US RETIREMENT STRATEGIES SHIFT TO DECUMULATION AND MASS PERSONALIZATION

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EXECUTIVE SUMMARY

Retirement is not the end of the road; it is the beginning of the open highway!

Traditionally, wealth management (WM) firms have focused on wealth accumulation and growth for clients. Firms claim they are personalizing services and offerings for retirees. However, they may not be serving some segments that most need to manage post-retirement spending efficiently.

Demand is high in the United States – not only from high-net worth individuals (HNWIs) but also from low net worth, mass affluent, and affluent segments. Everyone needs to determine a comfortable monthly retirement income level based on all income sources.

The most strategic firms are shifting focus from wealth *accumulation* to *decumulation*.

Retirement income decumulation milestones in the United States include:

- 1980 – Introduction of a defined contribution (DC) plan –or retirement plan concept – for workers
- 1994 – William Bengen's seminal paper on safe withdrawal rates (the 4% rule)
- 2000 – Sources of cash flow such as Social Security and pensions treated as retirement income and folded into retirement planning
- 2006 – Creation of the QDIA[1]

Today, new regulations, products, and services are shaping retirement planning services – primarily to support decumulation when a participant stays within a plan after retiring. Therefore, WM firms that traditionally rolled retirement plan assets into an IRA are being affected.

Future-focused firms will need to leverage a new capability - unified managed income (UMI) - that provides clients with a personalized strategy for holistic inflation-adjusted after-tax retirement income by factoring in all external assets/cash sources for participants and their spouses. Unlike Target Date Funds that can't automatically execute holistic retirement income, UMI provides strategies for uneven withdrawals while managing a client's potentially uneven spending, tax estimates, and offering advice around tax-optimal disbursals, after-tax spending plans, and unplanned spending disbursals.

In-plan personalized retirement income advice – supplemented with retail advisory services – is poised for prevalence. Moreover, UMI process automation will be critical for firms seeking to reduce service costs and dominate the market while providing robo/subscription-based advice to attract retirees and the near-retirement segment.

[1] A QDIA (Qualified Default Investment Alternative) is a retirement plan's default investment. When money is contributed to a plan (such as a 401k), it's automatically invested in the QDIA.

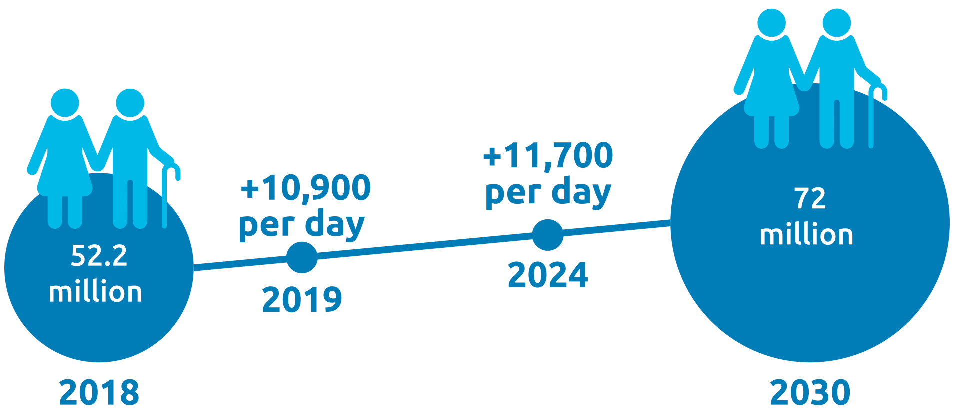
INTRODUCTION

ARE WEALTH MANAGERS PREPARED TO HELP CLIENTS TRANSITION TO RETIREMENT?

RETIREMENT INCOME PLANNING IS BECOMING AN ESSENTIAL SERVICE IN THE UNITED STATES AS BABY BOOMERS AND GEN X WIND DOWN CAREERS

US citizens nearing retirement age or who have already retired face a unique financial challenge – how to transition the wealth they have spent decades accumulating into a holistic retirement income across their savings and other cash-flow sources. In 2018, the United States was home to 52.2 million retirees; in 2019, 10,900 Americans reached age 65 every day; by 2024, that number is expected to reach 11,700.[2] The total number of US retirees is on track to reach 72 million by 2030 as longevity increases and health care improves.[3] Therefore, financial planning and retirement income planning will become increasingly important as more individuals transition to life after employment.

Figure 1. Projection of number of retirees in the US



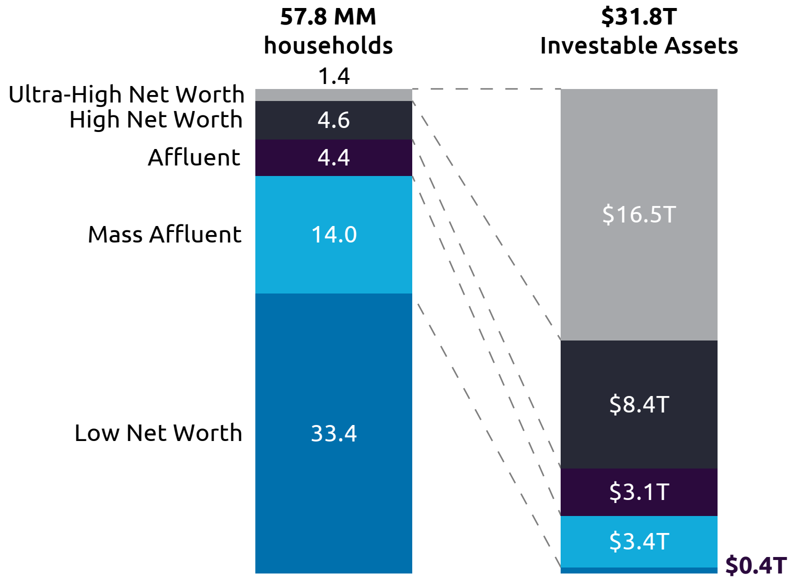
Note: Depicts the number of retirees in the US in 2018 and its future projection.

Source: LIMRA Fact Book on Retirement Income, 2019

[2] LIMRA, "LIMRA Fact Book on Retirement Income, 2019," accessed April 2021.

[3] Ibid.

Figure 2. Pre-retiree (age 55+) and retiree households market size (2017) US



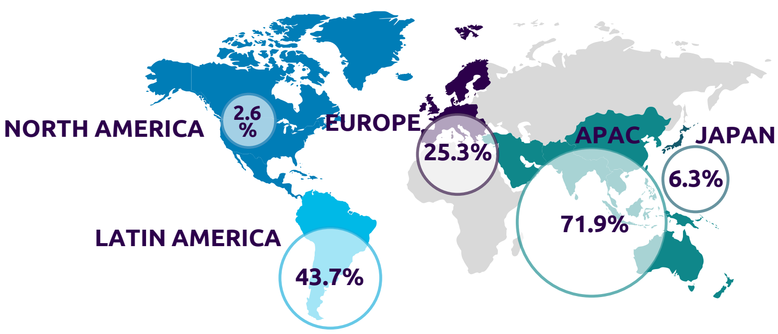
Source: LIMRA Fact Book on Retirement Income. 2019

This paper focuses primarily on mass affluent, affluent, and high-net worth individual (HNWI) segments, which offer WM firms an opportunity to deliver value-added services profitably.

WEALTH MANAGEMENT FIRMS CAN OPEN NEW REVENUE STREAMS BY CATERING TO THE UNIQUE NEEDS OF RETIREES AND NEAR-RETIREES

As more individuals move into retirement (or near retirement), they seek tailored strategies that address their unique needs. Moreover, persistently low interest yields and the rising costs of health care and long-term care are significant planning considerations. Still, firms may be missing opportunities. According to Capgemini's World Wealth Report 2020, only 2.6% of North American HNW investors older than 60 said they were satisfied with the personalized products and services their wealth management firm offered in 2019.[4]

Figure 3. Satisfaction with WM firm's personalized offerings (HNWIs age 60+)

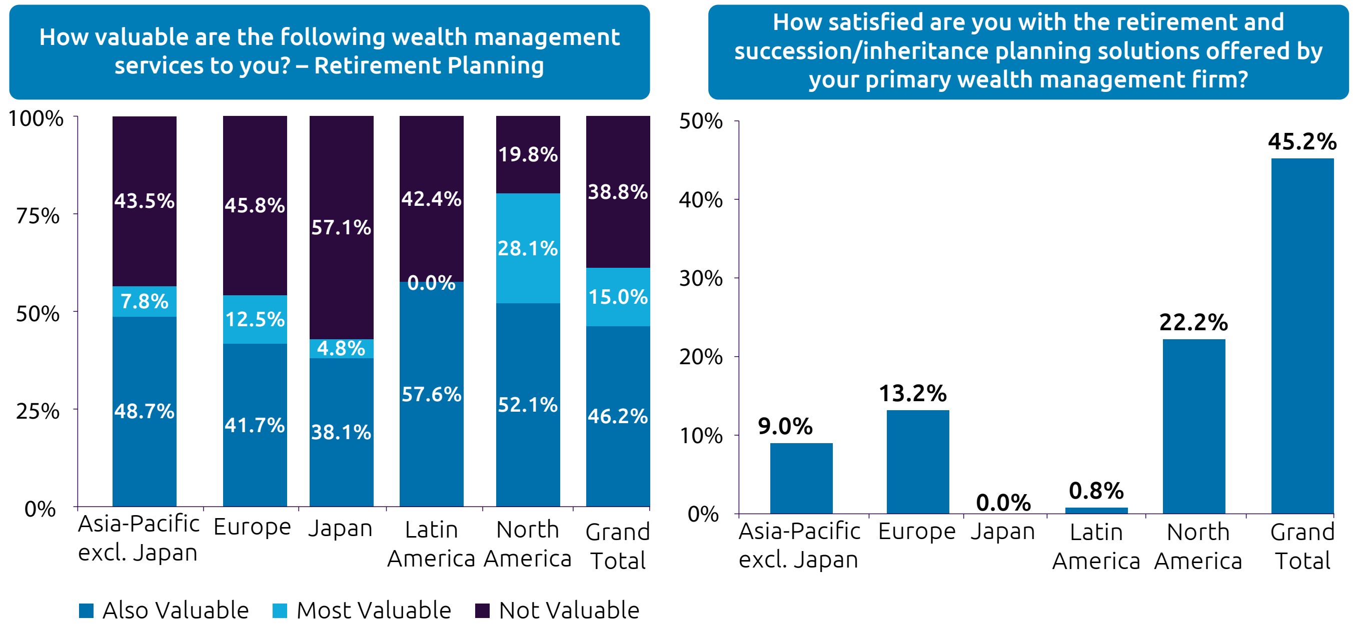


Source: World Wealth Report 2020, Capgemini Financial Services Analysis, 2021.

[4] Capgemini, World Wealth Report 2020, July 9, 2020.

Looking further back, the 2019 World Wealth Report found that more than 80% of HNWIs aged 60 and older said retirement planning is a *very valuable or most valuable* service. In fact, only 22.2% of respondents said they were happy with the retirement and succession/inheritance planning services they had received from their wealth managers.[5]

Figure 4. HNWI expectations vs. satisfaction with WM firm retirement planning solutions



Source: World Wealth Report 2019, Capgemini Financial Services Analysis, 2021.

Firms focused exclusively on wealth accumulation cannot effectively meet the needs of retirees who seek services that prioritize wealth decumulation.

[5] Capgemini, World Wealth Report 2019 July 9, 2019.

2. DECODING RETIREMENT DECUMULATION

SHIFTING FOCUS FROM WEALTH ACCUMULATION TO DECUMULATION FOR RETIREES

The wealth management and retirement sectors have focused on helping people save, invest, and grow money for a satisfying retirement. But after years of accumulating assets, retirees must plan how to optimize their post-work income. How much is safe to spend? And, to support that spending, how should withdrawals be structured across their various sources?

Traditionally, wealth management has focused solely on investable assets. However, retirement income cash flow is generated not just from savings and investment accounts but also from Social Security, pensions, and other assets, such as home equity and permanent life insurance. Retirees can opt to convert a portion of their assets into a guaranteed lifetime income cash flow from an annuity issued by an insurance company.

Tax consequences should be a consideration when clients withdraw money from any source. Unlike an individual's wealth accumulation phase – when salary primarily affects marginal tax rates on a portfolio's income return and capital gain – marginal tax rates are lower and may even be zero during retirement. As a result, how a retiree's income is structured across various sources determines tax rates.

Another variable to consider when talking about retirement decumulation is an individual's mortality. Life expectancy and unidentified future investment returns complicate how much a retired client can comfortably spend. As an industry, we must provide mechanisms to guide retirees about safe spending while optimizing their cash flow across all income sources tax-efficiently.

Demand for retirement advice is immense. It's not just wealthy retirees; we're also talking about people who have a hundred thousand dollars up to a million US dollars – low-net worth, mass affluent, and affluent segments (Figure 2). Everyone needs help determining a comfortable monthly retirement income level assembled from all income sources.

The challenge and opportunity are complicated because each person's income solution is unique based on age, age gap between spouses, Social Security benefits, pension payouts, qualified and non-qualified savings, and health-based life expectancy.

Currently, wealth and retirement managers rely on a mass-manufactured approach. They slot each client into one of several risk-profile-based asset-allocation models. Then, they manage the portfolio with tax efficiency in mind. Similarly, asset allocation glide paths are created in employer-sponsored retirement plans and offered as Qualified Default Investment Alternatives (QDIAs) that provide a cost-efficient way to grow money until retirement. Upon retirement, however, individuals need a personalized income solution.

How can the industry respond? First, wealth and retirement managers need the analytical capability to create a personalized solution on a massive scale. Second, automated execution capability is necessary to take that customized solution to 50- to 70-million retirees so they can receive cash in a timely and predictable manner. And for the substantial mass-affluent segment, where home equity is two to three times more than financial savings, the solution must deliver periodic and timely cash from the retiree's home equity along with other sources.

Retirement decumulation specialists must be able to answer these common retiree questions: ***Am I safe? Can I spend as planned?*** **And,** ***can I pay for unforeseen expenses?***

The structure of a retiree's income across various sources will determine taxes.

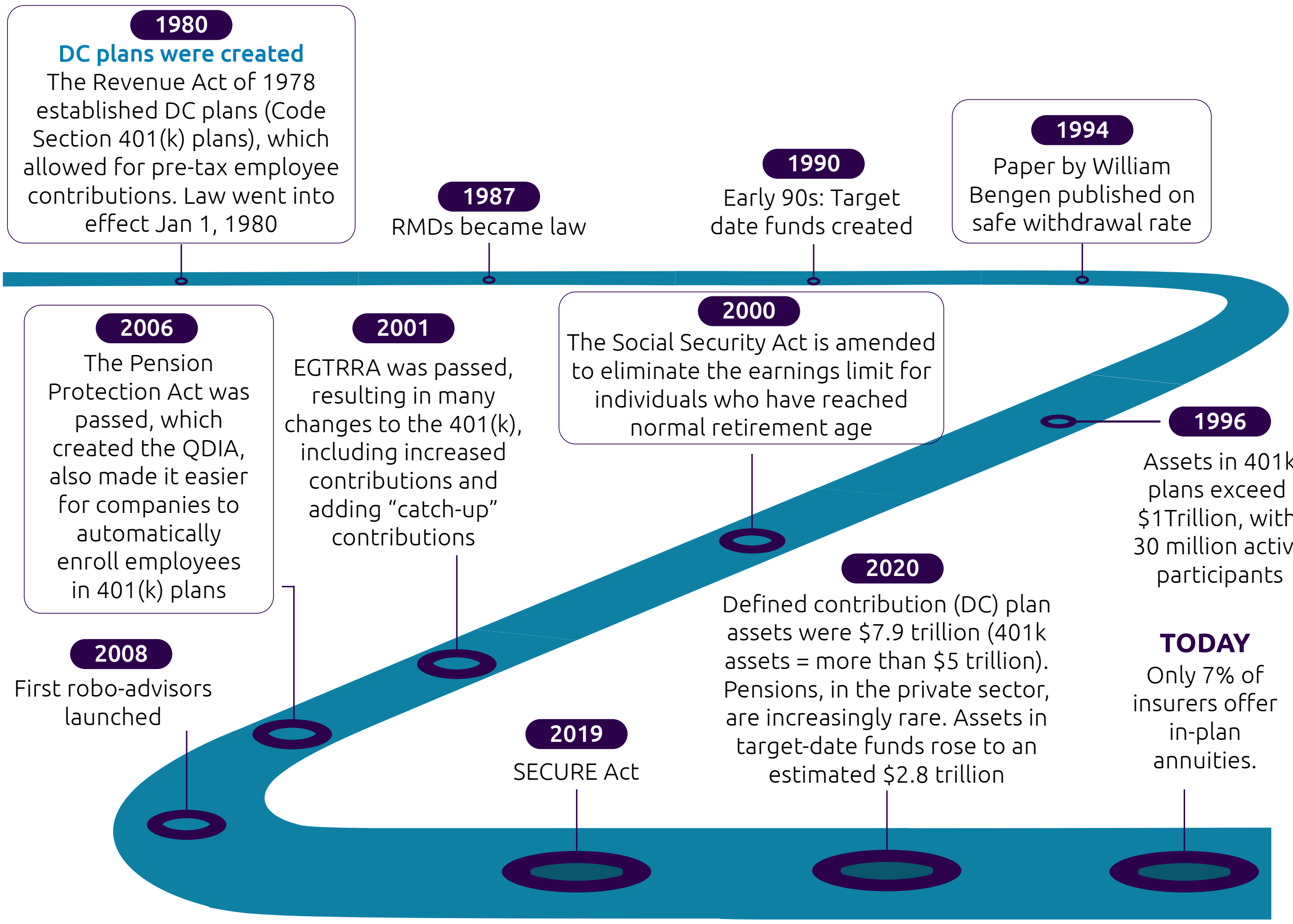
3. RETIREMENT DECUMULATION: THE PAST (PRE-2010 UNTIL 2018)

THE INDUSTRY UNDERGOES MAJOR MILESTONES

The wealth and investment management industry has undergone significant milestones concerning retirement monies and their decumulation. In 1980, a defined contribution (DC) – or retirement plan that initially supplemented a defined benefit plan – was created and ultimately became the dominant vehicle for retirement.[6]

Then, in 1994, California-based financial advisor William Bengen published a pivotal paper on a safe withdrawal rate.[7] Next, cash-flow sources such as Social Security and pensions were recognized as retirement income and folded into planning.[8] And, the QDIA was created in 2006. That drove adoption of glide path-based target-date funds in the retirement plans.[9]

Figure 5. Retirement decumulation solutions timeline



Source: Capgemini Financial Services Analysis, 2021, Income Discovery, 2021.

[6] Georgetown University Law Center, "A Timeline of the Evolution of Retirement in the United States," accessed March 2021.
[7] Financial Planning Association, "Determining Withdrawal Rates Using Historical Data," March 2004.
[8] Ibid.
[9] CNBC Make It, "A brief history of the 401(k), which changed how Americans retire," accessed March 2021.

WEALTH MANAGEMENT SECTOR AND RETIREMENT DECUMULATION

An early wealth management approach was to rely on an average rate of return expected during retirement. How much a client could withdraw to support lifestyle expenses was determined via a simple worksheet. A financial planner William Bengen identified the shortcomings of the approach in a now-iconic 1994 paper on a safe withdrawal rate.[10] By analyzing historical return data through rolling windows of 30 years, Bill Bengen showed that a safe withdrawal rate was far from what a constant average return-based assumption model showed, which brought to light an aspect called sequence-of-return risk.[11]

Bill Bengen showed that a safe withdrawal rate was far from what a constant average return-based assumption model implied, which brought *sequence-of-return risk* to light.

Subsequently, wealth management firms extended their Financial Planning Tools (FPTs) to show sequence-of-return risk through historical returns sequences and Monte Carlo simulation using forward-looking capital market assumptions to determine a safe retirement income level. Initially, the adoption of Monte Carlo simulation and reporting the probability of success of future withdrawals was met with skepticism but ultimately adopted uniformly across the industry.[12]

In the beginning, FPTs focused on a client's investment portfolio to determine safe withdrawal rates. Simplified assumptions about Social Security and other income from various tax-type accounts (qualified and non-qualified) were used. And, until recently, annuity modeling for lifetime income guarantees was almost non-existent. Now, FPTs calculate the benefits of a Social Security claim strategy and an annuity's allocation for lifetime income (usually tied to meeting essential expenses).

More recently, FPT analyses include Roth conversion strategies targeting tax brackets. However, targeting tax brackets may not serve clients best because it doesn't consider the incremental tax rate for the conversions due to higher Social Security and capital gains moving from zero to higher tax rates.

Today, FPTs evaluate various strategies individually, and the isolated impact of each strategy lever on probability of success. Financial advisors lead the analysis of alternative approaches by manually changing each lever iteratively to find an optimal combination, which can be time-consuming and challenging. FPTs don't optimize strategy levers holistically to offer advisors recommendations.

Financial advisors lead alternative approach analysis by manually changing each lever iteratively to find an optimal combination – a time-consuming and challenging task.

FPTs broadly assume a fixed order of sourcing of retirement income across multiple accounts rather than developing dynamic rule-based or threshold-based strategies. The lack of dynamic retirement income sourcing strategies limits the ability to cross from planning into income management (providing automated ongoing disbursal instructions executing on the selected income plan and strategy).

The wealth management industry offers professionally managed portfolios, where the client's risk profile and asset allocation are rebalanced to a target asset allocation periodically. In FPTs, a strategic asset allocation is implemented into a portfolio of securities under a managed account. Managed accounts have evolved to provide some household-level tax efficiency. Still, they don't yet offer the orchestration capability for retirement income withdrawals across multiple accounts coordinated with a retiree's other cash flows and taxes.

[10] Financial Planning Association, "Determining Withdrawal Rates Using Historical Data," March 2004.
[11] Ibid.
[9] Retirement Income Designed, "Chapter 8: Monte Carlo Mania: Robert D. Curtis," accessed March 2021.

RETIREMENT PLAN SEGMENT AND RETIREMENT DECUMULATION

DC plans (401(k), 403(b), and 457), which have become the dominant vehicle for retirement savings, spark the need for decumulation guidance. Before that, pension plans were the main mechanics, supplemented by Social Security retirement benefits, as the primary source of cash flow in retirement. As retirement plans became dominant, their approach to investment allocation options of fixed income and equity mutual funds became the primary way for people to save and grow their money. Each individual was responsible for managing allocation options. A new breed of managed accounts was offered to help plan participants make informed decisions. Such accounts were adopted, but not by the majority of plan participants.

After realizing the shortcomings of putting the investment allocation decision in the hands of an individual not qualified enough to make those decisions, the industry and regulators adopted guidelines to allow a Qualified Default Investment Alternative (QDIA) within retirement plans. Introduced as a result of the 2006 Pension Protection Act (PPA), QDIA enables professional advisors to manage asset allocations that change over time.[13] QDIA implementation led a significant movement of plan assets into Target Date Funds (TDFs). In 2019, 59% of new 401(k) plan contributions went into TDFs, and by year's end, TDFs accounted for $2.5 trillion (31.5%) of total 401(k) plan assets.[14] However, TDFs don't guide disbursement during retirement nor recognize an individual's other cash flow sources. Therefore, they fall short in meeting retiree needs.

In-plan managed accounts can offer retirees necessary personalized strategies. In the past, retirees were less likely to adopt these accounts versus TDFs. At the end of 2019, in-plan managed accounts held ~4% of total DC plan assets, with the top nine providers comprising more than $400 billion in assets.[15] However, the proposition of a personalized strategy factoring in all sources of income and assets is compelling for participants, especially for near-retirees and retirees. We describe the state of the current offering next in Section 4.

[13] CNBC, "A brief history of the 401(k), which changed how Americans retire," accessed March 2021.
[14] Cerulli, "Quarterly U.S. Retirement Market Research," accessed April 2021.
[15] Ibid.

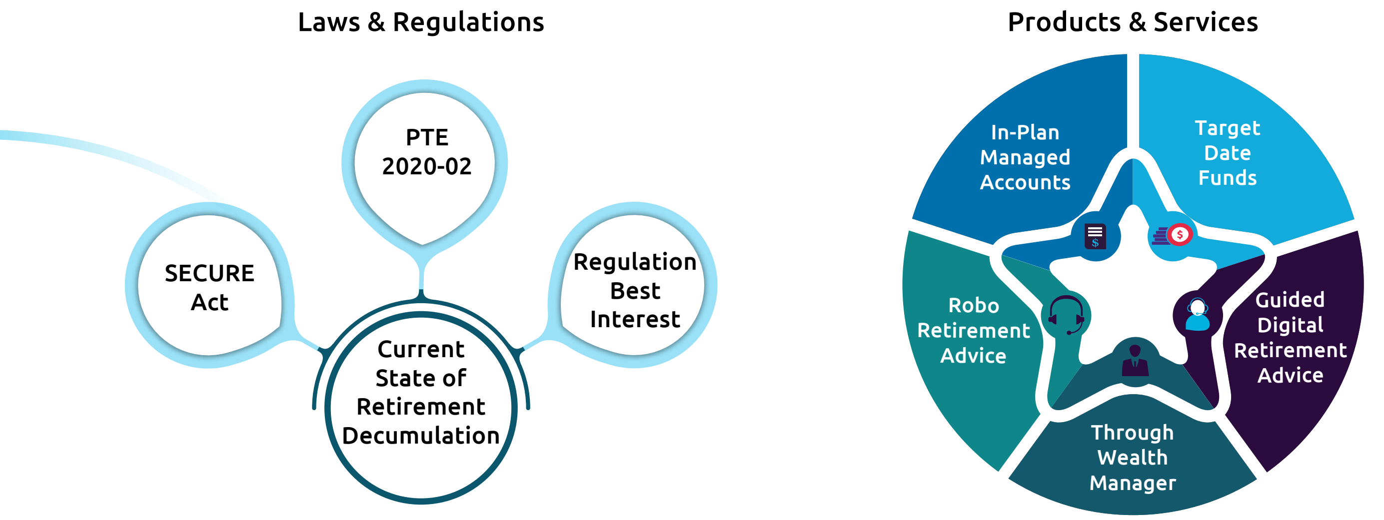
4. RETIREMENT DECUMULATION: THE PRESENT

NEW REGULATIONS, PRODUCTS, AND SERVICES EMERGE

Given recent regulations – the SECURE Act, DOL Fiduciary Rule, and RegBI – new products and services are being built to support retirement decumulation when a participant stays within the plan, even after retirement. And the wealth management industry, which has relied on assets gathered from retirement plans and rolled into IRAs, has been impacted.

Before we delve into the future of retirement decumulation, let's take stock of recent mandates and the current regulatory landscape. How is retirement income generated across the wealth management and retirement plan industry?

Figure 6. The current state of retirement decumulation



Source: Capgemini Financial Services Analysis, 2021, Income Discovery, 2021.

RETIREMENT DECUMULATION LAWS AND COMPLIANCE MANDATES

Three recent regulatory developments are shaping the current offering and future direction for delivering retirement decumulation solutions.

1. SECURE Act

The US Congress established the Setting Every Community Up for Retirement Enhancement Act of 2019 (SECURE) to enable guaranteed lifetime income through retirement plan annuities by providing appropriate safe harbors. It allows plans to function to provide retirement income and a vehicle for accumulating and growing retirement savings. Additionally, the SECURE Act requires the participant's retirement plan statement to contain an estimate of lifetime income. This estimate reframes an advisor's conversation from account balances to sustainable retirement income, encouraging a retiree to think about holistic retirement income across all sources and accounts.

2. PTE 2020-02

In 2020, the US Department of Labor adopted the Prohibited Transaction Exemption (PTE) 2020-02 (Improving Investment Advice for Workers & Retirees). The exemption defined advice to roll over from a retirement plan to an IRA as fiduciary advice. The exemption requires an advisor/institution to acknowledge fiduciary status in writing and disclose specific reasons the rollover recommendation is in the investor's best interest.

Moreover, the advisor/institution must find and factor in fees and expenses for investment options within the retirement plan and compare them with fees and expenses in the IRA to make the rollover recommendation. With this exemption, regulators intend to keep a retiree's assets within the retirement plan to retain low-cost expenses and fee advantages. The PTE regulation impacts WM firms that traditionally have relied heavily on IRA rollovers to advise retirees by providing them higher-value services but generally with higher fees. We describe the impact in more detail in Section 5: Retirement Decumulation: The Future & Industry Impact.

3. Regulation Best Interest 2020

The US Securities and Exchange Commission (SEC) implemented Regulation Best Interest (RegBI) in mid-2020 to enhance advisor conduct and ensure clients' best interests when making recommendations such as investment or investment strategy advice, a rollover, a distribution, choosing a fee or commission account, or other counsel. Stricter obligations under RegBI include additional disclosures, a belief that the recommendation is in the client's best interest, a requirement to take active steps to mitigate conflicts of interest, and to establish policies and procedures in this regard.

RETIREMENT PLANS AND RETIREMENT DECUMULATION

Recent regulatory activity has focused on transitioning retirement plans from retirement savings accumulation and growth to effective retirement income generation. This regulatory direction is encouraging plan sponsors to design programs that cover retirement income. Suggested support ranges from allowing periodic distribution during retirement to a retirement income guidance tool that helps users generate holistic retirement income across all sources, not just their retirement plan assets.

Innovative new offerings are needed. First, we describe the current status of various guidance/advice tools and managed accounts offered in retirement plans, focusing on their retirement decumulation and income-related aspects.

RETIREMENT INCOME THROUGH IN-PLAN MANAGED ACCOUNTS

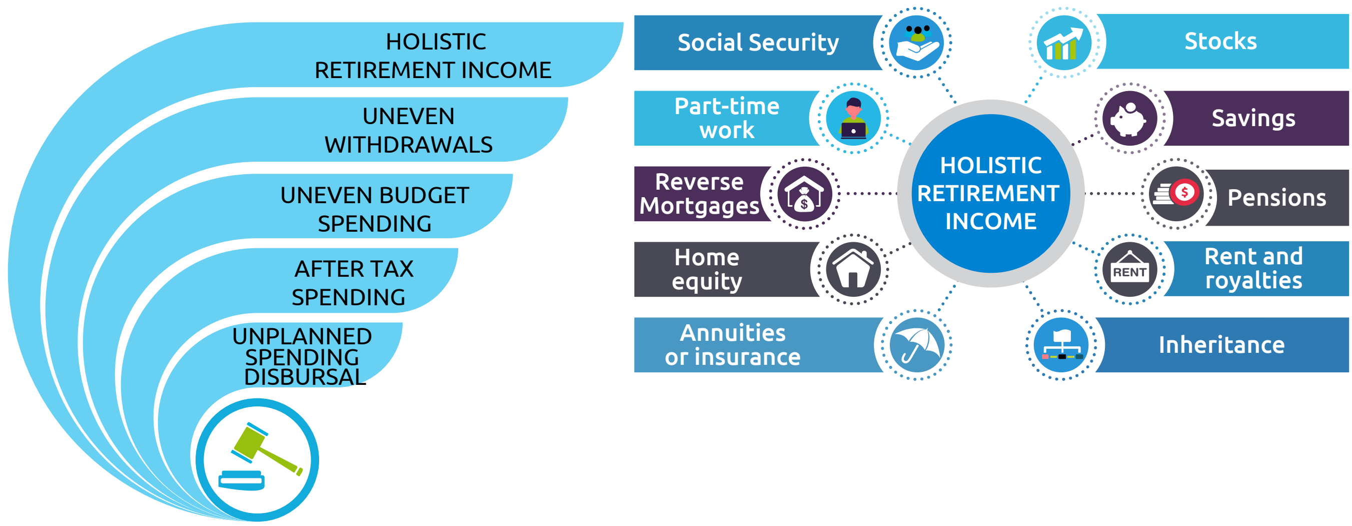
In-plan managed accounts provide an opportunity to offer a personalized strategy for holistic inflation-adjusted retirement income by factoring in all external assets and cash sources for the participant and their spouse. Such personalization is not possible with TDFs in their current form. We call this service Unified Managed Income (UMI).

Key UMI characteristics:

- **Holistic, automatically executed retirement income:** Essentially, UMI provides holistic retirement income by factoring in all income sources (Social Security, pension, rent, etc. at the household level) with inflationary adjustments, the in-plan managed account, plus all external assets including qualified accounts, retirement plans, and taxable accounts.

- **Uneven spending budget:** A retired household seeks after-tax retirement income matching their varying spending needs. Their base spending may not keep pace with inflation. In the initial years, retirees may have higher discretionary spending for leisure and travel. In addition, health care expenses will typically grow faster than inflation. UMI service aims to provide income to meet the cumulative budgeted spending with unique inflationary adjustments for each spending category.

Figure 7. What does Unified Managed Income include?



Source: Capgemini Financial Services Analysis, 2021, Income Discovery, 2021.

The goal is to generate a desired inflation-adjusted, after-tax spending amount for the household throughout retirement.

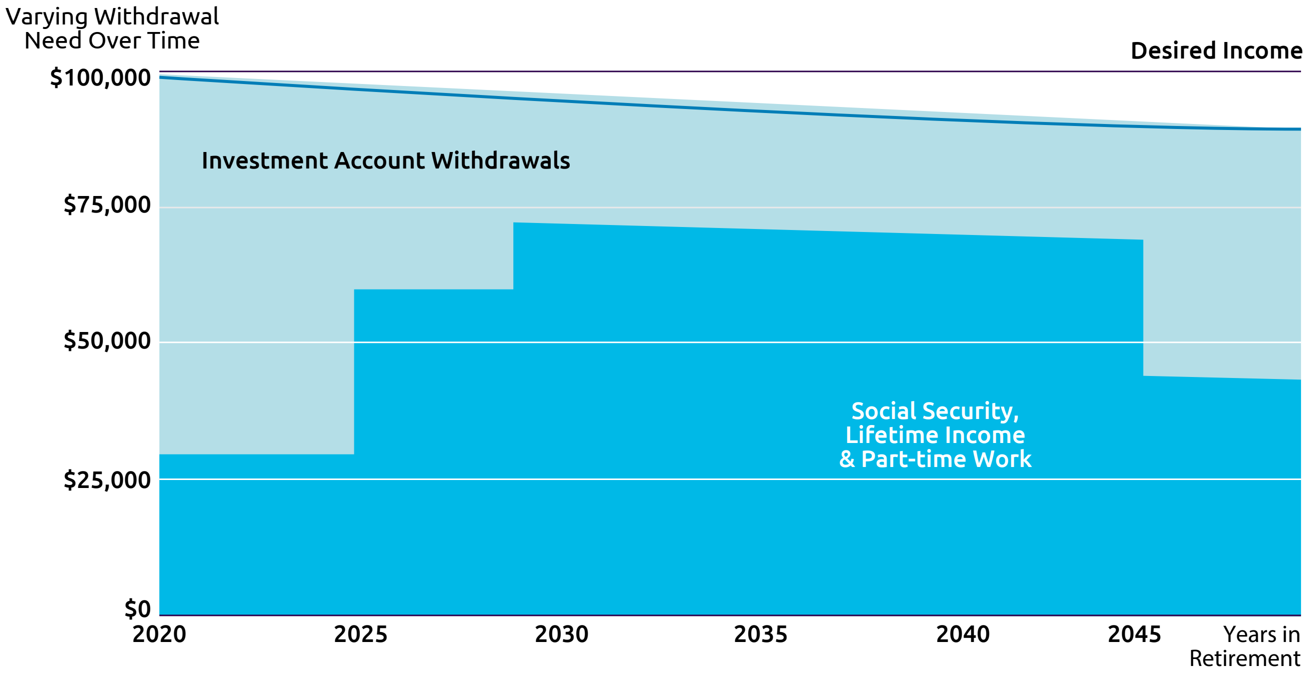
- **Uneven withdrawals for a targeted, holistic income:** UMI applies to strategies that rely on fixed sources that start at retirement and those that start at different times. (E.g., A different Social Security starting time compared to pension or lifetime income from an annuity; or strategies in which spouses retire at different times, creating uneven withdrawals from investment accounts.)

- **Tax estimates, tax-optimal disbursals, and after-tax spending:** During retirement, the decision to source retirement income determines the taxes. The UMI program follows a personalized tax-optimal withdrawal sequencing across various accounts and, based on the strategy selected, estimates the taxes, then generates retirement income to cover taxes in addition to the budgeted inflation-adjusted spending.

- **Unplanned spending disbursal:** Lastly, UMI capability provides disbursal instructions on sourcing cash for unexpected spending or expenses.

Based on a pre-selected strategy, UMI service auto-executes disbursals across multiple accounts, tracks other cash flow sources, and estimates taxes to collectively generate a desired after-tax, inflation-adjusted spending amount for every year of the client's retirement.

Figure 8. How does Unified Managed Income work?



Source: Capgemini Financial Services Analysis, 2021, Income Discovery, 2021.

Many managed account service providers are adding capabilities to provide this new UMI client service.

A review of Form ADVs covering a few in-plan managed account providers offer a snapshot of where the industry stands today. All service providers have an opportunity to provide a comprehensive optimization of retirement income strategy, with detailed sourcing of retirement income across all sources, once an income strategy is implemented. Currently, there is a lack of such capability in the industry.

- However, Bank of America Merrill Lynch's recent offering (April 2021) comes close: it aims to provide Unified Managed Income advice through retirement plans and pair it with a client's retail managed account. Its *Personal Retirement Strategy* (PRS) recommends a point-in-time allocation for all assets (including external assets) such that those assets along with other sources of income (Social Security, pension, and any other sources) collectively provide inflation-adjusted pre-tax total retirement income at a 75% probability of success. When a participant signs up for the in-plan managed account, the PRS program will implement the asset allocation within the DC plan's investment menu and rebalance the account quarterly to the target allocation.[16]

The program assumes a pre-tax retirement income goal of 85% of the projected pre-retirement salary when the participant and their spouse retire and claim Social Security benefits at their Full Retirement Ages (FRA). The participant can amend all assumptions. The program doesn't optimize for Social Security claim age as part of a holistic retirement income strategy.

Many managed account service providers are adding capabilities to provide UMI client service.

[16] Merrill Lynch, "Personal Retirement Strategy Brochure," March 22, 2021.

Next, we summarize offerings from other in-plan managed account providers. All other providers' publicly available brochures filed with the SEC suggests that there is still an opportunity to provide a detailed methodology description on providing Unified Managed Income. Many providers describe their investment methodology, portfolio selection, and management, and savings rate recommendation, which is an extension of their accumulation capabilities. Sparse information is available regarding modeling methods for critical retirement income components, including Social Security, lifetime income products, pensions with multiple payment options, and detailed tax calculations necessary to perform tax-efficient disbursals across retirement plans and other accounts, including Roth conversions.

- Edelman Financial Engines' (EFE) retirement income solutions include *Income+* for retirement plans and *Retirement Paycheck*® for retail services. EFE's Income+ optimization approach divides the portfolio into three components: fixed income for steady payouts until age 85, fixed income to support an optional purchase of an annuity outside of the plan, and equities to provide income raises over time.[17] Once that person is retired, Income+ seeks to manage investments and create payouts that can last for life (with the optional annuity purchase) or into their early 90s (without an annuity purchase).

  The retail Retirement Paycheck® service helps clients generate a consistent retirement income stream. Retirement Paycheck® accounts have two components. The income generation component places three years' worth of monthly income into a ladder of lower-risk investments. The remaining funds are invested in a diversified portfolio to help guard against inflation.[18]

- Empower Retirement (including Personal Capital) utilizes both Financial Engines' Income+ and Personal Capital as add-ons to their online advice and professional management services.[19] A retirement evaluation with an income projection is provided using both a projected portfolio balance and a Social Security benefit. Still, there are no details about optimizing various choices to maximize retirement income. The primary focus is portfolio advice with investment selection and savings rates.

- Personal Capital's (PC) retirement income offering was traditionally a retail advisory offering; however, we cover it here because of its acquisition by Empower Retirement. PC defines a personal strategy as a comprehensive investment portfolio. The focus is on their differentiated methods of SmartWeighted portfolios. Their Form ADV does not describe methodology on sourcing retirement income or delivering a Unified Managed Income. PC's website for retirement income planning discusses simplified assumptions on Social Security and other cash flows paired with a predetermined liquidation order as part of a retirement income plan.

- GuidedChoice similarly uses projected balances and saving rates and Social Security benefits to determine a measure they call *retirement readiness* related to the income need and projected range of income generation.[20] A client profile and risk tolerance determine investment portfolios. Each year, a client gets a spending report that details the liquidation of the retirement assets. Details on sourcing retirement income beyond asset liquidation were not available. GuidedChoice charges a $299 annual fee for a personalized distribution plan for all household retirement accounts with liquidation instruction.[21]

- Morningstar publicly shares extensive details about its capital market assumptions and model portfolio allocation services.[22] Morningstar determines investment allocations using actuarial data, investment exposure, probability analysis, mean-variance optimization, and simplifying assumptions about retirement income needs and other components to source the income, including Social Security.[23] Morningstar advice focuses on saving rates and a personalized portfolio. The firm says an income plan may include a recommendation for an in-plan annuity.[24] Its wealth forecasting methodology describes a fixed withdrawal sequence for all households of taxable accounts, after-tax and Roth retirement accounts (IRA/401K), variable annuities, and then pre-tax and qualified tax-deferred accounts (IRA/401K/403(b)), including non-qualified tax-deferred accounts.[25]

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[17] Edelman Financial Engines, "Part 2A of Form ADV: Firm Brochure," March 31, 2021.
[18] Ibid, "Part 2A of Form ADV: Firm Brochure,", Mar 31, 2021
[19] Personal Capital, "Personal Capital Advisors Corporation Wrap Fee Program Brochure," March 31, 2021.
[20] Guided Choice, "Guided Choice Disclosure Document," March 30, 2021.
[21] Ibid.
[22] Morningstar, "Form ADV Part 2A: Firm Brochure Retirement Plan Services for Individuals," April 6, 2021.
[23] Ibid.
[24] Morningstar, "Morningstar Retirement Manager," December 31, 2019.
[25] Morningstar, "Wealth Forecasting Methodology," accessed April 2021.

- Fidelity offers retail customers and retirement plan participants a comprehensive digital guidance tool – *Planning & Guidance Center* (PGC) – that analyzes both spouses' income sources and assets to deliver retirement income to meet detailed expenses. PGC can model retirement expenses and guide users to estimate various expense types. It calculates a Retirement Score and estimated monthly inflation-adjusted retirement income. The *Retirement Score* is the amount of monthly income estimated to be available at retirement, with a 90% probability of success using historical market scenarios, divided by the monthly income required to meet a household's retirement goal.

  Although available information doesn't mention it explicitly, the estimated retirement income is believed to be pre-tax. The analysis looks to replace 85% of a user's pre-retirement income, assumes Social Security is claimed at full retirement age, and does not recommend annuities, although users can add them. The tool guides the user through an interactive experience in which the user makes changes but doesn't offer advice or make recommendations. Fidelity offers Social Security claiming guidance through a rep-led Social Security optimizer.

  Fidelity's managed account for retirement income withdrawals recommends asset allocations to support retirement income distributions based on an expected withdrawal period (determined based on life expectancy), amount of guaranteed income, and the ratio of savings-to-withdrawals. Fidelity also offers automatic withdrawal strategies, including fixed monthly nominal withdrawal amount; fixed time-period with variable payments until the entire balance is paid out; varying withdrawals based on life expectancy using IRS tables; varying withdrawal based fixed percentage payout rate of the balance; withdrawing only earnings from investments, and managing cash flow strategy that provides stable current cash flow for a planning horizon.

TARGET-DATE FUNDS ADD RETIREMENT INCOME SUPPORT

TDFs have been a leading pre-retirement growth vehicle. And now they are being enhanced with an allocation to lifetime income products. The allocation begins when the TDF cohort is in their 50s and typically peaks at retirement age. Retirement age is either assumed to be a specific age such as 65 or the full retirement age defined by the Social Security Administration. Upon retirement, the lifetime income rider is assumed to be invoked, or if the lifetime income offers straight annuitization, annuitization is provided via a private contract in or outside the plan.

TDFs have been a leading pre-retirement income growth vehicle. And now they are being enhanced with an allocation to lifetime income products for 401(k) plans.

Offerings with support for annuities inside the TDF and retirement income payouts:

- BlackRock's *LifePath* target-date funds have helped investors save for retirement for more than 25 years.[26] In 2020, BlackRock announced plans to partner with insurance companies to add an annuity contract to the investment allocation. LifePath will continue to use its active asset allocation model for growth, increasing allocation to an annuity as an investor approaches retirement age to secure guaranteed income. Details about *LifePath Paycheck*, which will provide a monthly retirement income paycheck, are being finalized.
- Income America is a new in-plan target-date fund with a guaranteed lifetime withdrawal benefit (GLWB) formed by companies including American Century Investments, Lincoln Financial Group, Nationwide, and others.[27] The TDF offers an allocation to fixed annuity contracts from Lincoln Financial and Nationwide. Additionally, Income America provides a GLWB at age 65 or later for either a single participant or couple with a survivor benefit. The GLWB guarantees a fixed withdrawal rate for life on an income base determined at the time of invocation. A participant can remove the market value of their investments at any time without surrender penalties.

[26] Blackrock, "LifePath Paycheck™ Fund," accessed April 2021.
[27] Income America, "Income that's guaranteed to last as long as your retirement does," accessed April 2021.

DIGITAL RETIREMENT INCOME ADVICE / GUIDANCE TOOLS

In general, digital consumer-facing tools for comprehensive retirement decumulation strategy have been minimal. However, there have been many educational calculators offered as an attempt to provide retirement income strategy guidance. The typical call to action is either a managed account sign-up or, in the case of 403(b) plans, partial annuitization of annuity holdings into lifetime income.

A few stand-alone tools are profiled below:

- TIAA has a track record for industry-leading, innovative products, and services. And as baby boomers began approaching retirement en masse, the firm leveraged technology to provide mass personalized advice for retirement income planning. TIAA sought to provide consistent advice at scale and to demonstrate the value of a holistic retirement strategy, including products such as 403(b) plans along with fixed and variable annuities.[28] TIAA's solution illustrates the power of co-optimizing the Social Security claim strategy and annuitizing fixed annuities into guaranteed lifetime income and variable annuities to cover inflation risk. Additional optimization levers include purchasing new annuities and allocation of annuitized variable annuities and remaining investment assets. TIAA provides the solution through its wealth management advisors and directly to consumers in a mobile-friendly digital application. Consumers receive a detailed retirement income report describing their options and discuss annuitization decisions with their advisor or phone consultant.

- T. Rowe Price's *Retirement Income Calculator* is available to their retail prospects and customers.[29] The tool outputs a Confidence Zone with an associated probability of success out of 1,000 trials based on user inputs. The analysis assumes retiring at age 65, replacing 60–85% of pre-retirement income, Social Security claiming at age 70, and a user-selected asset allocation from a pre-set drop-down of conservative, moderate, or aggressive. The user can change inputs via sliders to see how the results change, including changing the asset allocation to one of the other pre-set options. The calculator is not investment advice, so it does not recommend asset allocation, an allocation to annuities, or any others. The calculator also explicitly excludes Roth IRAs and Roth savings in workplace retirement plans.

- Principal Financial's *Retirement Wellness Planner* determines what a plan participant will have and need at their desired retirement age and provides a *Retirement Wellness Score* to determine if they are on track.[30] The online tool does not delve into further retirement income analysis or guidance.

Other firms such as Vanguard, Empower, and Alight Solutions likely offer digital consumer-facing tools for retirement decumulation. However, the tools were not publicly available when we researched this paper, and evaluation was not possible.

RETIREMENT INCOME THROUGH WEALTH MANAGEMENT

Financial advisors (FAs) across broker-dealers and RIAs traditionally rely on FPTs to determine a prudent retirement income level and then use their model-based managed accounts to generate necessary disbursals. After determining the needed retirement income in the FPT, FAs generate disbursals upon client request. Financial advisors independently determine which accounts to source the disbursal from after factoring in RMDs. Currently, no system uses a consistent process for determining account-by-account disbursals.

FAs across broker-dealers and RIAs traditionally rely on FPTs to determine a prudent retirement income level and then use their model-based managed accounts to generate necessary disbursals.

[28] TIAA, "Retirement Income Evaluator," accessed April 2021.
[29] T. Rowe Price, "Retirement Income Calculator," accessed April 2021.
[30] Principal, "Retirement Wellness Planner," accessed April 2021.

Once account-by-account disbursals are determined, the FA relies on the managed account system to create trades for the disbursal or manually makes brokerage account trades to generate sufficient cash. Currently, the majority of FAs don't have access to a system with UMI capability. Nor do they have a system that tracks how disbursals correspond to the original plan set at retirement and how much was withdrawn under or above the original plan.

DIGITAL ROBO-RETIREMENT INCOME PROGRAM

Schwab focuses on generating pre-tax periodic withdrawals, specified by a user, from Schwab Intelligent Portfolio accounts with risk profile-based asset allocations that meet a target probability of success of 80% using simulated future returns sequences.[31] Periodic withdrawals remain constant until a client requests a change. If success probability drops below 75%, Schwab will alert the client but will continue to make the withdrawals until the client requests an adjustment or pause.

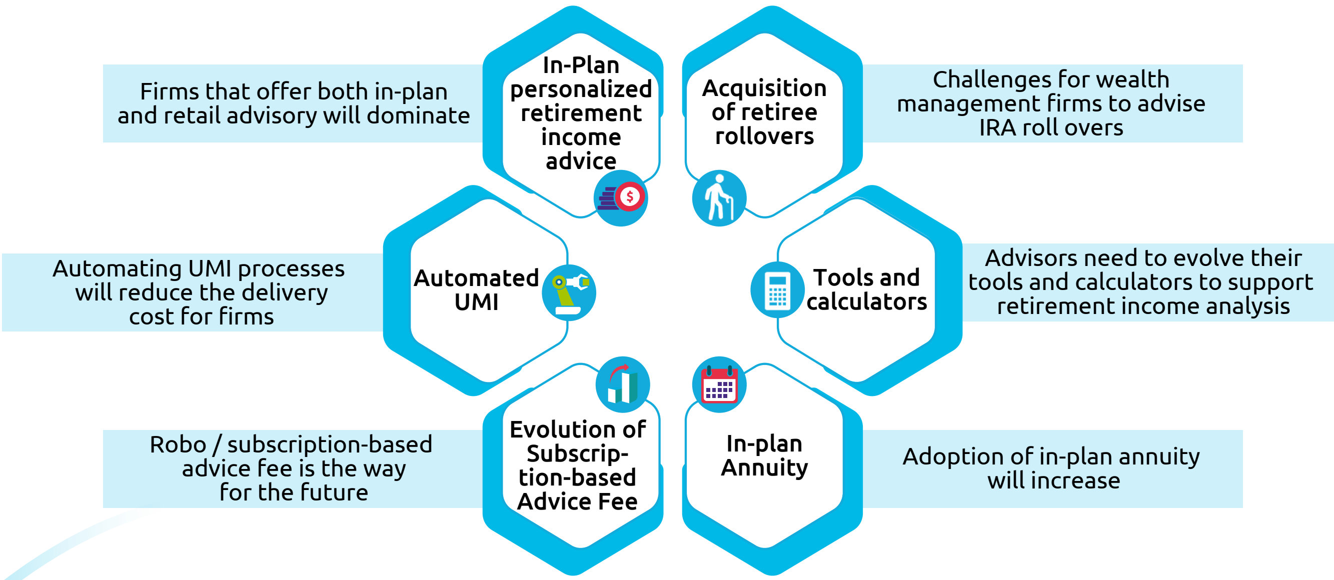
Intelligent Income is purely focused on making tax-smart withdrawals from the included accounts and does not consider other assets and income sources. Schwab's tax-smart withdrawals are a fixed withdrawal strategy across all accounts with RMDs first, followed by proportional withdrawals from taxable and tax-deferred accounts, and finally, Roth withdrawals. More advanced withdrawal strategies and a holistic plan including other sources of income, such as Social Security or annuities, are not considered, but users can combine the Schwab Intelligent Income feature with Schwab *Intelligent Portfolios Premium* for guidance from a certified financial planner.

[31] Charles Schwab, "Schwab Intelligent Portfolios and Schwab Intelligent Portfolios Premium," accessed March 2021.

5. RETIREMENT DECUMULATION: THE FUTURE & INDUSTRY IMPACT

The availability of low-cost retirement decumulation robo-advice paired with recent regulatory direction will profoundly impact both retail wealth management and retirement plans.

Figure 9. Impact and considerations to support the emergence of UMI



Source: Capgemini Financial Services Analysis, 2021, Income Discovery 2021.

IN-PLAN PERSONALIZED RETIREMENT INCOME ADVICE WILL BECOME PREVALENT

In-plan personalized retirement income programs will be supplemented with retail advisory services for non-qualified brokerage accounts. These combined services make a compelling case for a retiree to consolidate all assets with one service provider who can seamlessly orchestrate retirement income across their brokerage accounts and retirement plans.

In-plan personalized retirement schemes supplemented with retail advisory services make a compelling case for participants to consolidate their assets with a single service provider that seamlessly orchestrates retirement income across brokerage accounts and retirement plans.

Considering many pre-retiree assets in a retirement plan and all other previously outlined factors, firms that offer advisory services in retirement plans and the retail advisory market will dominate.

Just like Empower Retirement expanded into retail digital advice with the Personal Capital acquisition and similar acquisitions by Financial Engines (Mutual Fund House and merger with Edelman Financial Services) and Principal Financial (RobustWealth),[32],[33],[34] other retirement plan service providers will consider building or acquiring digital advice capabilities. Current digital advice capabilities are mainly accumulation-focused advice but will be expanded similar to Merrill's PRS to provide retirement decumulation advice.

[32] Businesswire, "Empower Retirement to Acquire Personal Capital," June 29, 2020.
[33] Businesswire, "Edelman Financial Engines Announces Investment From Warburg Pincus LLC," March 15, 2021.
[34] Principal, "Principal completes RobustWealth acquisition," July 03, 2018.

Private equity-funded retail Registered Investment Advisor (RIA) aggregator firms that offer retail advice may consider merging with in-plan managed account providers to have a complete offering spanning both these segments.

WEALTH MANAGEMENT CHALLENGES IN ACQUIRING RETIREE ROLLOVERS

Retirement plan stakeholders – plan sponsors, recordkeepers, third-party administrators, managed account providers, fiduciary consultants – are making strategic efforts to serve retirees through the retirement plan and retain assets in the plan.

ICI Research estimated 2016 annual retirement plan rollovers into a Traditional IRA at $431B.[35] These assets have traditionally flowed to retail financial advisors, where they are either advised for a fee or used to buy an annuity in an IRA.

Regulations make it difficult to recommend a 401(k)-to-IRA rollover, however. They force advisors to compare expenses, fees, and benefits of in-plan investment options with the proposed rollover account and its costs, fees, and benefits. And the comparison must include the client's current investments as well as what is available within the plan. Regulators aim to have retirees take advantage of in-plan institutionally priced low-cost investment products, lifetime income products, and investment advice.

Since the bar for an advisor to recommend a 401(k) to IRA rollover is now much higher, it affects rollovers and encourages assets to stay in 401(k) plans post-retirement for periodic retirement income distributions. FAs advising new retirees will need a cost-benefit analysis to demonstrate why their higher-value services are better and merit higher advisory fees to justify the 401(k) to IRA rollover.

Regulations that force advisors to compare in-plan expenses, fees, and benefits make it difficult to recommend a 401(k)-to-IRA rollover. A client's current plan investments must be explained as well as what is available within the proposed rollover account.

TOOLS AND CALCULATORS WILL NEED TO CHANGE

FAs practice advanced strategies such as tax-loss harvesting, active management of asset allocation models for strategic and tactical changes, capital gain management strategies, and tax-optimal distributions. But the tools they currently use for retirement income analysis don't demonstrate the net value of these strategies. FAs will require tools that can objectively evaluate and convey the importance of an advanced strategy, and then model advisory fees in the analysis. In the future, modeling for advisory fees will have to be supported in retirement income analysis tools.

Retirement plan recordkeepers provide digital calculators that estimate retirement income from the retirement plan balance using simple methodologies. Given that a lifetime income guaranteed payment estimate must be included in retirement plan statements this year (mandated by the SECURE Act), these calculators and retirement income estimates will need to be updated to a more rigorous method and to explain any differences. Additionally, in-plan digital tools will need to be updated to provide holistic retirement income advice factoring in all sources, including Social Security, pensions, part-time work, and external assets. We expect simple calculators to morph into advice tools, which will be point-in-time advice for the investment allocation. These digital advice tools will be an opening to enrollment in a personalized retirement income service.

FAs will require tools that can objectively evaluate and convey the importance of advanced strategies and then model advisory fees in the analysis.

[35] ICI, "The Role of IRAs in US Households Saving for Retirement, 2019," accessed March 2021.

IN-PLAN ANNUITY ADOPTION WILL GAIN STEAM

58% of retail annuities for income are funded by IRAs (typically by rolling over a 401(k) into an IRA first).[36] Once institutionally priced low-cost annuities are available inside a retirement plan, an FA may find it difficult to recommend a retail annuity purchase by rolling over the 401(k) into an IRA. With the possibility of lifetime income annuities getting embedded within the retirement plans as part of a QDIA (either a TDF or a managed account), adoption acceptance may increase.

> If institutionally priced low-cost annuities are available inside a retirement plan, it may be a challenge for FAs to recommend a retail annuity purchase by rolling a 401(k) into an IRA.

Availability of digital guidance and advice tools that demonstrate the value of a lifetime income guarantee as part of a holistic retirement income plan in generating an inflation-adjusted retirement income will positively impact the use of lifetime income guarantees.

403(b) plans that have had annuities for a long time can provide a guiding template to 401(k) plans to adopt annuities, especially for the income phase. At TIAA, a dominant 403(b) recordkeeper, adopting lifetime income guarantees through a holistic retirement income plan has demonstrated a significant positive impact.

SUBSCRIPTION-BASED ADVICE FOR DECUMULATION, INCLUDING ROBO-PROGRAMS, IS EVOLVING

Holistic retirement income distributions involve service above and beyond investment portfolio asset allocation. Therefore, we expect these services to be offered separately at a flat annual subscription fee.

- Guided Choice currently charges an annual flat fee. Merrill's PRS program relies on AUM fees. Schwab's Intelligent Income robo-only offering includes no AUM-based advisory fees (excluding ETFs expense ratios), but human professional support is available at a similar annual subscription fee.

Although current robo-programs don't provide UMI, they will likely evolve to include these features, which pressure FAs to lower retail advisory fees.

AUTOMATED UNIFIED MANAGED INCOME DISBURSALS WILL REDUCE DELIVERY COST

The FA-led delivery model requires many manual steps for the advisor orchestrating a client's disbursal requests. The FA responds to every request to take a disbursal from the portfolio, using his/her own rules to source the money. How disbursals correspond to the agreed planned spending isn't tracked. The situation creates operational risk, and manual execution can be pricey.

The industry is on track to systematize and automate income disbursals. Automation cost efficiency will help offset fee compression to maintain profitability. In addition, automated Unified Managed Income disbursals will empower wealth managers to serve many retirees without expanding staff and while providing clients high-value services. As a result, the opportunity to grow AUM from the acquisition of affluent and HNW retirees is significant.

> **Automated Unified Managed Income disbursals will empower wealth managers to serve many retirees without expanding staff while providing clients high-value services.**

[36] LIMRA, "LIMRA Fact Book on Retirement Income, 2019," accessed April 2021.

6. CONCLUSION

Wealth management and retirement plan firms that don't offer personalized advice to retirees will miss out on a potentially significant revenue stream. Retirees who were served well with mass-manufactured asset allocation during their wealth accumulation phase now need personalized decumulation guidance and advice.

Previously, private wealth managers offered personalized planning by exploring one strategy at a time in FPTs and then manually executing disbursals to generate a client's retirement income paycheck. Yet, FPTs don't optimize strategy levers holistically to make recommendations. All of this will change with mass personalized retirement income delivery.

For 52 million US retirees with less than a million dollars in savings, digital decumulation advice can provide an initial retirement income plan and ongoing disbursals. In addition, wealth managers can offer Unified Managed Income service to clients with more than a million dollars in retirement plan savings at a fixed annual subscription fee. UMI aims to provide holistic retirement income. It factors in all income sources with inflationary adjustments, the in-plan managed account plus all external assets, including qualified accounts, retirement plans, and taxable accounts, to generate desired inflation-adjusted, after-tax spending for the household throughout retirement.

UMI capability opens multiple opportunities for retirement plan firms and retail wealth management firm advisors to enhance retiree services. Standardized tax-optimal retirement income plans and automated disbursals can serve vast numbers of retirees.

THE FUTURE FOR RETIREMENT DECUMULATION SERVICES IS EXCITING

An in-plan personalized retirement income plan supplemented with retail advisory services will entice retirees to consolidate all of their assets with one service provider that can seamlessly orchestrate retirement income across their brokerage accounts and retirement plans. Also, with the possibility of lifetime income annuities embedded within retirement plans as part of a QDIA (either a TDF or a managed account), resistance to adoption will likely decline.

However, it will be challenging for firms to acquire retiree rollovers. FAs advising new retirees will need a cost-benefit analysis to demonstrate why higher-value services are better and worth the higher advisory fees to justify the 401(k) to IRA rollover. The result is FAs will be required to evolve their calculators and tools to accommodate advanced strategies such as tax-loss harvesting, capital gain management strategies, and tax-optimal distributions. Moreover, these new set of services can be offered at an additional flat annual subscription fee, separate from AUM fees for asset allocation.

UMI is on track to become the new normal for the wealth management and retirement plan industry. The question is, how quickly can firms provide in-plan personalized retirement income advice? How fast can they evolve their tools and calculators to support retirement income analysis? And how quickly can they adopt the robo/subscription-based fee structure to remain relevant for tomorrow's retirees?

7. APPENDIX – EVALUATION OF VARIOUS TOOLS AND SERVICES

To understand current retirement income capabilities across the industry, we evaluated various offerings using the questions listed below. When publicly available documents didn't contain sufficient details, firms were approached for more information. We included information offered by firms within our summaries. Otherwise, evaluations were based solely on publicly available information.

DIGITAL TOOLS FOR RETIREMENT INCOME GUIDANCE OR ADVICE

- How is the level of sustainable retirement income determined – is it user-specified or recommended by the tool? Is the retirement income estimate pre-tax or post-tax; is it inflation-adjusted?
- Are multiple strategies for generating retirement income presented? How many?
- What metrics are used to communicate strategy effectiveness? E.g., success probability or percent of desired income that can be sourced sustainably?
- Which capital market assumptions are used to model portfolio returns and inflation – fixed average annual return, historical returns sequence, or multiple sets of future simulated returns?
- Does it allow the user to explore custom strategies or different levels of retirement income?
- Social Security claim – is the claim age assumed, specified by the user, or recommended using an optimization? Are spousal or survivor benefits calculated and modeled in the analysis?
- Is an annuity allocation for guaranteed lifetime income supported? Is the allocation recommended or user-specified?
- Is lifetime income from annuity assuming a straight annuitization of the balance or through a lifetime income rider on a fixed indexed or variable annuity?
- Is a recommendation made for asset allocation for the investment balance (after annuity allocation)? What criteria are used to make suggestions – client's risk profile, goal-based method of maximizing success probability?
- What is the assumption of life expectancy? Does it vary by gender? Is the single survivor phase appropriately modeled?
- How are taxes estimated post-retirement? Are full federal tax brackets modeled, or are effective tax rate assumptions used? What capital gains federal tax rate assumptions are used? What Social Security tax assumptions are used? Are state taxes estimated? Are effective state tax estimates or brackets used? Are future federal tax rates assumed based on current legislation (such as sunsetting of tax cuts)?
- What is the withdrawal strategy across various tax-type accounts? Is it fixed or dynamic based on rules that may target taxes?
- Is the estimated retirement income holistic across all cash-flow sources and all accounts, including held-away assets?
- Are cash-flow sources – Social Security, pension etc. – modeled for appropriate inflation adjustment?

DIGITAL ROBO-ADVICE FOR RETIREMENT INCOME DISTRIBUTION

- Does the program cover only retirement income distributions from the robo-managed account, or does it deliver disbursal guidance for holistic retirement income distributions across all sources of cash flow, managed accounts, and held-away assets?
- Does the program adjust total retirement income with annual cost of living adjustment?
- If the program aims for holistic retirement income distributions, does it model inflationary adjustments of Social Security, pensions, annuities, and other cash-flow sources?
- Does the generated disbursal target a post-tax retirement income and estimated taxes, or target a pre-retirement income?
- At what frequency does the program deliver distributions to a retiree?
- Is the account traded every time a distribution is needed, or less frequently to generate cash for multiple future periodic distributions?
- Does the program change the recommended asset allocation for investments in response to updated capital market return expectations and user-provided information? If so, what criteria drive the change?

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Income Discovery is an AI-powered platform that makes complex retirement decumulation simple. Its AI engine, AIDA, combs through thousands of options to determine a personalized optimal strategy for each client. AIDA discovers the precise plan that maximizes after-tax Safe Retirement Income by as much as 30%. AIDA is already driving revenue growth in the wealth and retirement industry. It has serviced more than 106,000 retirees with $80 billion in assets as of 12/31/20, and aims to deliver a Full & Rich Retirement to each client.

Income Discovery's capabilities also include Paycheck -- a solution to manage disbursals for planned spending, unplanned spending, and Roth conversions during retirement. Paycheck is holistic, flexible, and integrates with a firm's existing planning tools and systems to deliver tax-optimized withdrawals between managed and held away accounts based on the client's selected strategy. Advisors easily create and monitor personalized income plans and paychecks for retiree clients, saving time and money by eliminating manual work currently required for retirement income disbursals. The paycheck capability also provides safety tracking, assurance and automated income adjustments if necessary.

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