seek to change the retirement planning story from accumulation to income generation, but they continue to use existing traditional products.

There have been incremental changes to existing investment and insurance business models. Some continue to be accumulation-focused rather than income-generation focused, and few seem to address the transition management need for products with downside protections. The transition management phase is an 18 to 20 year time period encompassing the eight to 10 years prior to retirement and the first 10 years in retirement. It is during this phase that poor performance and lack of guarantees can literally

ruin the ability of a portfolio to generate adequate income throughout retirement.

Given the magnitude of the potential money-in-motion of which \$18.2 trillion comes from non-retirement financial wealth including securities and deposits and \$13.6 trillion comes from retirement wealth such as government plans, IRAs, defined contribution plans, defined benefit plans and annuities, guaranteed income generation products may have capacity constraints as an increasing number of investors demand reliability and guarantees from their financial products. It certainly raises the question of how much more longevity risk the insurance industry collectively and insurance companies individually can add to their balance sheets. It also opens the door for major opportunities for insurance and investment companies to be more innovative in product, tool and process development.

Further and based on industry results to date as well as forward-looking research reports, it remains unclear if the retirement income opportunity will be addressed with simply incremental changes to traditional business models. It is possible, and perhaps probable, that new business models will emerge. These new businesses would reach beyond the traditional insurance and investment methodologies, industry silos, and professional skill sets, such as alpha generation, beta benchmarking, delta hedging, actuarial models, advice generation, and credit modeling, in order to construct the latest, outcome-delivering solutions that will help meet the entire volume of money-in-motion. At a minimum, we should expect that a significant number of additional, traditional and non-traditional products, tools and processes will reach the market over the next few years.

New One-of-A-Kind Research

To further a collective understanding of these trends and questions, RIIA sponsors quarterly investor-level research. Conducted by SRI Consulting-Business Intelligence and Turner Consulting, this research complements the silo-specific research needed in the daily management of the existing business models.

The first report, (see www.riia-usa.org) presents a snapshot of the total assets and wealth of American families and relates them to their specific retirement income needs. The report uses a brand new typology that divides American households into different categories of wealth: wealthy (top five percent), affluent (next 15 percent), mass market (middle 50 percent), marginal last 30 percent). Plus it combines these categories into life stages: starters, builders, pre-retirees and retirees.

From the view of the new typology, the research looks at household assets and income, institutions where the assets are held, the kinds of retirement products being used, household decision making and use of financial advisors, and selected financial attitudes toward investing, Social Security and retirement. According to Chris McNickle of Greenwich Associates and Kathleen Beichert of OppenheimerFunds, co-Chairs of RIIA's Research Committee, the analysis is a detailed look at the retirement products, distributors, advisors and financial services firms that each category of customer uses.

RIIA's research indicates that the affluent pre-retired as compared with the wealthy pre-retired and already retired have a comparable amount of assets. However, fewer of the affluent group's assets are 'in play' because these people are still focused on accumulating assets and continue to confront major life events that will require assets to move and be reallocated. In addition, their assets are distributed over a wide variety of financial institutions.

"Some firms pursuing retirement income opportunities direct their programs and services at wealthy households who are, or will soon be, retirees," says Larry Cohen, co-author of the RIIA study. "Yet, because there are so many more of them, the somewhat-less-wealthy affluent pre-retirees have almost twice as much money in retirement plans in total as wealthy retirees. Firms and advisors would be wise to include the affluent pre-retirees in their focus, since these households continue to contribute to assets under management."

Additionally, over half of all the retirement typology segments, with the exception of the marginal segments, get advice before making a major financial decision; the proportion is even higher among the affluent (60 percent) and wealthy (80 percent), notes Elvin Turner, the other co-author of the study.

When the full-extent of this new research is fully absorbed, new thinking will emerge that will help financial services firms focus more precisely on retirement income market opportunities. The result will be new, exciting product development, business models and processes that will be focused on the emerging needs of American households as they age and accumulate wealth.▲