Employee Benefit Research Institute 64th Policy Forum

Optimization in terms of a portfolio of products
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Agenda

► Middle America

► Key tenets of an effective retirement income framework

► Product allocation models applied at the point of rollover to affect the middle market outcome

   ► Models for income

   ► Models for income and endowment

► Desirable outcomes from the use of product allocation models

► Closing remarks

Middle America

**Average Financial Assets
($ thousands)**
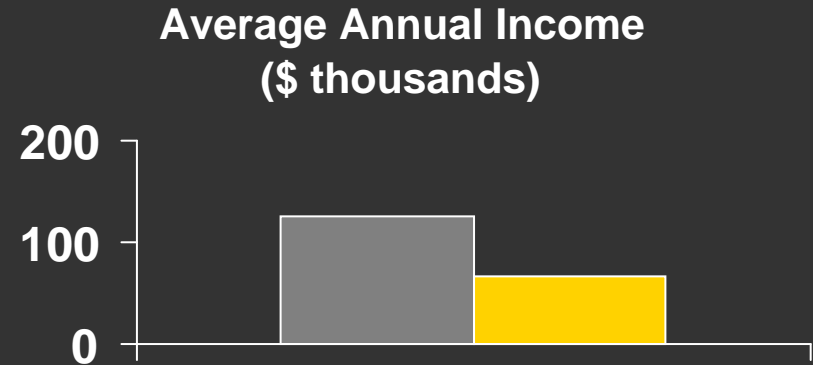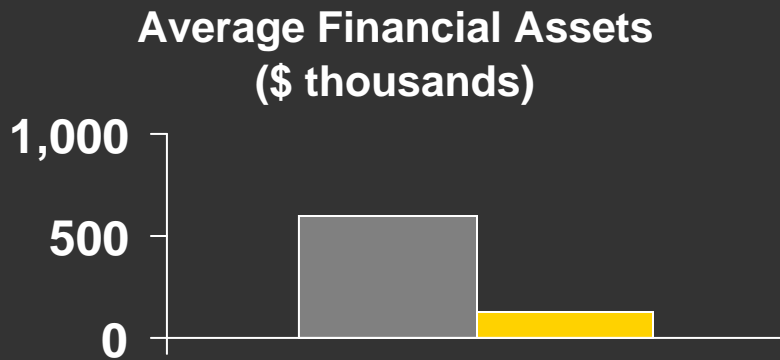
**Average Annual Income
($ thousands)**

Pre-retired households

■ **Affluent**   ■ **Middle**

Average financial assets are $450k for affluent households and $95k for middle wealth households

Average annual income of $125k for affluent households and $66k for middle wealth households

Source: Ernst & Young calculations as of February 2009
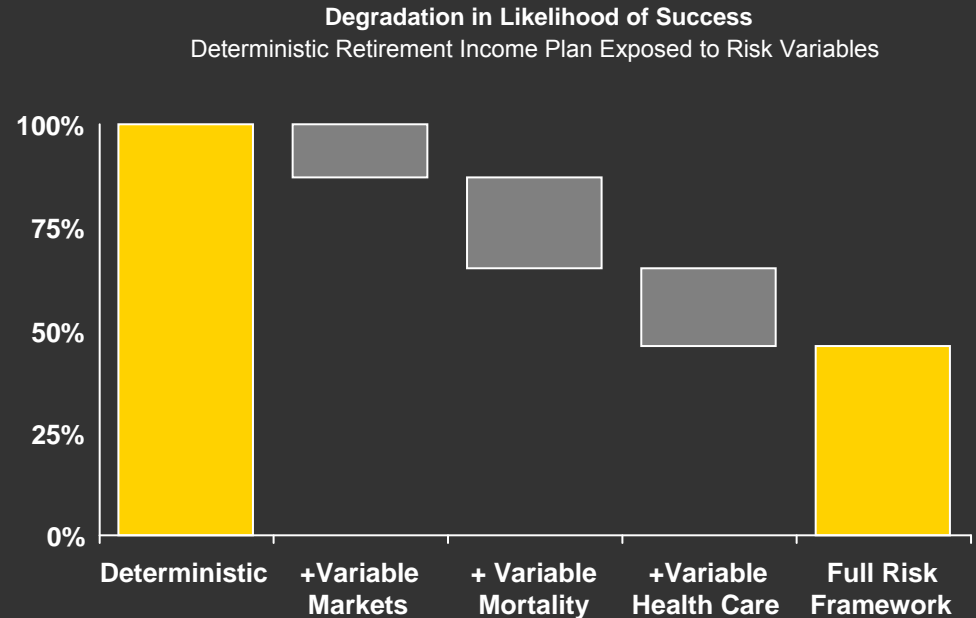
The middle American retirement problem

► Four out of ten newly retired couples will outlive their financial assets if they attempt to maintain their pre-retirement standard of living (9 out of 10 for those without DB income)

　► Americans like these must plan to reduce their standard of living by an average of 20% to minimize their likelihood of outliving their financial assets (40% for those without DB income)

► Seven out of ten middle market households approaching retirement will outlive their financial assets if they attempt to maintain their pre-retirement standard of living (nearly 10 out of 10 for those without DB income)

　► Americans like these must plan to reduce their standard of living by an average of 30% to minimize their likelihood of outliving their financial assets (50% for those without DB income)

Source: Americans for Secure Retirement and Ernst & Young as of February 2009

The middle American retirement problem Traditional accumulation frameworks

► Self-directed literature and tools continue to be based on deterministic approaches to retirement income planning

  ► Certainty is implied

  ► Trade-offs cannot be communicated

► Traditionally developed solutions manage only the market risks in retirement

  ► Fixed horizons assumed

  ► Key retirement risks ignored

Degradation in Likelihood of Success
Deterministic Retirement Income Plan Exposed to Risk Variables

| | Deterministic | +Variable Markets | + Variable Mortality | +Variable Health Care | Full Risk Framework |

Key tenets of an effective retirement income framework

► Holistic approach
  ► All risks considered
    ► Market volatility and sequence of returns
    ► Inflation uncertainty
    ► Age(s) of death
    ► Unbudgeted health care costs
  ► All solutions valued consistently – product agnostic

► Outcome oriented
  ► Focus on relevant outcomes to consumer instead of returns
  ► Use after-tax, real income as the benchmark
  ► Endowment objectives
  ► Liquidity requirements
  ► Tolerance for shortfalls

Building solutions in the effective retirement income framework

► Timing and packaging are the key to getting the benefit to the customer effectively and inexpensively

► Timing
  ► Driven by relationship criteria and financial product designs

► Packaging
  ► Packages advice and financial product options in scalable fashion

► Value of choice
 ► Choices clearly illustrate consumer trade-offs between the options

What are product allocation models?

► A starting allocation of insurance, investment, and annuity products that satisfy the desired outcomes of the individual

► Investment Products
  ► Mutual funds
  ► Bond and CD ladders
  ► Structured products

► Insurance / protection products
  ► Life insurance
  ► Long term care insurance

► Annuity products
  ► Fully annuitized (IVA, fixed)
  ► Deferred annuities with living benefits

Investments

Advice

Derivatives   **Insurance**

Depiction courtesy of the Retirement Income Industry Association

Models for income
Mutual funds available
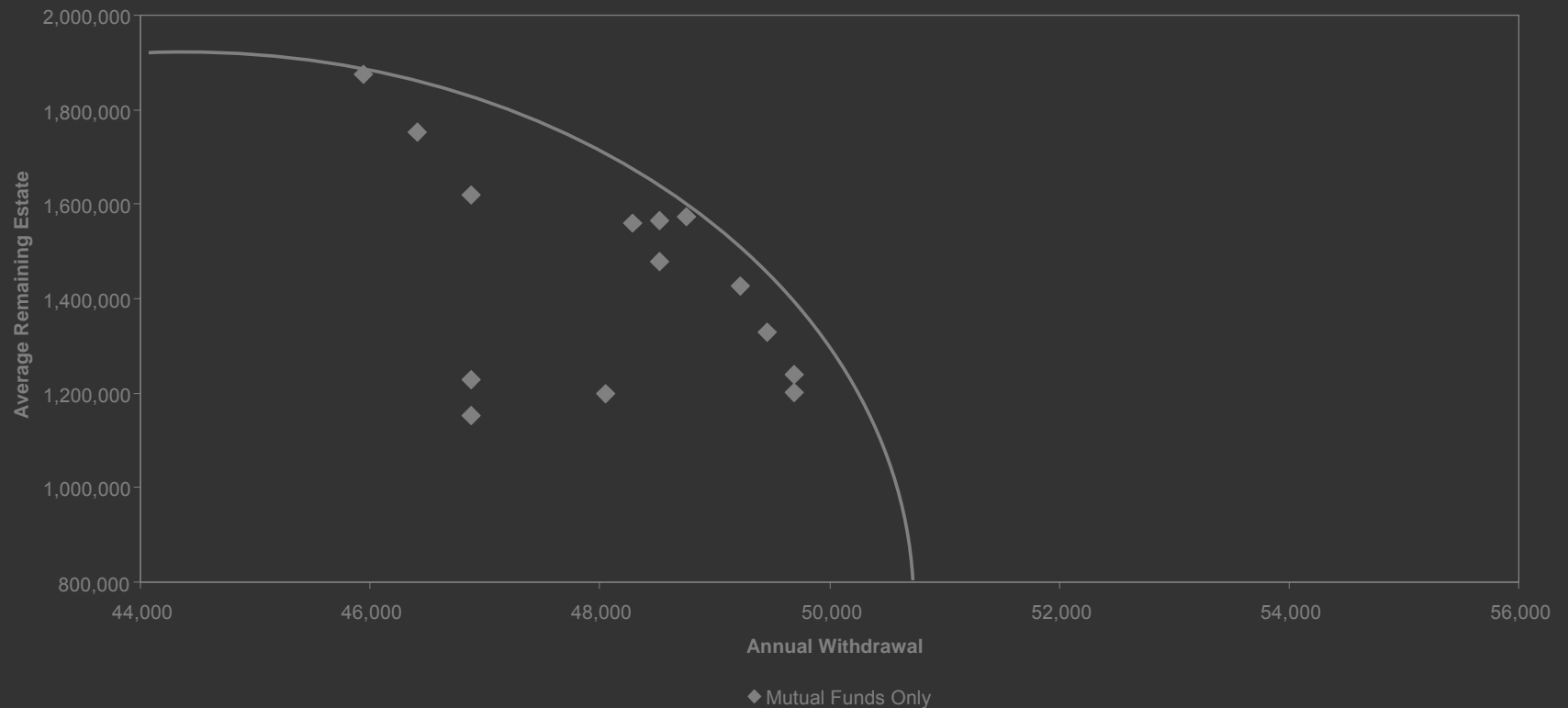
Models for income
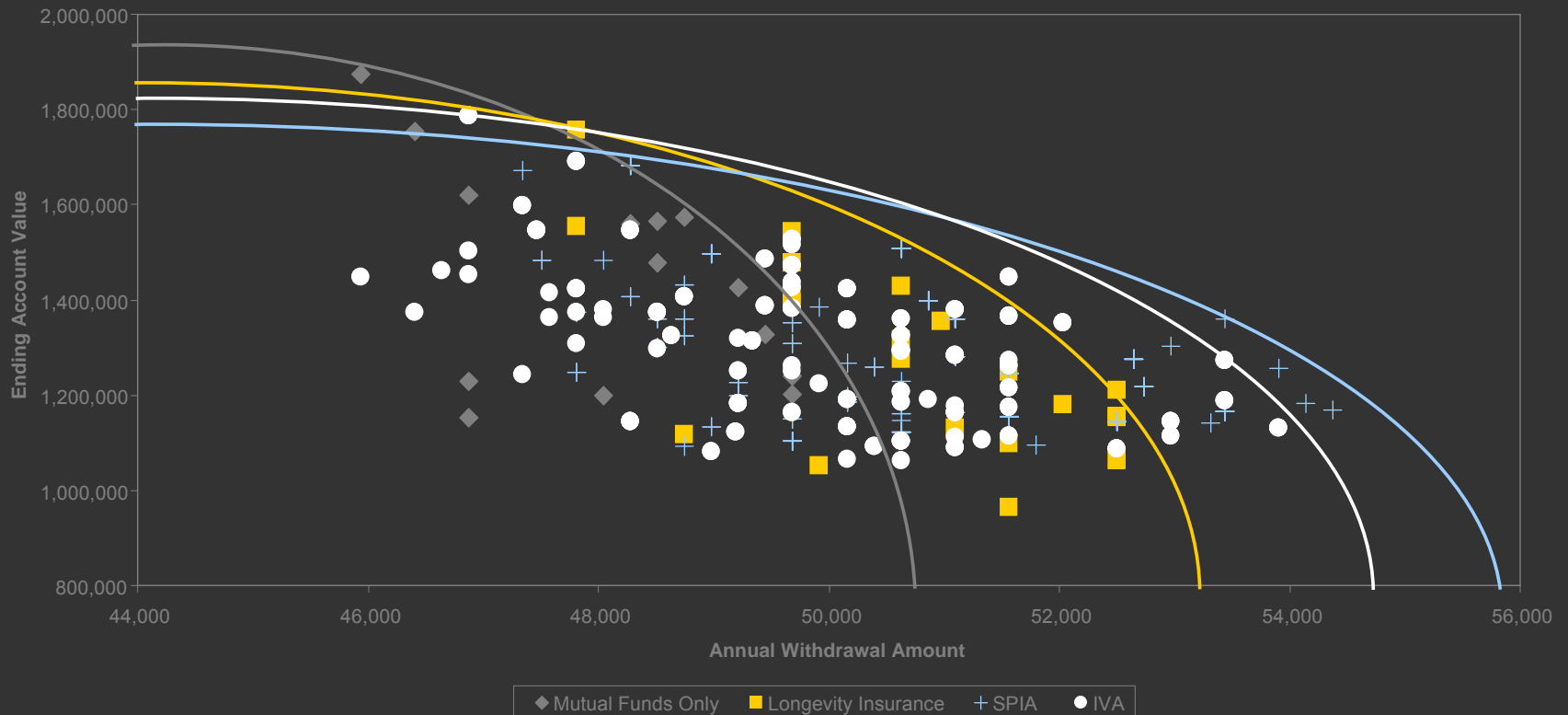# Longevity insurance available
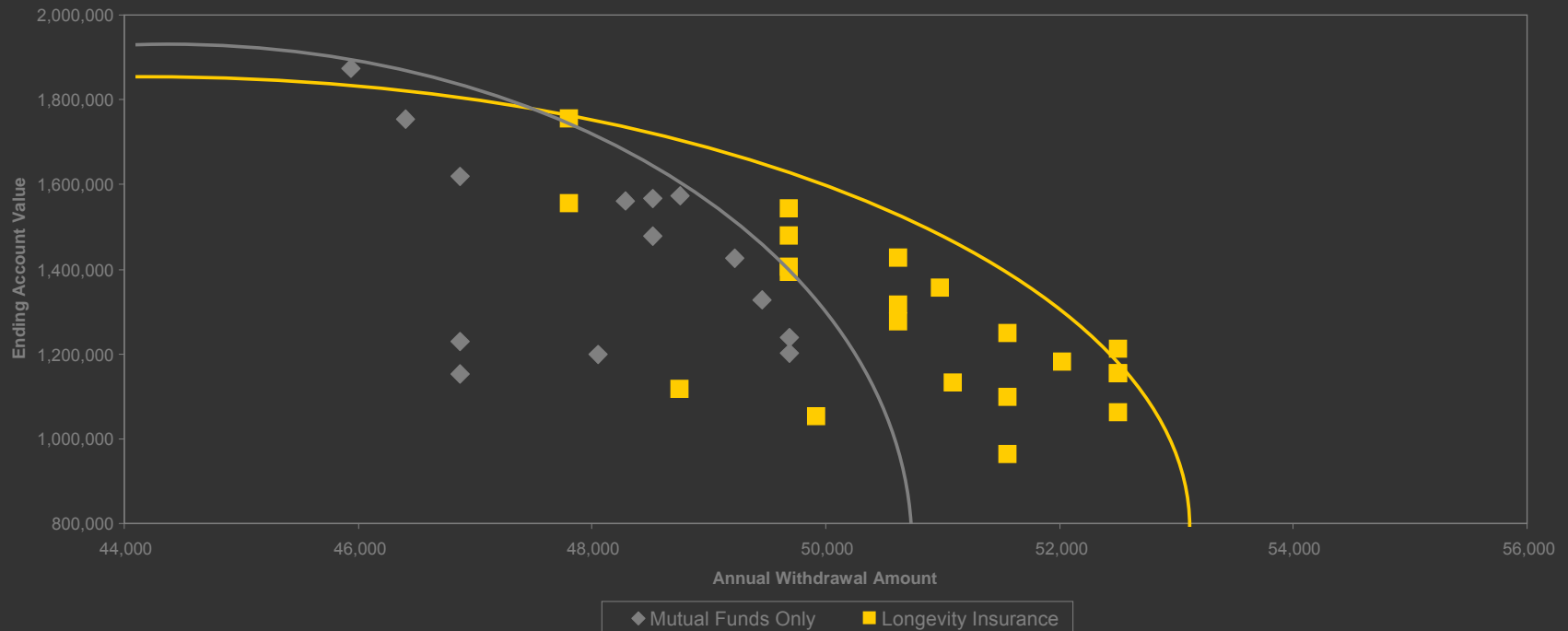
Models for income GLWB available
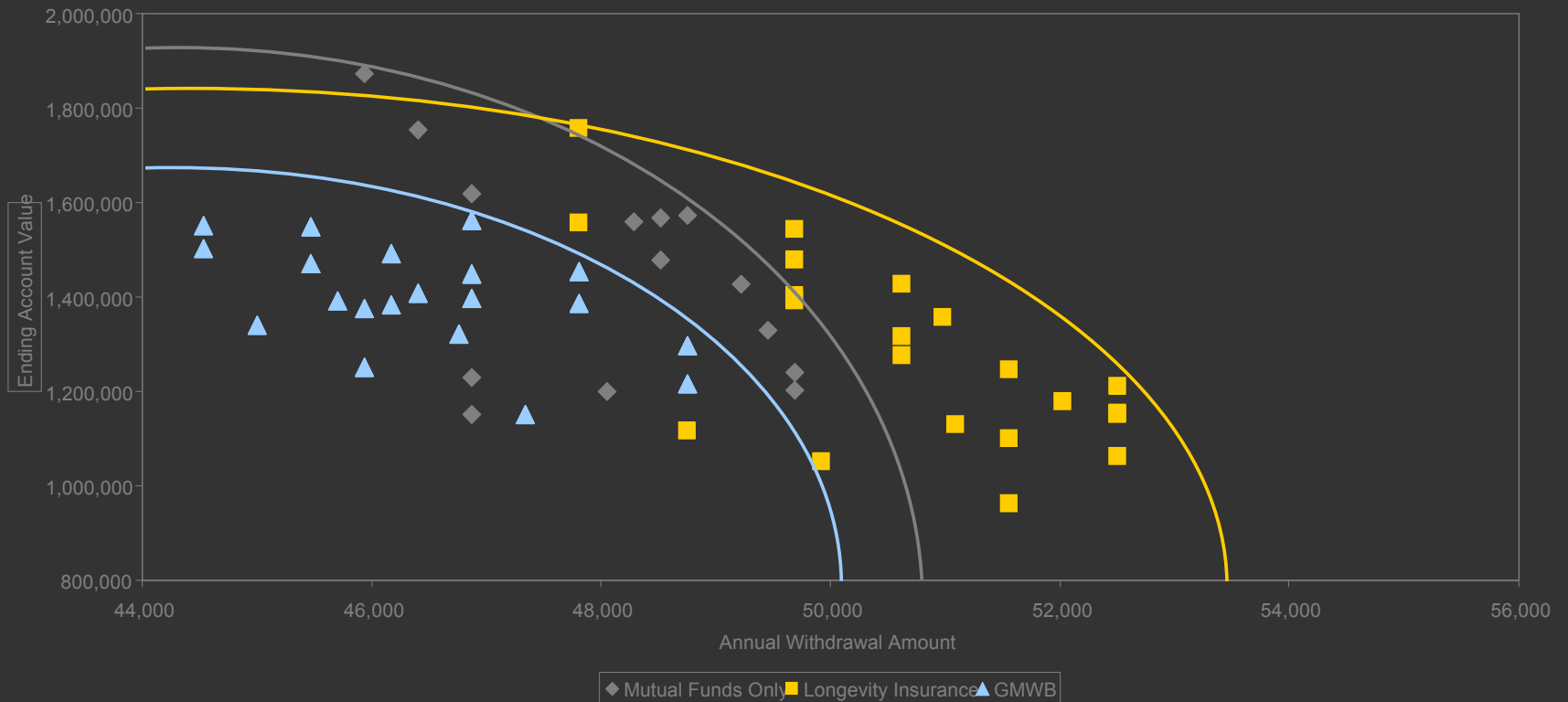
Models for income
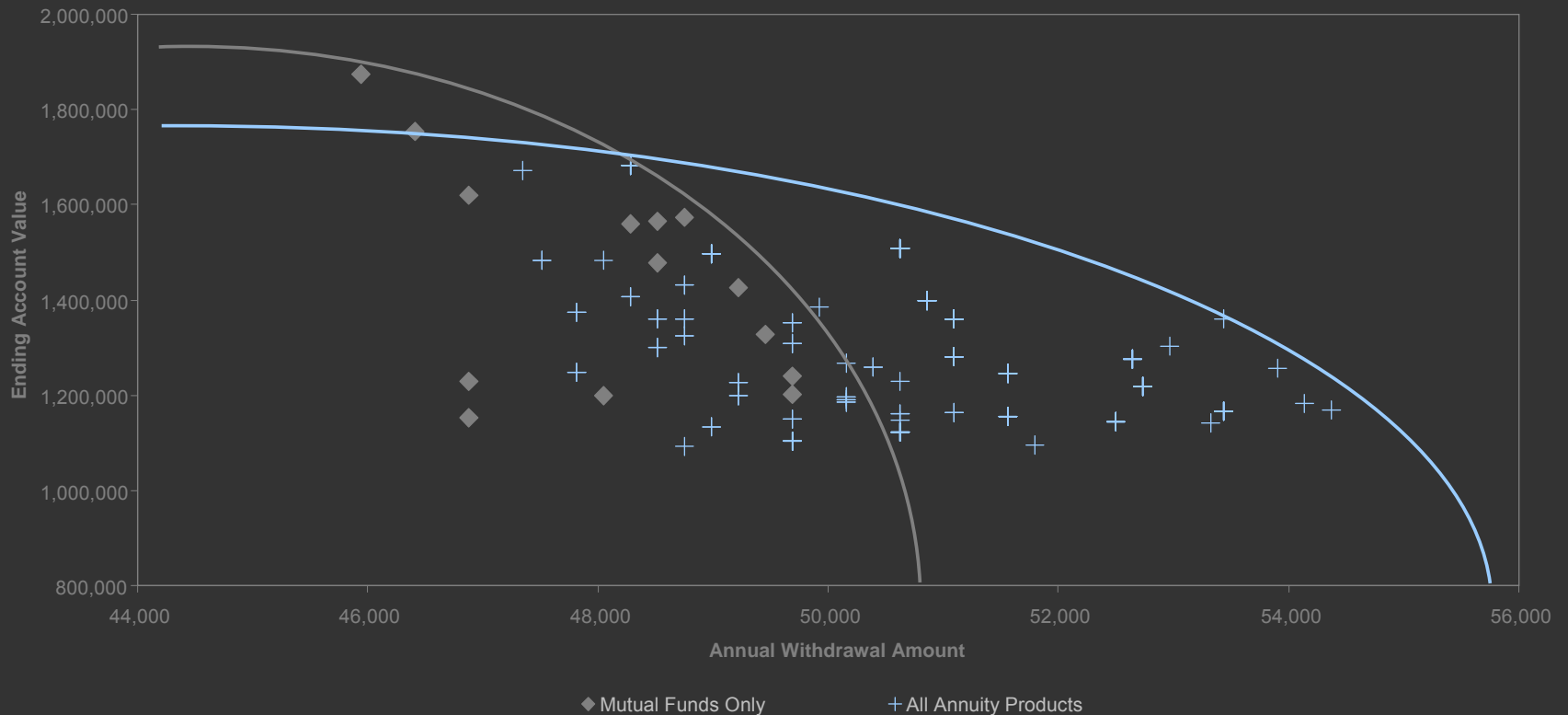# Immediate variable annuities available
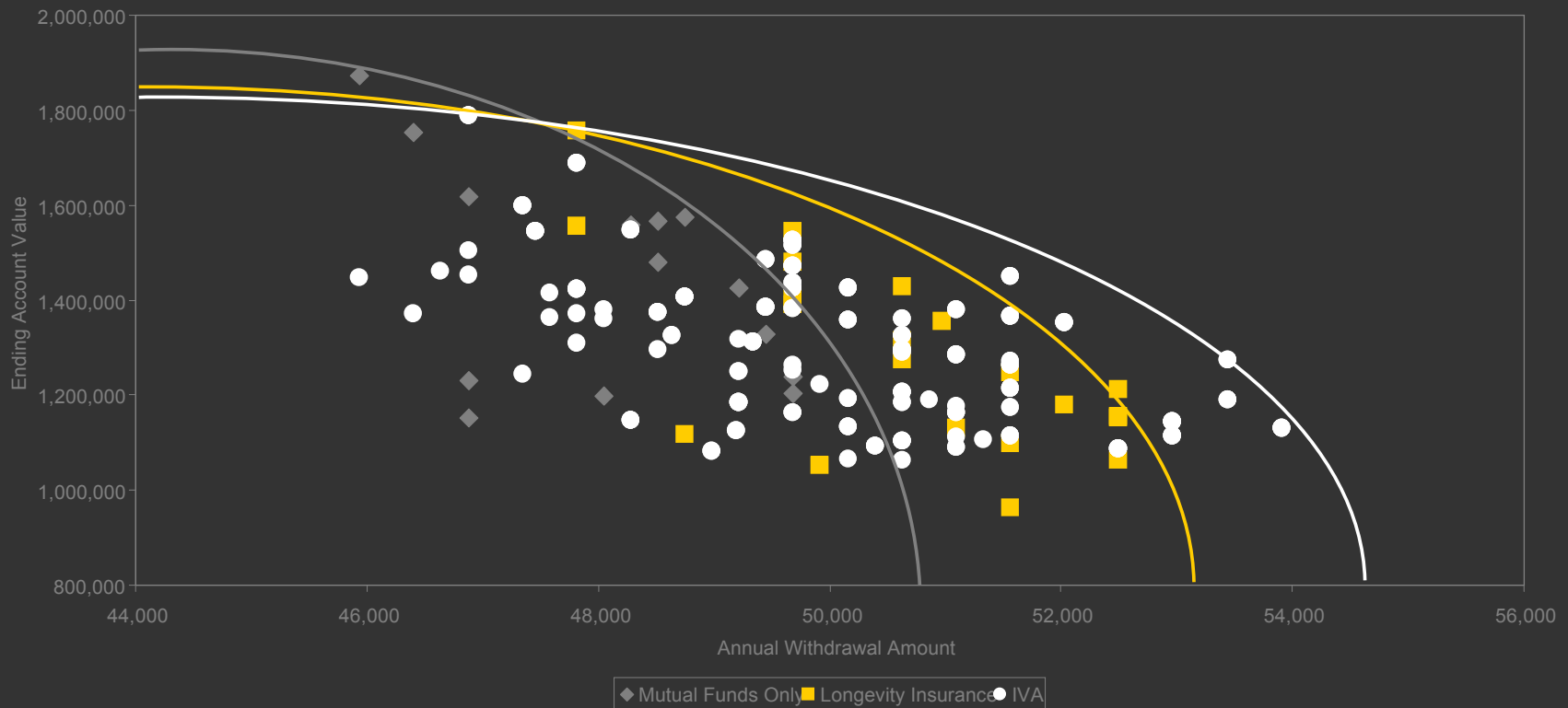
Models for income
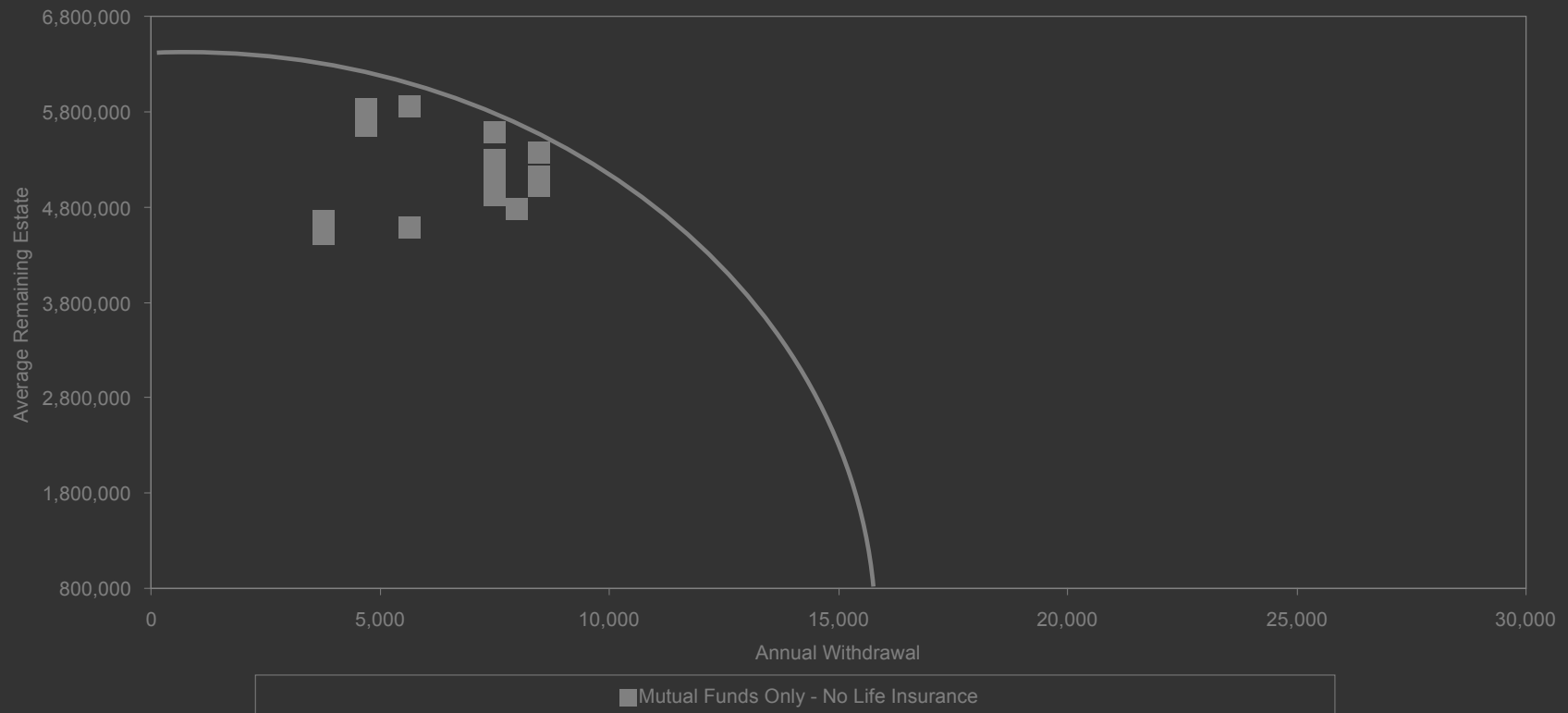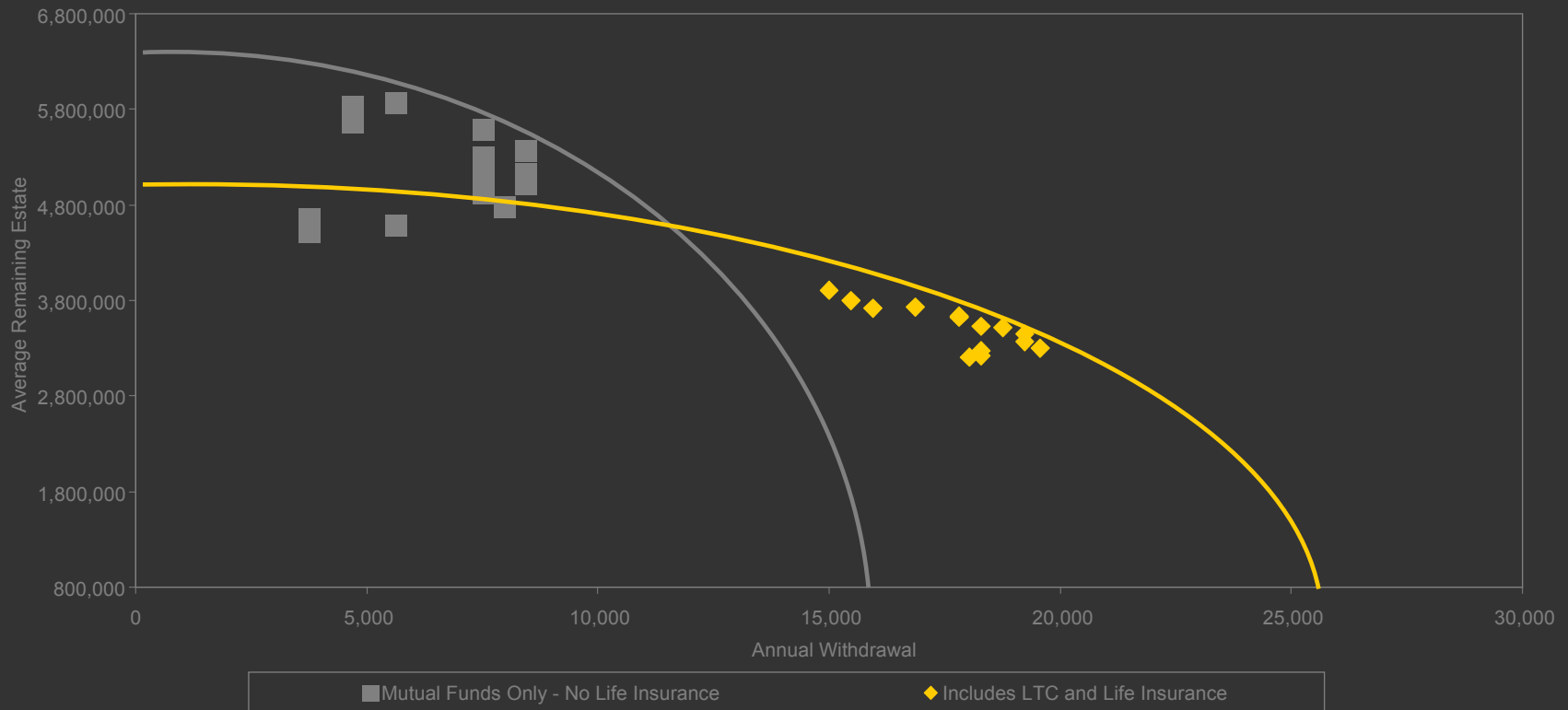# Immediate fixed annuities available

Models for income Summary

Models for income and endowment
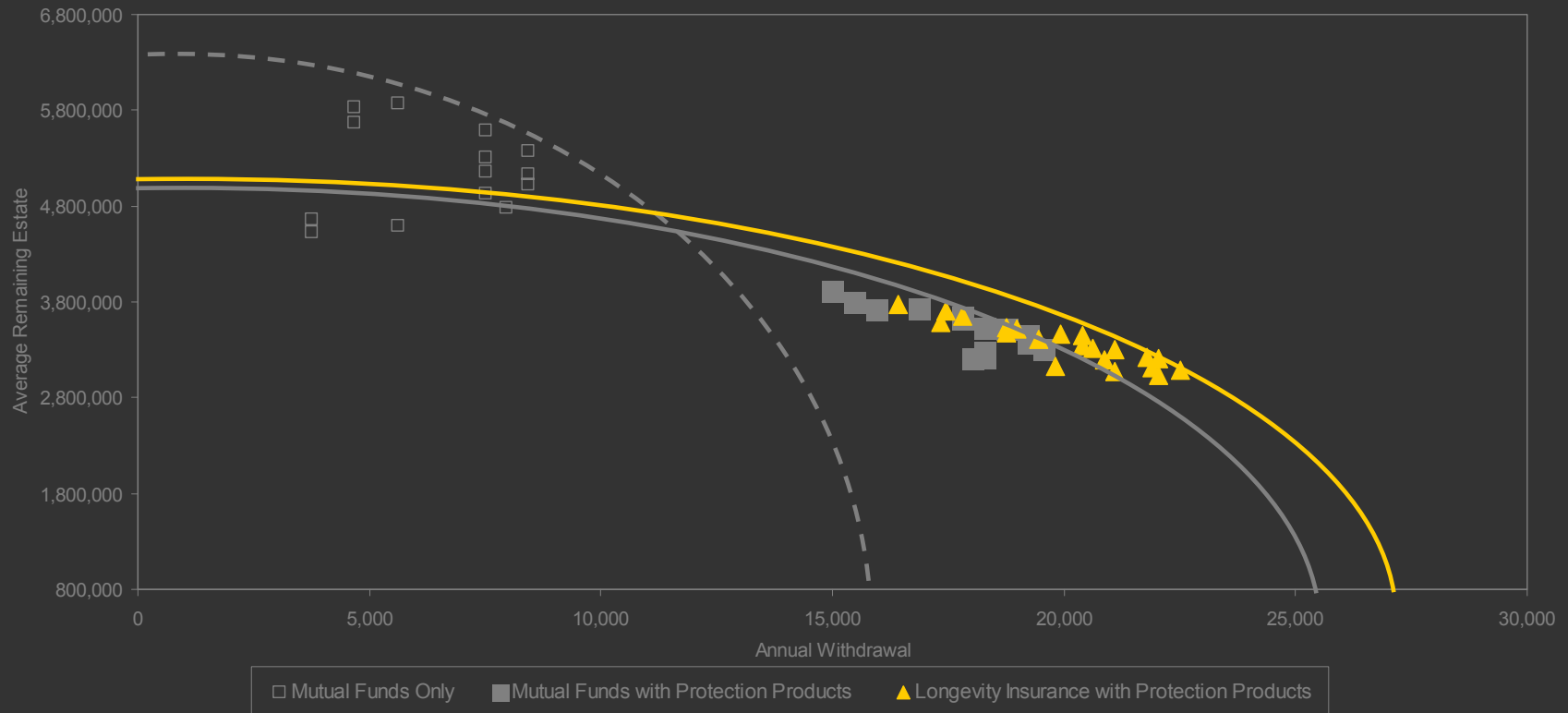# Mutual funds only

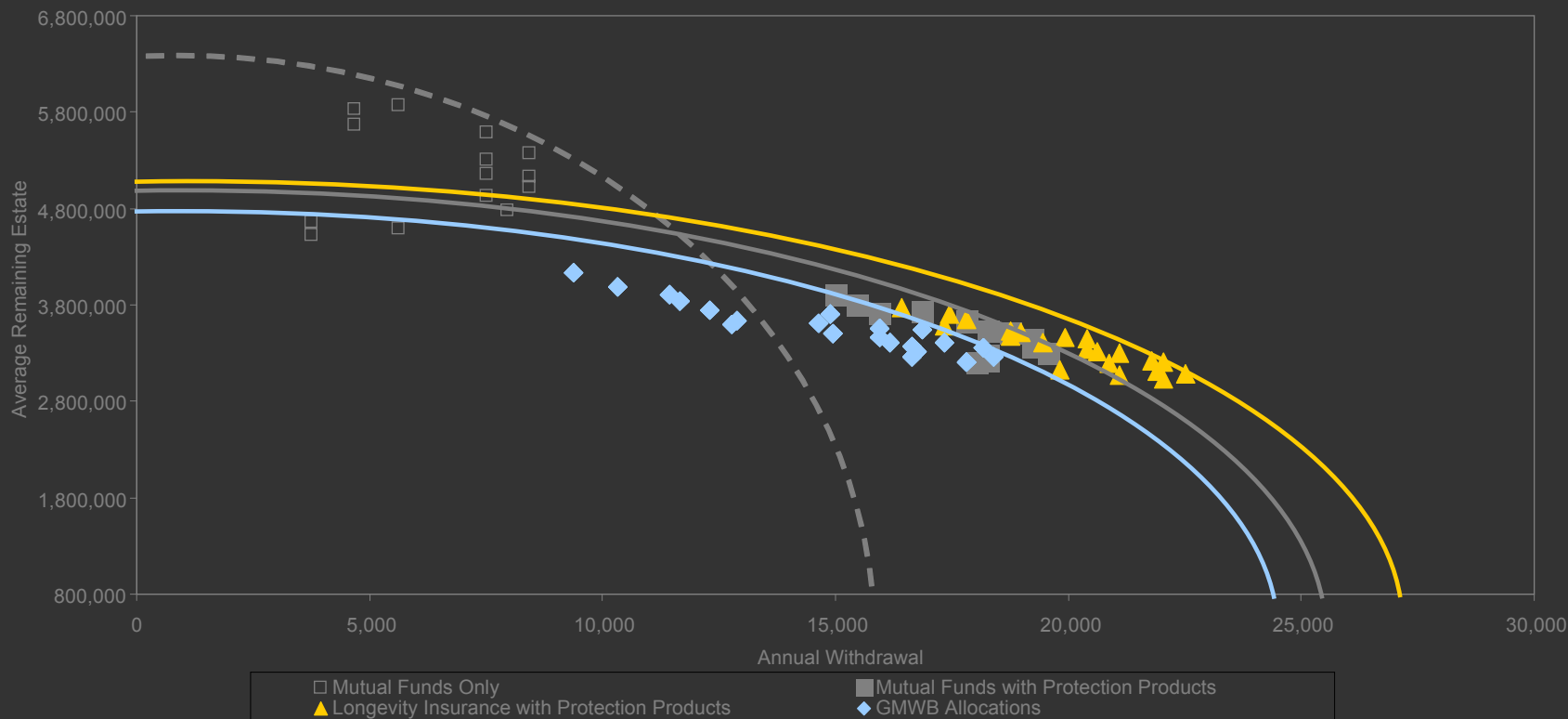# Models for income and endowment Protection products available

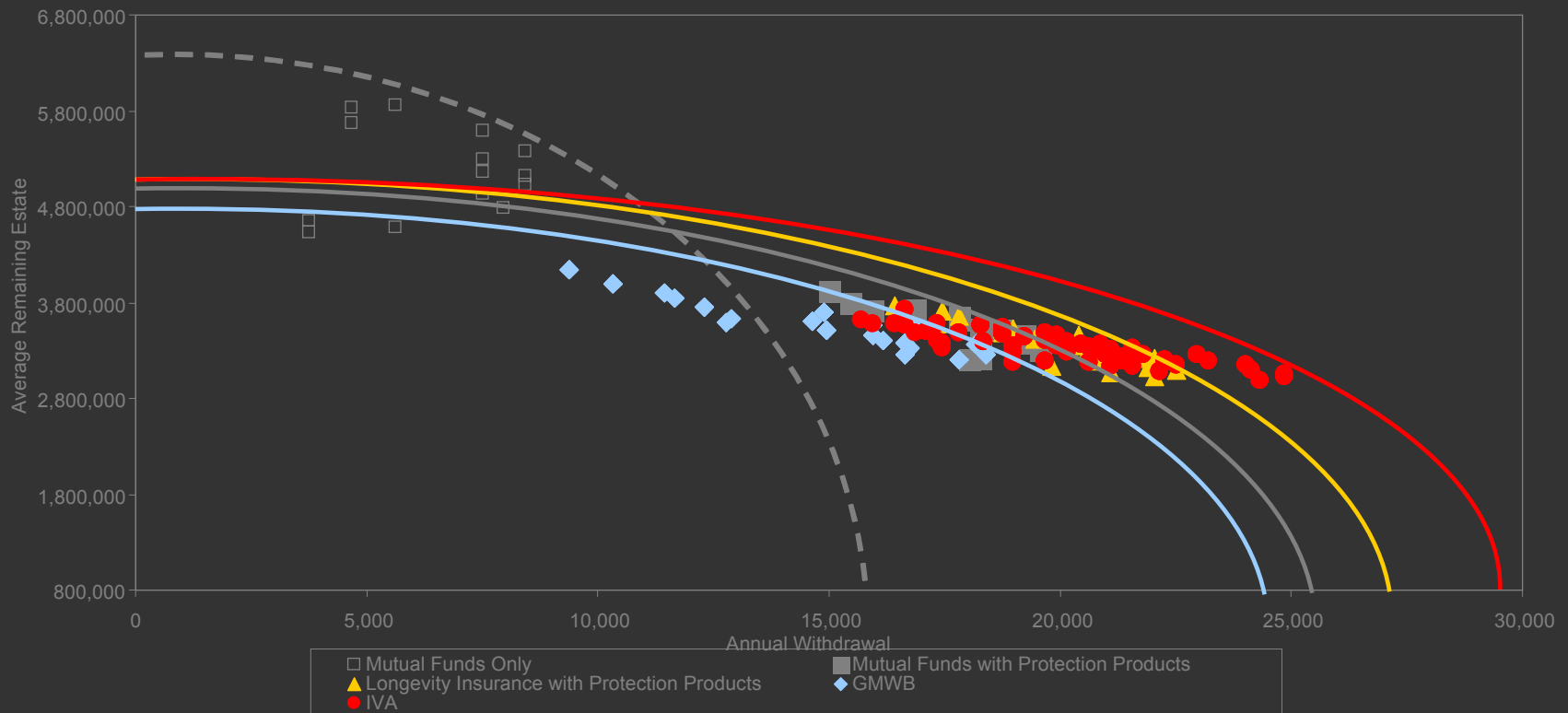# Models for income and endowment Longevity insurance available

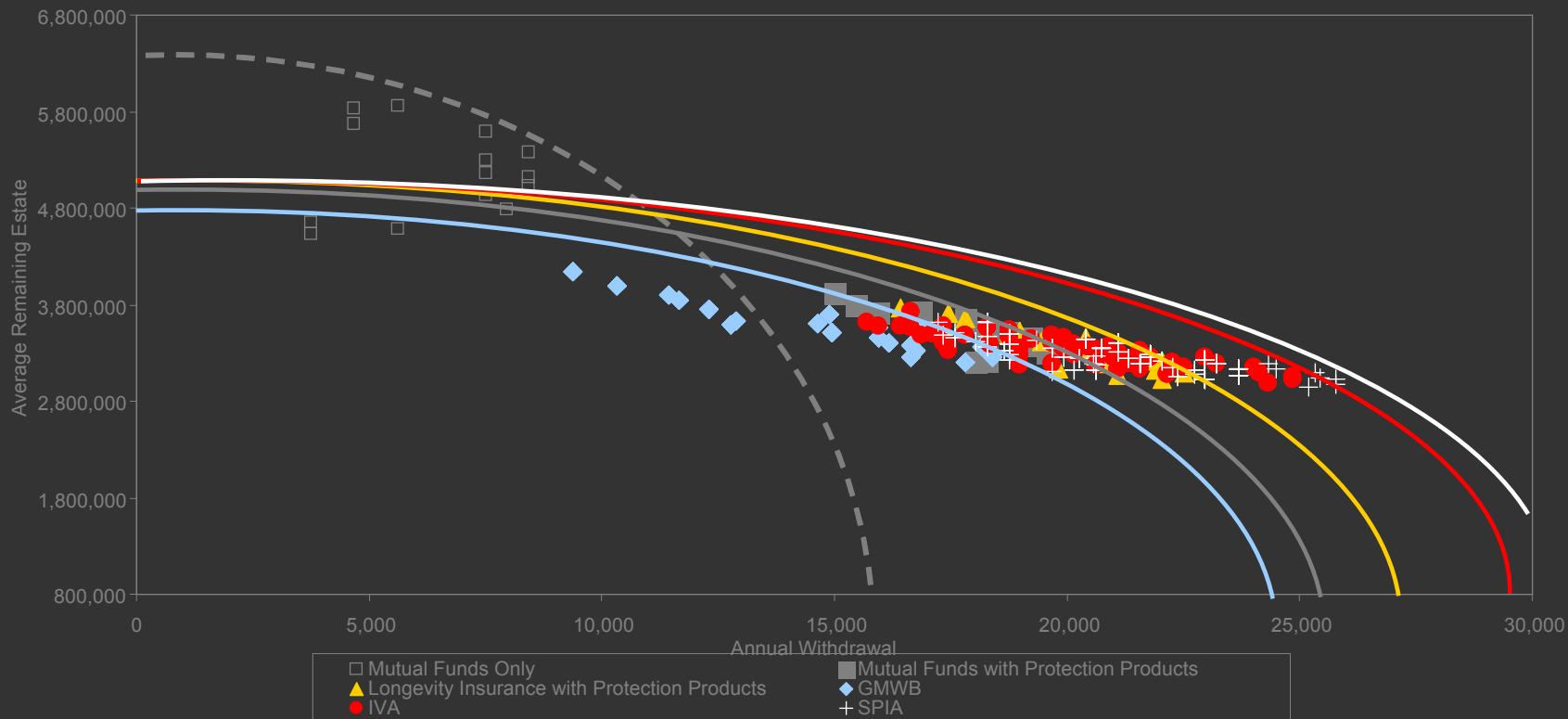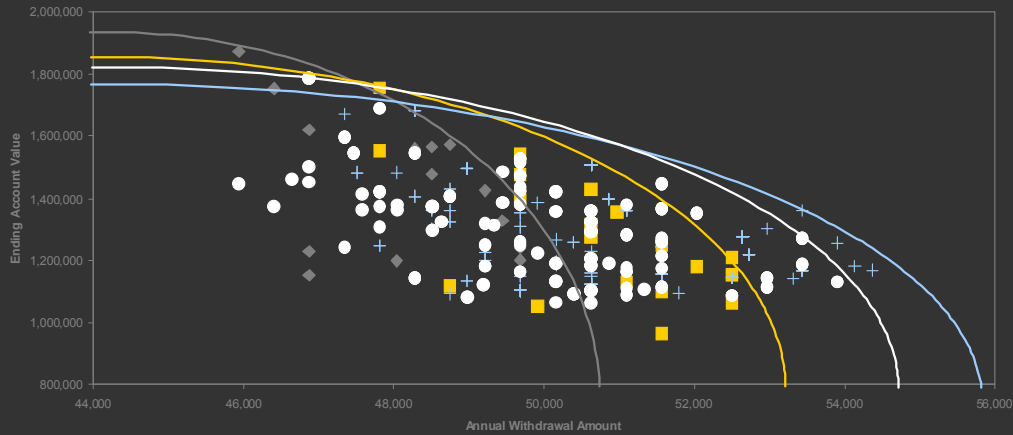# Models for income and endowment GLWB available

Models for income and endowment Immediate variable annuity available
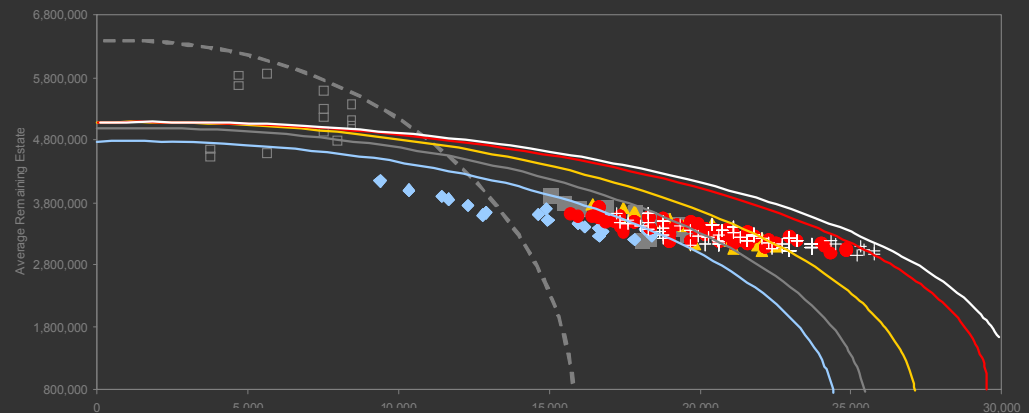
Models for income and endowment Summary

Product allocation models

Allocation models for income

Allocation models for income and endowment

Benefits arising from the use of product allocation models

- ► Two significant impacts for consumers as a result of product allocation model adoption
  - ► Outcomes for middle America are significantly improved
  - ► Outcomes exhibit improved stability when exposed to adverse events

- ► Manufacturer profit drivers move from being only mutual fund revenue share to a more stable combination of product premiums, product fees and mutual fund revenue shares

- ► Advisor motivations improved through appropriately aligned compensation
  - ► Timing of compensation matches effort to put plan in place
  - ► Incremental increases in compensation for persisting clients is now consistent with the value-add

Closing remarks

► Many allocations are within acceptable tolerances

► Many more allocations must be avoided

► Consumer outcomes improved

► Applications
  ► in-plan options
  ► pre-rollover participants