Distribution Planning: Retirement Income Planning

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“Retirement at sixty-five is ridiculous. When I was sixty-five I still had pimples.”

George Burns
Retirement Income is “everywhere”

- Google “Retirement Income”
  - 73 million results appear

- Google “American Idol”
  - 250 million results appear

- Google “Pension Reform”
  - 6 million results appear
Retirement Income is “everywhere”

- Designations
  - RIIA’s Retirement Management Analyst (RMA)
  - Retirement Income Certified Professional (RICP)

- Conferences
  - AdvisorOne Retirement Income Symposium
  - Pensions&Investments Retirement Income Solutions Summit

- Books
  - *Retirement Income Redesigned: Master Plans for Distribution*
  - *Your Retirement Income Blueprint*
Your retirement saving needs

Regardless of your retirement saving strategy, the big question when you begin retirement is:

Will I have enough money?

More than a third of Americans (37%) admit they have no idea how much money they will need to support themselves in retirement.¹

¹ 2010 Wells Fargo Retirement Survey, 2010
Will you outlive your assets?

You could spend 10, 20, or 30+ years in retirement.

Probability of a 65-year-old in good health living to various ages:

**Male**
- 85 yrs old (50% chance)
- 92 yrs old (25% chance)

**Female**
- 88 yrs old (50% chance)
- 94 yrs old (25% chance)

**Couple***
- 92 yrs old (50% chance)
- 97 yrs old (25% chance)

*Source: Annuity 2000 Mortality Table, Society of Actuaries
*Longevity estimates for one member of a 65-year-old couple in good health
Longevity

The Numbers are Staggering

By 2025, 32 States in this country will have the same demographics as the State of Florida has now!

Sources: Alliance for Aging Research, Baby Boom Headquarters (www.BBHq.com), Census Bureau Projections
The Diversified Income Approach

Product Categories

Workers with a Pension

<table>
<thead>
<tr>
<th>Guaranteed</th>
<th>Guaranteed income for life</th>
</tr>
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<tbody>
<tr>
<td></td>
<td>Combination of insurance and Annuity products create a stream of guaranteed income designed to cover essential expense</td>
</tr>
<tr>
<td></td>
<td>Liquidity need, Insurance fees and limited control of assets</td>
</tr>
<tr>
<td></td>
<td>How long assets will last and market volatility</td>
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</table>

* EBRI 2011, Private Sector Workers With A Pension
What American’s Are Saying About Retirement

- In general, over half of pre-retirement Americans (53%) are not confident they will have saved enough for the life they want in retirement.
  - Mass affluent – 65% are confident they have saved enough
  - Affluent – 88% feel confident they have saved enough
- With the mass affluent and affluent segments, “healthcare” is their primary concern in retirement with “running out of money” second.
- When asked how much will you take out of savings annually in retirement the mass affluent said “10%” and the affluent segment said “7%”

Note:
- Mass Affluent - $100,000 - $249,999 in investable assets
- Affluent – over $250,000 in investable assets

Source: Wells Fargo Harris Interactive Retirement Survey 2012
What American’s Are Saying About Retirement

- A study by Hewitt Associates found that American’s will have to save 15.7 times their final pay when factoring inflation and healthcare in retirement.
  - Social Security will take care of 4.7 of it leaving employees responsible for 11 times final pay.
- Defined Contribution plans will meet 74% of the employee’s retirement needs according to the study
- Hewitt found that companies that have “auto-enroll” have a 90% participation rate on average, but employees often run into inertia. They recommend “auto-escalation” for employers so that employees continue to increase their contribution levels over the years

Source: Hewitt Associates 2012
Understanding The Retirement Landscape

A Different View Towards Savings & Spending

- Shopped at “Woolworths”
- Dined out only on her Birthday
- Put Money in a Passbook Savings
- Hated to turn on the Air Conditioner
- Saved Green Stamps
- Sewed clothes for her Children
- Wouldn’t pay to have her car washed
- Re-used tea bags and Aluminum Foil
Understanding The Retirement Landscape

Do you know this couple?

- Shop at Nordstrom
- Dine out frequently
- Stop daily at Starbucks
- Lease a new car every 2 years
- Vacations at resorts
- Buy the latest electronics
Low Interest Rates
Health care costs continue to rise

Have you considered the estimated cost of health care in retirement?

For a couple*

$376,000

For a couple*

$224,000

For a woman

$196,000

For a man

Source: EBRI Issue Brief No. 317. The amounts shown give retirees a 90% chance of having enough savings to cover health care costs. This assumes retirees have employment-based retiree health benefits to supplement Medicare, and their former employer does not subsidize premiums.
Risks in Retirement

Risks to Savers
(Accumulation Phase)

- Tax Rates on the Rise
- Inflation
- Low Interest Rate Environment
- Macro - Economic Risks
- Market Volatility
- Sequence of Returns
Risks in Retirement

<table>
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<tr>
<th>Risks to Savers (Accumulation Phase)</th>
<th>Additional Risks to Spenders (Distribution Phase)</th>
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</thead>
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<tr>
<td>Tax Rates on the Rise</td>
<td>Retirement “System” Upheaval</td>
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<tr>
<td>Inflation</td>
<td>Better Health Care &amp; Rising Costs</td>
</tr>
<tr>
<td>Low Interest Rate Environment</td>
<td>Little Planning or Budgeting</td>
</tr>
<tr>
<td>Macro - Economic Risks</td>
<td>Consumer, Behavior</td>
</tr>
<tr>
<td>Market Volatility</td>
<td>Dependant Extended Family</td>
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Risks in Retirement

Risks to Savers  
(Accumulation Phase)

- Tax Rates on the Rise
- Inflation
- Low Interest Rate Environment
- Macro - Economic Risks
- Market Volatility

Additional Risks to Spenders  
(Distribution Phase)

- Retirement “System” Upheaval
- Better Health Care & Rising Costs
- Aging Population & Increasing Longevity
- Little Planning or Budgeting
- Consumer, Behavior
- Dependant Extended Family

Sequence of Returns
Retiring in a down market

Starting portfolio value: $500,000  Annual withdrawals in retirement: 5%, adjusted for inflation
Time period: 1973 – 1993  Portfolio: 50% large company stocks, 50% intermediate bonds

Actual historical return sequence

A retirement portfolio being eroded simultaneously by a bear market and 5% annual withdrawals.

Past performance is no guarantee of future results. Hypothetical value of $500,000 invested at the beginning of 1973. Assumes inflation-adjusted withdrawal rate of 5%. Portfolio: 50% large company stocks and 50% intermediate term bonds. This is for illustrative purposes only and not indicative of any investment. An investment cannot be made directly in an index.

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Industry Landscape: Retirement Income

- Various views and strategies across the industry. Some are taking a narrow view or niche while others view this as a way to get new clients and gather more assets in their firm.
- New calculators, software to track income streams, financial planning processes and products to produce income are all in the works.
- Focus groups of pre-retirees and retirees are a very popular way for companies to shape their message and marketing approach, even their advertising.
- White papers on the topic – Blackrock, for example.
Convert Resources into Income

5. Convert resources into income

4. Identify options for addressing the gaps

1. Estimate duration of retirement assets
2. Identify and manage retirement risks
3. Identify distribution, tax and estate issues and opportunities

6. Maintain and update the plan

Data Collection

Provide a Process – Not Just a Product
Another Look at Retirement Income

**Total Return Planning**
(allocated to growth)

- High Yield Bonds
- US Large Cap Stock
- Emerging Markets Stock
- US Small Cap Stock
- Int'l Small Cap Stock

**Diversified Income Planning**
(allocated for income)

- Guaranteed
- Stable
- Growing

Client Assets

<table>
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<th>Client Age</th>
<th>Client Assets</th>
</tr>
</thead>
<tbody>
<tr>
<td>58</td>
<td>58</td>
</tr>
<tr>
<td>68</td>
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Accumulation

Distribution
Generating Income from a diversified portfolio

- **Guaranteed Income**
  - Fixed and Index Annuities
  - Immediate Annuities
  - Variable Annuities
  - Social Security

- **Growing Income**
  - Dividend paying stocks
  - Mutual Funds
  - Closed-End Funds

- **Stable Income**
  - Government, Corporate, Muni Bonds
  - CD’s
Generating Income from a diversified portfolio

Different Approaches

- **SWP: %**
  - Easy to understand and calculate
  - Flexible and meet varying needs of the client
  - Subject to “Sequence of Return” risks

- **Income Only**
  - Live off the interest and dividends of the portfolio
  - Inflation risks

- **Bucket**
  - Phase 1 – First 10 years of Retirement (short term investments cash, CD’s, fixed income)
  - Phase 2 – Next 10 years (Income and & Growth investments)
  - Phase 3 – Invested for growth
One way to create income in retirement - annuities
# Annuities 101: Guaranteed Lifetime Income

<table>
<thead>
<tr>
<th>Best if you want</th>
<th>Immediate annuity</th>
<th>Variable annuity with Lifetime Income</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>To convert a portion of your accumulated assets into an income stream for life that can start within 30 days to a year after you establish the annuity.</td>
<td>To prepare now for guaranteed lifetime income payments to start sometime in the future, but you want to keep your assets invested in the market</td>
</tr>
</tbody>
</table>

| Key Features | May provide the highest amount of guaranteed income for life | Tax-deferred savings for retirement, plus a guaranteed retirement income for life |

| Rate of Return | • Provides a guaranteed stream of income for a period of time selected by the policy owner (often for life) • Payment amounts can be based on interest rates, the age and life expectancy of the client, and the options chosen | • Depends on the performance of subaccounts selected by the annuity holder • There may be a minimum growth rate of the value associated with the income options chosen |

Source: [https://www.wellsfargo.com/investing/annuities/compare](https://www.wellsfargo.com/investing/annuities/compare)
The following illustrations are intended to show how the performance of the underlying investments could affect the annuity’s account value and contractual benefits, and are not intended to predict or project investment results. The hypothetical returns are used for illustrative purposes only and should not be deemed a representation of past or future performance or a guarantee of any kind.
Generating retirement income in 10 years

Amy and George (both age 57) plan to retire at 67 when they will begin receiving pension payments and are eligible for full Social Security benefits.

As they plan for retirement, Amy and George are:

- Needing $60,000 a year for essential expenses in retirement
- Concerned about market volatility as an unknown risk to their savings
- Seeking to manage inflation through their portfolio’s growth potential
## Amy and George’s retirement income sources

<table>
<thead>
<tr>
<th>Projected annual income at 67</th>
<th>Guaranteed income shortfall at 67</th>
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<tbody>
<tr>
<td><strong>Social Security:</strong> $28,000</td>
<td>Desired guaranteed income: $60,000</td>
</tr>
<tr>
<td><strong>Pension income:</strong> + $12,000</td>
<td>Projected actual income: -$40,000</td>
</tr>
<tr>
<td><strong>Total guaranteed income at 67:</strong> $40,000</td>
<td><strong>Shortfall:</strong> $20,000</td>
</tr>
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</table>
Solution: Variable annuity with living benefit rider

To meet Amy and George’s goal of covering all essential expenses with guaranteed income sources, their financial advisor recommends using $250,000 of their retirement savings to purchase a variable annuity with a living benefit rider. This annuity:

- Provides 5% lifetime withdrawals beginning at age 67
- Generates at least $20,361 in annual income
- Covers their guaranteed income shortfall
- Offers a 5% credit for deferring withdrawals
- Locks in any account growth through annual step ups
What if the equity markets are down in 10 years?
Living benefit riders: Protection from down markets

Amy and George are protected from a down market and can receive a 5% credit for delaying income withdrawals.

The $250,000 benefit base grows by 5% per year in the first 10 years, providing predictable growth of the benefit base.

After 10 years, the benefit base grows to $407,223 and guarantees 5% annual income of $20,361.

Negative market returns reduce the account value to $185,000 after 10 years.

This hypothetical graph assumes no withdrawals for the first 10 years. The withdrawal benefit base is only used to determine withdrawal amount, and may not be withdrawn as a lump sum or in cash. This information is hypothetical in nature and is provided for information purposes only. It is not intended to represent any product or investment, nor is it indicative of future results. Returns do not represent any specific time period or index. Returns include annual contract costs of 3.25%. Surrender charges may apply for withdrawals that exceed the contract’s annual free withdrawal amount and be as high as 9%.
Meeting Amy and George’s needs in a down market

Projected annual income at 67

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<th>Source</th>
<th>Amount</th>
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<td><strong>Total guaranteed income at 67:</strong></td>
<td><strong>$60,361</strong></td>
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Meets Amy and George’s goal of having $60,000 in guaranteed income sources.
What if the equity markets are up after 10 years?
Living benefit riders: Benefit from market growth
As Amy and George’s principal grows, they lock in a higher benefit base value.

If the account value on the contract anniversary is higher than the current benefit base, the higher account value would become the new protected benefit base.

After 10 years, their benefit base is $470,000 and they will receive 5% lifetime withdrawals of $23,500.

This hypothetical chart assumes no withdrawals for the first 10 years. The withdrawal benefit base is only used to determine withdrawal amount, and may not be withdrawn as a lump sum or in cash. This information is hypothetical in nature and is provided for information purposes only. It is not intended to represent any product or investment, nor is it indicative of future results. Returns do not represent any specific time period or index. Returns include annual contract costs of 3.25%. Surrender charges may apply for withdrawals that exceed the contract’s annual free withdrawal amount and be as high as 9%.
Conclusion:

- Tools, products, research, advertising and marketing will only increase and get better in the years to come on the topic of “retirement income”.
- American’s need an “income plan”
- Planning early and being realistic is important
- Saving rates need to continue to increase
Important disclosures

Variable annuities are long-term investments suitable for retirement funding and are subject to market fluctuations and investment risk.

Guarantees are based on the claims-paying ability of the issuing insurance company. Guarantees apply to minimum income from an annuity; they do not guarantee an investment return or the safety of the underlying funds.

Insurance products are offered through nonbank insurance agency affiliates of Wells Fargo & Company and are underwritten by unaffiliated insurance companies.