

# DSG DIMENSIONS

Selected observations, insights, and updates for the benefit of our clients and friends

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## *From the Editor:*

Towards the end of 2009, DSG completed a couple of major research studies that gave us two unique perspectives on the retirement income market: first, from the financial advisers who incorporate retirement income products into their practice and then from the manufacturers and providers of these products.

The first study, conducted in conjunction with the Financial Planning Association (and sponsored by Nationwide), was a quantitative study among 460 FPA members that examined their attitudes and perceptions about the retirement income market. The second study, our 10th annual **Retirement Income Products & Solutions Study**, surveyed 42 of the key corporate participants in the retirement income market and then followed up the survey with 17 lengthy executive interviews.

The two articles in this issue of DSG DIMENSIONS provide an extract of some selected findings from these two studies. We hope you find them of interest. If you have any comments on these articles, or wish to find out more about acquiring the full reports, please drop me a note at [jims@dsg-network.com](mailto:jims@dsg-network.com).

With this issue of DSG DIMENSIONS, we are making the switch from paper to electronic copies. This not only saves paper and speeds up our turnaround time from concept to publication, but also makes it easier for you to pass along copies of articles to other interested parties. And we enthusiastically encourage you to share with anyone who has an interest in retirement income market topics. Also, if you are reading a copy that originally went to someone else, drop me a note with your e-mail address, and I will gladly add you to our list.

*Jim Sholder, Editor DSG DIMENSIONS*

## Dispelling the Myths About Financial Advisers and the Retirement Income Market

*Robert F. Vickery*

*Editor's Note: This article is based on recent findings from the research study, 2009 Financial Adviser Attitudes and Perceptions About the Retirement Income Distribution Market, produced by DSG in conjunction with the Financial Planning Association and sponsored by Nationwide Financial.*

For the past four years, DSG and the Financial Planning Association have surveyed FPA membership on how advisers are managing the retirement income aspect of their practices. Perhaps due to the oncoming demographic wave, or maybe as a result of the deep recession of 2008 and 2009, our most recent study is demonstrating a change in how advisers are approaching retirement income planning. The differences in our view are striking and are beginning to unravel the industry's conventional thinking about how financial advisers view the market. To that

end, we have come up with four myths that may be on the verge of getting busted.

***Myth 1: Financial advisers have not made the leap from accumulation to decumulation.***

For those of you who think retirement income is still lagging behind the accumulation side of the

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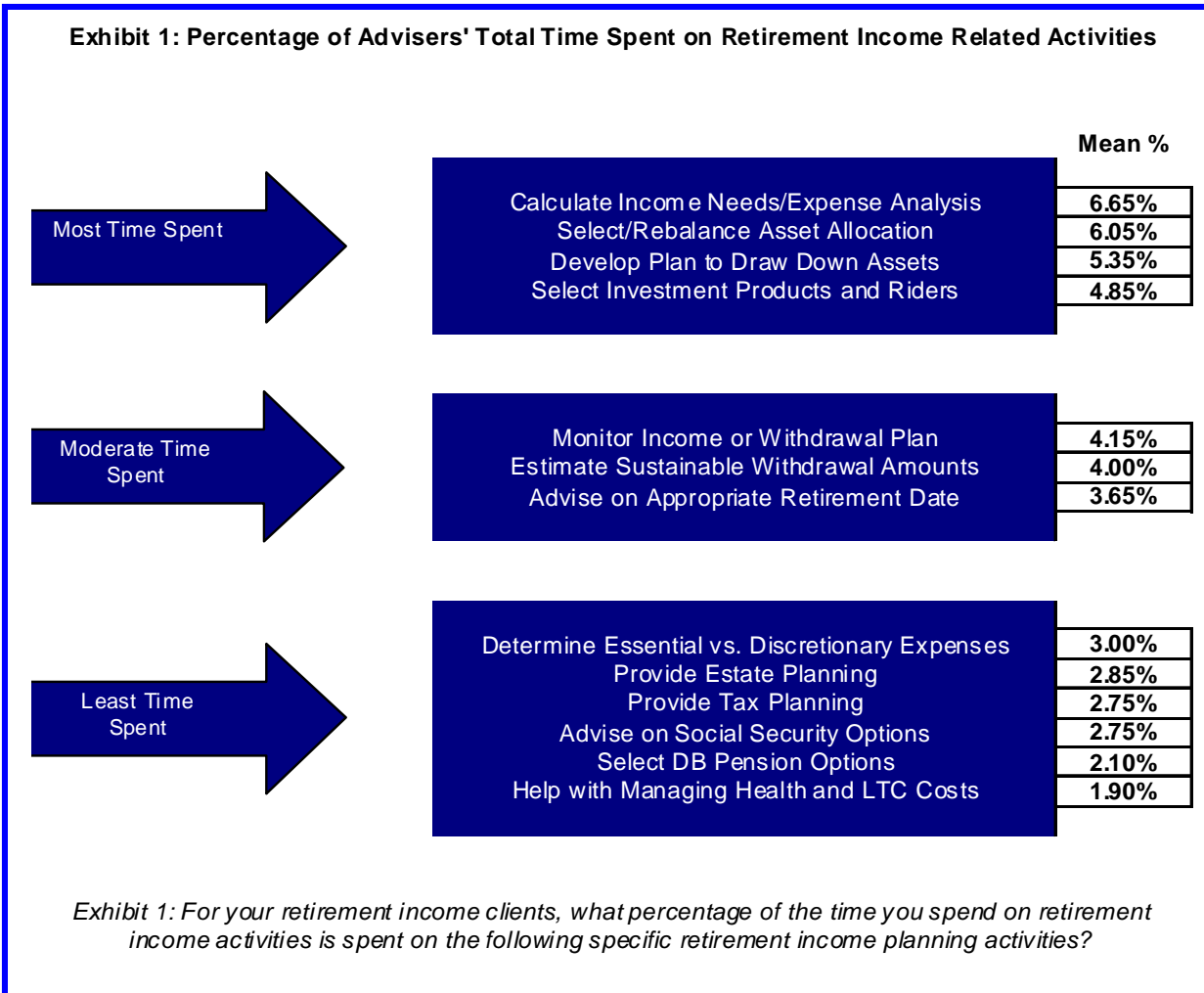
financial services business, you should think again - and check with your sales distribution. DSG's recently completed market research study, *2009 Financial Adviser Attitudes and Perceptions About the Retirement Income Distribution Market*<sup>1</sup>, shows that advisers are now spending 50% of their time on retirement income activities. On average, advisers provided some level of retirement income services to 53% of their clients. And nearly 2/3 of advisers indicated that this percentage had increased from the prior year.

This represents a major shift from what advisers were telling us about the retirement income market a few years back when DSG first began collecting data on the topic from FPA members. At that point, while advisers realized that the retirement income market was going to be an impor-

tant component of their business, they told us that the market was well down the road and would grow at a much slower pace. Well, the retirement income market is now front and center and advisers are spending a great deal of time working through the much more complex planning activities that income distribution presents.

So what retirement income related activities are taking up the most time for advisers? Not surprisingly, nearly half of the time spent on retirement income is dealing with the true income distribution planning functions as well as the necessary in-depth analysis of which products and solutions are best suited to the individual clients' situations. (See Exhibit 1.)

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<sup>1</sup> 2009 Financial Adviser Attitudes & Perceptions About the Retirement Income Distribution Market, FPA Press, December 2009.

Most of the remaining half of their time spent on retirement income activities is in providing advice for other retirement issues and monitoring clients' existing asset withdrawal plans. Tax planning and estate planning are currently requiring less of an adviser's time, but these items will most likely increase if and when new income tax, estate and inheritance rules are enacted.

***Myth #2: Advisers can't make any money in the retirement income market.***

Another popular misconception about the retirement income business is that advisers will suffer financially as clients' assets are being drawn down. FPA members clearly dispute that notion. As a matter of fact they anticipate significant growth in their revenues over the next five years as a result of offering retirement income products, services or guidance. The increase in revenues is expected to come from three primary sources:

- New clients added as a result of advisers' growing experience and confidence in retirement income services.
- Consolidation of additional assets from existing clients as a result of the retirement income planning process.
- Incremental fee revenues as clients transition from accumulation to income distribution.

Advisers are now demonstrating that by promoting themselves as retirement income experts they are able to increase revenues. Over 9 in 10 of the FPA member respondents were able to acquire new clients by highlighting their retirement income knowledge and nearly half of the members were

able to consolidate additional assets from their current clients.

In addition, as previously mentioned, devising a comprehensive retirement income plan and withdrawal strategy is a time consuming task. As a result more than half of the FPA member respondents believe fee income on these planning and consulting services will increase substantially over the next 5 years.

***Myth #3: A Structured Systematic Withdrawal Program is basically the only formal strategy financial advisers use to draw down income for their clients.***

While systematic withdrawals remains the most common method for drawing down assets (primary method for 40% of the FPA members), two somewhat more sophisticated strategies are beginning to take root. (See Exhibit 2, next page.)

Time-Based Segmentation (or the 'Bucket Approach') and the Essential vs. Discretionary Income Approach are becoming more popular and are now being used by slightly less than half of the FPA membership as their most common draw down strategy. It is believed that the new methods can provide an adequate flow of income as well as more risk protection in a time of greater fear among their client base.

It is interesting to note that advisers using the structured systematic withdrawal program feel that the sustainable annual withdrawal percentage

*(Continued on page 4)*

**Recently Completed Research**

Two recently completed research studies are now available from DSG:

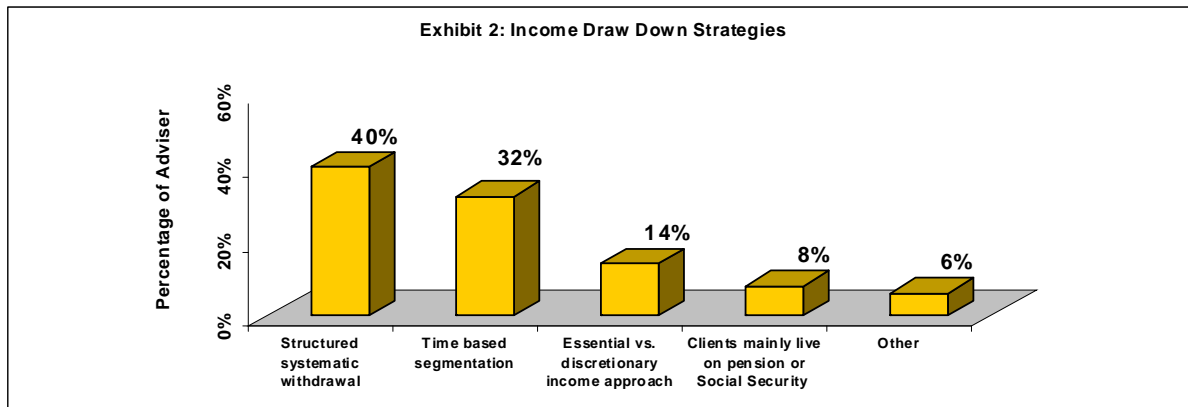
***2009 Financial Advisers' Attitudes & Perceptions About the Retirement Income Distribution Market***

Conducted in conjunction with the FPA, and sponsored by Nationwide, this in-depth quantitative study focuses on the perceptions and activities of the financial planner channel regarding the post-retirement client and retirement income opportunity.

***2009 Retirement Income Products & Solutions Study***

This 10th study in our annual research series maps the retirement income products "universe," including guaranteed living benefits, immediate annuities, new mutual fund solutions, and emerging products currently under development. Included is a comprehensive review of retirement income market activity and results during the economic turmoil of 2008 and 2009.

**For more information about these studies, contact Borden Ayers at  
610-989-1710 ext. 21 or at [bordena@dsg-network.com](mailto:bordena@dsg-network.com)**



*Exhibit 2: Which one of the following best describes the most common strategy you use to provide retirement income to your clients?*

from their clients' portfolios should be 4.4% on average. This percentage has been dropping over the last couple of years from a high of 5.3% in 2007. Although in the midst of the worst financial period in the last 60 years, it is also interesting that only 4% of the advisers recommend a withdrawal rate of less than 4%. This may be due to the depletion of client assets over the past two years or the high confidence levels the financial advisers exhibit towards virtually every aspect of retirement income planning and client interface.

***Myth #4: Advisers believe annuitization is a dirty word and is to be avoided at all times.***

Well, to be honest, this myth isn't quite busted yet, but it is beginning to show some cracks. In the study, FPA members were asked how frequently they recommend each retirement income related product or solution from a given list of possibilities. While traditional solutions such as income and dividend paying investments and laddered CDs or bonds were the most frequently recommended solutions, single premium immediate annuities were listed in the middle of the pack and were ranked above such solutions as fixed deferred annuities, target maturity funds and payout funds. In fact, a measure of recommendation frequency nearly doubled for SPIAs from 2007 to 2009.

This may not illustrate a giant breakthrough for annuitization, but it does suggest that advisers are recognizing a need for a guaranteed income stream after a very difficult period for assets in all investment classes.

As an aside, with target maturity and payout funds coming in at the bottom, these rankings

also demonstrate that the mutual fund industry has far to go in either developing true retirement income solutions or in convincing the financial adviser community of their value.

***Summary***

As you may know, DSG has carefully tracked the retirement income market for nearly 15 years – from the days when everyone was trying to determine the market's opportunity to today - when many constituents have made the leap into the market and are executing and refining their strategies and tactics. All along financial services executives have believed that their companies were well ahead of their distribution in embracing and managing the retirement income market. That may no longer be the case.

The FPA membership firmly believes they are well into the planning and execution cycle of retirement income. They are spending a significant amount of their time and are providing income distribution related services to a majority of their clients. They are devising and monitoring withdrawal strategies and recommending a variety of viable retirement income products and solutions. In addition, the FPA membership told us that they are highly confident in their abilities in virtually all phases of retirement income planning, including their client communication techniques on the topic.

With the economic turmoil over the past two years forcing many financial services companies to pull back on their retirement income initiatives, companies may now find they have much to learn from their distribution partners. ***DSG***

## The Changing Retirement Income Landscape

James R. Sholder

For the past 10 years, we have conducted an annual research study that examines the state of the retirement income market, with a primary focus on products and solutions. This year's study<sup>1</sup>, which involved a 42-company survey combined with 17 executive interviews, takes a look at the retirement income marketplace as perceived by some of its most active participants. Combined with a decade's worth of input, this latest research yields a comprehensive picture of the changing retirement income landscape, recent activities, and where the market appears to be trending.

### *An Evolving Industry*

The first indicator of change is in the annual re-design of the study itself. Typically, the survey and interview questions need to be revised each year to keep pace with changes that are occurring in the retirement income arena. As an example, in the early years of the study, a good number of questions focused on immediate variable annuities (IVAs) because they were seen by many as a key element of the retirement income solution. Now, IVAs make up only a minor piece of the study, having been superseded by other, more innovative, products and solutions that are more attractive to advisers and their clients.

As our latest study suggests, today's retirement income landscape and its future outlook is being influenced by two key factors: the ongoing transformation that results from competitive pressures and marketplace activities, and the recent 2008/2009 economic turmoil which has led to some serious re-thinking of products, product features, risks, and the consumer's retirement goals.

### *Recent Changes*

Certainly, 2009 has been a year of adjustment to new realities for many firms, and 2010 looks to be a transition year to "a new normal" — probably an environment that includes more fearful clients, higher expectations of advisers and their companies, and greater attention to managing the riskiness of products. These factors, combined with competitive trends already underway, result

in a revised picture of the retirement income landscape. Some of the changes that are already apparent include:

#### **Guarantees have become more important.**

For consumers who are approaching retirement age, the economic turmoil has led to a serious loss of confidence about their financial future. Thus, we find that guarantees are viewed as a more important product ingredient by both insurance and mutual fund executives.

The pursuit of an income stream with more guarantees is logically leading to several outcomes:

- SPIAs are gaining more acceptance as an important element in the client's retirement income plan. Executives generally agreed that the payout annuity will likely have a more important role for retirees, primarily in the form of a fixed immediate annuity. In fact, SPIAs are now viewed as the most significant challenge to GLBs by our survey respondents. It

*(Continued on page 6)*

### **Guaranteed Retirement Income Solutions**

**A syndicated research project to examine the current state of the market for guaranteed retirement income from the perspectives of both consumers and producers.**

This study, planned for the first half of 2010, and using both quantitative and qualitative methods, will examine usage, popularity, and preferences for products and features that provide guaranteed income solutions. The research will include two major stages: a consumer survey and producer interviews.

Guaranteed products will include fixed and variable immediate annuities, annuitization of deferred annuities, various annuity products with guaranteed withdrawal benefits, and guarantees attached to mutual funds. The overall goal of this research is to identify preferred products and features, determine successful marketing approaches, and specify preferred customer and producer profiles.

**For further information, contact Borden Ayers at 610-989-1710, ext. 21, or [bordena@dsg-network.com](mailto:bordena@dsg-network.com).**

<sup>1</sup> **2009 Retirement Income Products & Solutions Study**, DSG, December 2009.

remains to be seen whether this popularity will continue for SPIAs if the economy improves sufficiently for consumer confidence to rise to a more traditional level.

- Variable annuities with guaranteed withdrawal benefits (GMWBs/GLWBs) are retaining their popularity as a retirement income product, despite recent problems caused by the economy. Although sales growth expectations for these products have declined somewhat as a result of the economic upheaval, these products continue to maintain their position as the most frequently recommended retirement income product by the insurance industry.
- Mutual fund companies will be under increasing pressure to provide some means of guaranteeing a payout for retirees. Looking ahead for the next couple of years, 1/3 of our survey respondents with proprietary funds have plans to provide some sort of guaranteed income rider with their products. This could also eventually lead them to forming partnerships with insurance firms to provide these guarantees.

**Variable annuities with guaranteed living benefits (GLBs) are being revamped.**

As a result of the 2008/2009 market turbulence, some GLB products were permanently discontinued and others were put on a temporary hold. However, most of the GLB product activity focused on revisions to bring these products more in line with acceptable risk parameters.

Out of 20 GLB providers in our survey, 16 indicated they were revising their products as a result of the market upheaval. Price increases, restrictions on asset allocations, and reduced withdrawal rates were the most common revisions for GLWBs as exemplified on Exhibit 1. It's possible that some of these revisions could negatively affect the popularity of these products, and it re-

<b>Revisions Implemented</b>	<b># of Companies (n = 16)</b>
Increased price for guarantees	9
Lowered withdrawal rate	7
Tightened restrictions on asset allocation options	6
Eliminated or slowed benefit base resets	4
Reduced benefit amount	4
Removed/reduced step-up frequency	2

mains to be seen whether this will cause a further slowing in their sales growth.

**Despite recent difficulties, most companies are relatively optimistic about their retirement income business.**

- Only 1/5 of survey respondents stopped or reduced their level of activity in the retirement income market as a result of the 2008/2009

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**Retirement Healthcare Executive Forum**

The Retirement Healthcare Executive Forum (RHEF) is being formed as a cross-sectional industry study group of executives that will focus on the healthcare portion of retirement planning, with special emphasis on healthcare funding mechanisms and asset protection strategies. Membership will likely include senior executives in various industry segments such as insurance and benefits firms, senior care facilities, and major employers.

Forum meetings will occur twice each year, and will typically include roundtable discussions, guest speakers, member presentations, and other member-determined activities, plus networking opportunities. Charter members of the RHEF will be invited to an initial organization meeting to finalize the Forum's policies, schedule, and activities.

For more information, or to request a more detailed description, please contact:

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turmoil. Most common actions involved cutting personnel and holding or reducing spending levels.

- Most retirement income products are expected to show some sales growth over the next two years.
- About 2/3 of survey respondents believe that new spending on retirement income products and programs at their firm will take place during the first half of 2010.

### ***Do Forecasts Need Revision?***

In a 2007 DSG DIMENSIONS article, we made four general predictions about the future of the retirement income market. They were:

1. SPIAs will capture a greater share of the retirement income market.
2. Variable annuities with guaranteed living benefits (GLBs) will show sales growth at a double-digit rate for the foreseeable future.
3. Mutual fund companies will become a growing factor in the retirement income market.
4. Longevity insurance will be a difficult sale.

Although we would likely moderate the expected growth rate of GLBs over the near-term, nothing that has occurred or shown up in our research findings would lead us to change these predictions of longer-term industry trends, despite all that has happened in the economy and the marketplace over the past two years.

### ***Looking Ahead — Questions to Consider***

For companies that seek to build a growing business around retirement income solutions, what are their key challenges in light of the market melt-

down, product retrenchments, and changing consumer perspectives?

A sampling of the more pressing questions that executives will need to address includes:

- How will they help clients to build a workable retirement income plan that gets them back on track after their assets have been significantly reduced from earlier levels?
- After all the market turmoil, will consumer and adviser mindsets be permanently altered, or will these groups gradually revert back to previous expectations?
- How necessary are guaranteed income products, and what does that imply for both insurance and mutual fund companies that are trying to build a business around retirement income?
- How much effect will new or alternative products have in solving for the changing consumer needs? Can healthcare products and hybrid products become the growth areas of the future?
- Will managers be able to justify their use of resources to support retirement income activities without a clear set of metrics that allows them to specify and quantify the value of these programs for the overall enterprise?

In order to be competitive in the retirement income market, companies will need to ask and answer these and other pertinent questions. How they answer and act on these questions will determine the direction of the retirement income market, and their success within this market. ***DSG***

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